Tencent 腾讯

TENCENT HOLDINGS LIMITED

騰 訊 控 股 有 限 公 司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 700)

PROPOSED ISSUE OF SENIOR NOTES AND EXTRACT OF CORPORATE AND FINANCIAL INFORMATION

The Company proposes to conduct an international offering of Notes to certain professional investors. In connection with the Proposed Notes Issue, the Company will provide certain professional investors with recent corporate and financial information regarding the Group, which information may not necessarily have been made public previously or may be presented in the manner customary in the context of international debt offerings including, but not limited to, risk factors, a description of the Company's business, management's discussion and analysis of financial condition and results of operations, related party transactions and indebtedness information. For purposes of equal, effective and timely dissemination of information to Shareholders and the investment community, an extract of such information is attached hereto and is available on the Company's website at *www.tencent.com/ir*. The completion of the Proposed Notes Issue is subject to a number of important conditions including, but not limited to, global market conditions and investor interest. None of the Notes will be offered to the public in Hong Kong or be placed to any connected person of the Company.

Goldman Sachs, Deutsche Bank and Barclays are the joint global coordinators, and Goldman Sachs, Deutsche Bank, Barclays, Citigroup, Credit Suisse, J.P. Morgan and ANZ, as the joint bookrunners and the joint lead managers, are managing the Proposed Notes Issue. The Company intends to use the net proceeds for general corporate purposes.

The Company intends to seek a listing of the Notes on the Stock Exchange. A listing eligibility letter has been received for the listing and quotation of the Notes on the Stock Exchange. Admission of the Notes to the official list of the Stock Exchange and quotation of the Notes on the Stock Exchange is not to be taken as an indication of the merits of the Company or the Notes.

As no binding agreement in relation to the Proposed Notes Issue has been entered into as at the date of this announcement, the Proposed Notes Issue may or may not materialize. The completion of the Proposed Notes Issue is subject to a number of important conditions including, but not limited to, global market conditions and investor interest. Investors and Shareholders are urged to exercise caution when dealing in the securities of the Company.

Further announcement in respect of the Proposed Notes Issue will be made by the Company as and when appropriate.

PROPOSED NOTES ISSUE

Introduction

The Company proposes to conduct an international offering of Notes to certain professional investors. In connection with the Proposed Notes Issue, the Company will provide certain professional investors with recent corporate and financial information regarding the Group, which information may not necessarily have been made public previously or may be presented in the manner customary in the context of international debt offerings including, but not limited to, risk factors, a description of the Company's business, management's discussion and analysis of financial condition and results of operations, related party transactions and indebtedness information. For purposes of equal, effective and timely dissemination of information to Shareholders and the investment community, an extract of such information is attached hereto and is available on the Company's website at *www.tencent.com/ir*.

The completion of the Proposed Notes Issue is subject to a number of important conditions including, but not limited to, global market conditions and investor interest. Goldman Sachs, Deutsche Bank and Barclays are the joint global coordinators, and Goldman Sachs, Deutsche Bank, Barclays, Citigroup, Credit Suisse, J.P. Morgan and ANZ, as the joint bookrunners and the joint lead managers, are managing the Proposed Notes Issue.

The Notes to be issued by the Company have not been, and will not be, registered under the U.S. Securities Act or with any securities regulatory authority of any state or other jurisdiction in the United States. The Notes will only be offered (i) in the United States to qualified institutional buyers in reliance on the exemption from the registration requirements of the U.S. Securities Act provided by Rule 144A or in transactions not subject to the registration requirements of the U.S. Securities Act and (ii) in offshore transactions in compliance with Regulation S under the U.S. Securities Act. None of the Notes will be offered to the public in Hong Kong or be placed to any connected person of the Company.

Proposed use of net proceeds

If the Notes are issued, the Company intends to use the net proceeds for general corporate purposes.

The foregoing represents the Company's current intentions based upon its present plans and business conditions to use and allocate the net proceeds of this Notes offering. The Company's management, however, will have significant flexibility and discretion to apply the net proceeds of this offering. If an unforeseen event occurs or business conditions change, the Company may use the proceeds of this offering differently from the proposed use of net proceeds.

Listing

The Company intends to seek a listing of the Notes on the Stock Exchange. A listing eligibility letter has been received for the listing and quotation of the Notes on the Stock Exchange. Admission of the Notes to the official list of the Stock Exchange and quotation of the Notes on the Stock Exchange is not to be taken as an indication of the merits of the Company or the Notes.

GENERAL

As no binding agreement in relation to the Proposed Notes Issue has been entered into as at the date of this announcement, the Proposed Notes Issue may or may not materialize. The completion of the Proposed Notes Issue is subject to a number of important conditions including, but not limited to, global market conditions and investor interest. Investors and Shareholders are urged to exercise caution when dealing in the securities of the Company.

Further announcement in respect of the Proposed Notes Issue will be made by the Company as and when appropriate.

DEFINITIONS

In this announcement, unless the context requires otherwise, the following expressions have the following meanings:

Term	Definition
"ANZ"	Australia and New Zealand Banking Group Limited
"Barclays"	Barclays Bank PLC
"Board"	the board of Directors
"Citigroup"	Citigroup Global Markets Inc.
"Company"	Tencent Holdings Limited, a limited liability company organized and existing under the laws of the Cayman Islands and whose Shares are listed on the main board of the Stock Exchange
"connected person"	has the meaning ascribed to it under the Listing Rules
"Credit Suisse"	Credit Suisse Securities (Europe) Limited
"Deutsche Bank"	Deutsche Bank AG, Singapore Branch
"Director(s)"	director(s) of the Company
"Goldman Sachs"	Goldman Sachs (Asia) L.L.C.
"Group"	the Company and its subsidiaries from time to time
"HK$"	Hong Kong dollars, the lawful currency of Hong Kong
"Hong Kong"	the Hong Kong Special Administrative Region of the People's Republic of China
"J.P. Morgan"	J.P. Morgan Securities plc
"Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange

"Notes"	the senior notes expected to be issued by the Company
"Proposed Notes Issue"	the proposed issue of Notes
"Shareholders"	holder(s) of the Shares
"Share(s)"	the ordinary share(s) with par value of HK$0.0001 each in the share capital of the Company
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"U.S." or "United States"	the United States of America, its territories and possessions and all areas subject to its jurisdiction
"U.S. Securities Act"	the United States Securities Act of 1933, as amended

By Order of the Board
Ma Huateng
Chairman

28 August 2012

As at the date of this announcement, the directors of the Company are:

Executive Directors:
Ma Huateng, Lau Chi Ping Martin and Zhang Zhidong;

Non-Executive Director:
Charles St Leger Searle; and

Independent Non-Executive Directors:
Li Dong Sheng, Iain Ferguson Bruce and Ian Charles Stone.

This announcement contains forward-looking statements relating to the business outlook, forecast business plans and growth strategies of the Group. These forward-looking statements are based on information currently available to the Group and are stated herein on the basis of the outlook at the time of this announcement. They are based on certain expectations, assumptions and premises, some of which are subjective or beyond our control. These forward-looking statements may prove to be incorrect and may not be realized in future. Underlying these forward-looking statements are a large number of risks and uncertainties. In light of the risks and uncertainties, the inclusion of forward-looking statements in this announcement should not be regarded as representations by the Board or the Company that the plans and objectives will be achieved, and investors should not place undue reliance on such statements.

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CERTAIN DEFINITIONS, CONVENTIONS AND CURRENCY PRESENTATION

This document has been prepared using a number of conventions, which you should consider when reading the information contained herein. When we use the terms "**we**," "**us**," "**our**," "**Tencent**" and words of similar import, we are referring to Tencent Holdings Limited, the Company itself, or to the Company, its subsidiaries and consolidated affiliated entities, as the context requires. References to the "**Group**" are to the Company, its subsidiaries and consolidated affiliated entities.

Market data and certain industry forecast and statistics in this document have been obtained from both public and private sources, including market research, publicly available information and industry publications. Although we believe this information to be reliable, it has not been independently verified by us and neither we nor our directors make any representation as to the accuracy or completeness of that information. In addition, third-party information providers may have obtained information from market participants and such information may not have been independently verified.

The statistics set forth in this document relating to the PRC and the Internet, mobile and telecommunications, online games, online advertising, e-Commerce and other industries in the PRC were taken or derived from various government and private publications. We do not make any representation as to the accuracy of such statistics, which may not be consistent with other information compiled within or outside the PRC. Due to possibly inconsistent collection methods and other problems, the statistics herein may be inaccurate and should not be unduly relied upon.

In this document, all references to "US$" and "U.S. dollars" are to United States dollars, the official currency of the United States; all references to "HK$" and "H.K. dollars" are to Hong Kong dollars, the official currency of the Hong Kong Special Administrative Region of the PRC ("**Hong Kong**" or "**HK**"); and all references to "RMB" or "Renminbi" are to Renminbi, the official currency of the People's Republic of China (the "**PRC**").

Unless otherwise noted, all translations from Renminbi to U.S. dollars and from U.S. dollars to Renminbi in this document were made at a rate of RMB6.3530 to US$1.00, the exchange rate set forth in the H.10 statistical release of the Federal Reserve Board on June 29, 2012, and all translations from H.K. dollars to U.S. dollars and from U.S. dollars to H.K. dollars were made at a rate of HK$7.8 to US$1.00, the official exchange rate set by the Hong Kong Monetary Authority. We make no representation that any U.S. dollar, Renminbi, or H.K. dollar amounts could have been, or could be, converted into U.S. dollars, Renminbi or H.K. dollars, as the case may be, at any particular rate, at the rates stated above, or at all.

References to "PRC" and "China," for the purposes of this document, are to the People's Republic of China excluding Hong Kong, the Macau Special Administrative Region and Taiwan. "PRC government" or "State" means the central government of the PRC, including all political subdivisions (including provincial, municipal and other regional or local governmental entities) and instrumentalities thereof, or, where the context requires, any of them.

Totals presented in this document may not tally correctly due to the rounding of numbers.

NOTICE REGARDING PRESENTATION OF FINANCIAL INFORMATION

The consolidated financial statements and financial information of the Company included in this document have been prepared in accordance with IFRS, which differ in certain material respects from U.S. GAAP and thus may not be comparable to the consolidated financial statements of U.S. companies. The financial information included in this document is not intended to, and does not, comply with the financial reporting requirements of the SEC. Compliance with such requirements would require, among other things, the presentation of U.S. GAAP financial information.

No comparative segment information was provided for our e-Commerce transactions business prior to 2012 since an insignificant amount of revenue was generated from e-Commerce transactions, which was not a reportable segment prior to January 1, 2012. As a result, discussions of our results of operations as of and for the six months ended June 30, 2012 in this document are based on our current segmentation, and discussions of our results of operations as of and for the years ended 2009, 2010 and 2011, and as of and for the six months ended June 30, 2011, in this document are based on our previous segmentation.

In addition, we refer to the terms EBITDA and Adjusted EBITDA (as defined in "Summary Consolidated Financial and Other Data—Other Financial Data") in various places in this document. These are supplemental financial measures that are not prepared in accordance with U.S. GAAP or IFRS and are therefore referred to as "non-GAAP financial measures". Any analysis of non-GAAP financial measures should be used only in conjunction with results presented in accordance with IFRS. The non-GAAP measures used by the Company may not be comparable to similar measures presented by other companies. The non-GAAP financial measures presented in this document may not comply with the SEC rules governing the presentation of non-GAAP financial measures. In addition, our measurements of EBITDA and Adjusted EBITDA may not be comparable to those of other companies. Please see "Summary Consolidated Financial and Other Data" for a discussion of our use of EBITDA and Adjusted EBITDA in this document, including the reasons that we believe this information is useful to management and a reconciliation of EBITDA and Adjusted EBITDA to the most closely comparable financial measure calculated in accordance with IFRS.

GLOSSARY OF TECHNICAL TERMS

This glossary contains terms used in this document as they relate to our business. As such, these terms and their meanings may not always correspond to standard industry meaning or usage of these terms.

"4.625% Senior Notes"	U.S. dollar denominated 4.625% senior notes due 2016 in the aggregate principal amount of US$600.0 million, issued by the Company on December 12, 2011. The issue price of the 4.625% Senior Notes was 99.74% of the aggregate principal amount.
"2008 CIT Law"	the PRC Corporate Income Tax Law (中華人民共和國企業所得稅法), which came into effect on January 1, 2008
"ACG(s)"	advanced casual game(s)
"ACU"	average concurrent user accounts
"Adjusted EBITDA"	adjusted EBITDA
"Analysys"	Analysys International, a third-party market research firm
"Avatar"	customizable virtual character
"B2B"	business-to-business
"B2C"	business-to-customer
"BBS"	bulletin board system
"Board of Directors"	the board of Directors of the Company
"BVI"	the British Virgin Islands
"CAGR"	compound annual growth rate
"C2C"	consumer-to-consumer
"China Mobile"	China Mobile Communications Corporation (中國移動通信集團公司) and its branches, subsidiaries and affiliates
"China Telecom"	China Telecommunications Corporation (中國電信集團公司) and its branches, subsidiaries and affiliates
"China Unicom"	China United Network Communications Corporation Limited (中國聯合網絡通信集團有限公司) and its branches, subsidiaries and affiliates
"CNNIC"	China Internet Network Information Center (中國互聯網網絡信息中心)
"Companies Law"	the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands
"Cyber Tianjin"	Tencent Cyber (Tianjin) Company Limited (騰訊數碼(天津)有限公司), a company established on February 8, 2004 in the PRC with limited liability and a wholly owned subsidiary of the Company

"Cyber Shenzhen"	Tencent Cyber (Shenzhen) Company Limited (騰訊數碼(深圳)有限公司), a company established on January 17, 2007 in the PRC with limited liability and a wholly owned subsidiary of the Company
"Director(s)"	director(s) of the Company or any of them
"EBITDA"	earnings before interest, tax, depreciation and amortization
"eMarketer"	eMarketer, Inc., a third-party market research firm
"GAPP"	PRC General Administration of Press and Publication (中華人民共和國新聞出版總署)
"GMV"	gross merchandise value
"IDC"	International Data Corporation, a third-party market research firm
"IFRS"	International Financial Reporting Standards
"IM"	instant messaging
"iResearch"	iResearch Consulting Group, a third-party market research firm
"IVAS"	Internet value-added service
"IVR"	Interactive Voice Response, a software application that accepts a combination of voice telephone input and touchtone keypad selection and provides appropriate responses in the forms of voice messages, facsimiles, callback or emails
"LIBOR"	London inter-bank offered rate
"MCG(s)"	mini casual game(s)
"MIIT"	Ministry of Industry and Information Technology of the PRC (中華人民共和國工業和信息化部), formally known as Ministry of Information Industry of the PRC (MII) (中華人民共和國信息產業部), including its local branches
"MMOG(s)"	massively multi-player online game(s), a form of computer game that involves a large number of users playing a game online simultaneously
"MMORPG(s)"	massively multi-player online role-playing game(s)
"MMS"	multimedia messaging service, a communications technology that allows users to exchange multimedia communications between capable mobile devices
"MOC"	Ministry of Culture of the PRC (中華人民共和國文化部), including its local branches
"MOFCOM"	Ministry of Commerce of the PRC (中華人民共和國商務部), including its local branches

"MPS"	Ministry of Public Security of the PRC (中華人民共和國公安部)
"MVAS"	mobile and telecommunications value-added service
"PBOC"	People's Bank of China (中國人民銀行), the central bank of the PRC
"PBOC Rate"	the exchange rate for foreign exchange transactions set daily by the PBOC based on the PRC inter-bank foreign exchange market rate of the previous day and with reference to current exchange rates on the world financial markets
"PCU"	peak concurrent user accounts
"Post-IPO Option Scheme I"	the Post-IPO Share Option Scheme adopted by the Company on March 24, 2004, terminated upon adoption of the Post-IPO Share Option Scheme II
"Post-IPO Option Scheme II"	the Post-IPO Share Option Scheme adopted by the Company on May 16, 2007
"Post-IPO Option Scheme III"	the Post-IPO Share Option Scheme adopted by the Company on May 13, 2009
"SAFE"	State Administration of Foreign Exchange of the PRC (中華人民共和國國家外匯管理局), including its local branches
"SAIC"	State Administration for Industry and Commerce of the PRC (中華人民共和國國家工商行政管理總局), including its local branches
"Sanook"	Mweb Holdings (Thailand) Limited, a limited liability company incorporated in Thailand
"SAT"	State Administration of Taxation of the PRC (中華人民共和國國家稅務總局), including its local branches
"SEHK"	The Stock Exchange of Hong Kong Limited
"SFO"	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong), as amended, supplemented or otherwise modified from time to time
"Shenzhen Domain"	Shenzhen Domain Computer Network Company Limited (深圳市網域計算機網絡有限公司), a company established on April 28, 1997 in the PRC with limited liability
"Shiji Kaixuan"	Shenzhen Shiji Kaixuan Technology Company Limited (深圳市世紀凱旋科技有限公司), a company established on January 13, 2004 in the PRC with limited liability
"Shijiaqi"	Shenzhen Shijiaqi Investment Company Limited (深圳市世佳琦投資有限公司), a company incorporated in the PRC with limited liability

"SME2C"	small and medium enterprise-to-consumer, a C2C e-Commerce business model, which comprises individual merchants as well as small- and medium-sized merchants
"SMS"	short message service, a service that allows text messages, which may comprise words, numbers or an alphanumeric combination, to be transmitted on mobile devices
"SNS"	social networking services
"State Council"	State Council of the PRC (中華人民共和國國務院)
"Strategy Analytics"	Strategy Analytics, Inc., a third-party market research firm
"Tencent Beijing"	Tencent Technology (Beijing) Company Limited (騰訊科技(北京)有限公司), a company established on March 30, 2005 in the PRC with limited liability and a wholly owned subsidiary of the Company
"Tencent Charity Fund"	a charity fund established by the Group
"Tencent Chengdu"	Tencent Technology (Chengdu) Company Limited (騰訊科技(成都)有限公司), a company established on July 10, 2008 in the PRC with limited liability and a wholly owned subsidiary of the Company
"Tencent Computer"	Shenzhen Tencent Computer Systems Company Limited (深圳市騰訊計算機系統有限公司), a company established on November 11, 1998 in the PRC with limited liability
"Tencent Shanghai"	Tencent Technology (Shanghai) Company Limited (騰訊科技(上海)有限公司), a company established on July 23, 2008 in the PRC with limited liability and a wholly owned subsidiary of the Company
"Tencent Technology"	Tencent Technology (Shenzhen) Company Limited (騰訊科技(深圳)有限公司), a company established on February 24, 2000 in the PRC with limited liability and a wholly owned subsidiary of the Company
"Tencent Wuhan"	Tencent Technology (Wuhan) Company Limited (騰訊科技(武漢)有限公司), a company established on November 18, 2011 in the PRC with limited liability and a wholly owned subsidiary of the Company
"WAP"	Wireless Application Protocol, an open, global specification that allows Internet access and other broadband services on mobile wireless devices
"web game"	browser-based online game that does not require installation of client or plug-in
"WFOEs"	Tencent Technology, Cyber Tianjin, Tencent Beijing, Cyber Shenzhen, Tencent Chengdu, Tencent Shanghai and Tencent Wuhan
"U.S. GAAP"	United States generally accepted accounting principles

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements, including, without limitation, words and expressions such as "expect," "believe," "plan," "intend," "aim," "estimate," "project," "anticipate," "seek," "predict," "may," "should," "will," "would" and "could" or similar words or statements, including without limitation, in the sections entitled "Risk Factors", "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this document in relation to future events, our future financial, business or other performance and development, strategy, plans, objectives, goals and targets, the future development of our industry and the future development of the general economy of our key markets and globally.

These statements are based on numerous assumptions regarding our present and future business strategy and the environment in which we will operate in the future. These forward-looking statements reflecting our current views with respect to future events are not a guarantee of future performance and are subject to certain risks, uncertainties and assumptions, including the risk factors described in this document and the following:

- our ability to successfully execute our business strategies and plans;
- our ability to maintain and enhance the "QQ" brand names;
- our ability to maintain and expand our user base and convert registered users to paying users;
- the development and marketing of our latest service and product offerings, including, but not limited to, offerings in our IVAS and MVAS, such as online games, SNS and social media;
- our ability to grow our e-Commerce transactions business, including our ability to expand our customer and merchant base, develop our marketplaces and increase our service and product offerings;
- development of online advertising as an accepted marketing channel and our ability to provide solutions to meet our advertising clients' needs;
- the impact and future prospects of our strategic alliances and acquisitions, and our ability to cooperate with our alliance partners or integrate acquired businesses;
- changes in our relationships with telecommunications operators, content providers, application developers, device manufacturers and other key players in the PRC Internet and telecommunications industries;
- the development of the regulatory environment and changes in the policies or guidelines of the telecommunications operators in the PRC;
- competition and general industry outlook for the Internet, mobile and telecommunications, online game, SNS, social media, online advertising and e-Commerce industries in the PRC;
- departure of key management personnel;
- the overall PRC and global economy; and
- other factors beyond our control.

This list of important factors is not exhaustive. Additional factors that could cause the actual results, performance or achievements to differ materially include, but are not limited to, those discussed under "Risk Factors". When evaluating any statement made in this document, you should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.

Subject to the requirements of applicable laws, rules and regulations, we do not have any obligation to update or otherwise revise the forward-looking statements in this document, whether as a result of new information, future events or otherwise. As a result of these and other risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this document might not occur in the manner we expect, or at all. Accordingly, you should not place undue reliance on any forward-looking information.

In this document, statements of or references to our intentions are made as of the date of this document. Any such intentions may change in light of future developments.

SUMMARY

You should read the entire document, including "Risk Factors" and the consolidated financial statements and the related notes thereto.

OUR BUSINESS

We are a leading integrated Internet services company in the PRC, operating the largest IM community in the country with over 783.6 million monthly active IM user accounts as of June 30, 2012. We are also the largest SNS provider in terms of monthly time spent by users and our QQ.com is the No. 1 portal by user traffic in terms of daily unique visitors in the PRC, both according to iResearch in June 2012. Tencent Microblog has become one of the leading microblogs in the PRC with 468.7 million registered user accounts and 81.6 million daily active user accounts as of June 30, 2012. Leveraging our IM platform and our massive IM user base, we aim to become the hub for fulfilling Internet users' online lifestyle needs, encompassing communication, social networking, entertainment, content, search and e-Commerce. The breadth of our highly popular services extends to: QQ IM, QQ Mail, Qzone, Pengyou, Tencent Microblog, QQ Game Platform, QQ.com, our integrated e-Commerce platform, Buy.qq.com, our wireless portal, 3G.QQ.com and our mobile communication service, WeChat (Weixin).

We were founded in November 1998 and we launched our QQ IM service in February 1999. Currently, we have five lines of business: (i) Internet value-added services, which mainly consist of online games, community and open platforms, (ii) mobile and telecommunications value-added services, which include bundled SMS packages, mobile games, mobile books and mobile music services, (iii) online advertising, which primarily comprises brand display advertising, performance display advertising and search advertising, (iv) e-Commerce transactions involving sales of merchandise and services on our B2C open platform, SME2C marketplaces and other open platforms providing lifestyle services and offline-to-online e-Commerce and (v) others, which includes trademark licensing, software development services and software sales.

We aim to build an Internet eco-system that provides benefits to users, content providers, applications developers, our own platforms and the Internet industry as a whole. We believe our users are attracted to our large and active online community as well as our diverse offering of innovative applications. We will continue to leverage our massive user base, proven platforms and well recognized brand to capitalize on the continued growth in Internet and mobile usage in the PRC.

We went public and were listed on the SEHK in June 2004 (Stock Code: 00700). We have been one of the constituent stocks of the Hang Seng Index since June 2008. For the year ended December 31, 2011, our total revenue was RMB28,496.1 million and our profit for the year was RMB10,224.8 million, an increase of 45.0% and 26.0%, respectively, over the year ended December 31, 2010. For the six months ended June 30, 2012, our total revenue was RMB20,175.1 million (US$3,175.7 million) and our profit for the period was RMB6,072.9 million (US$955.9 million), an increase of 54.3% and 16.2%, respectively, over the six months ended June 30, 2011. We have had positive cash flows from operating activities since 2001. As of June 30, 2012, our cash and cash equivalents and term deposits with initial term of over three months amounted to RMB27,617.2 million (US$4,347.1 million).

OUR STRENGTHS

We believe that the following strengths contribute to our success and differentiate us from our competitors:

- Large and highly engaged user base with strong network effect

- Successful monetization through diversified products and services
- Significant market leadership in multiple service areas
- Highly cash generative consumer-oriented business model
- Stable and proven management team

OUR STRATEGIES

Our strategic objective is to strengthen our market leading position and become the hub for fulfilling Internet users' online lifestyle needs in the PRC. We will undertake strategic initiatives focused on expanding our market shares, diversifying our product and service offerings and sustaining our growth and profitability. In particular, we will seek to:

- Further expand our user base and increase user engagement
- Further monetize our user base and user traffic
- Pursue an open platform strategy that promotes innovation and collaboration
- Capture the emerging mobile Internet trend
- Pursue selective investments and acquisitions to enhance our business portfolio, proprietary content, distribution channels, technology and international presence

INDUSTRY

The PRC has the world's largest Internet user base measured by the total number of Internet users. According to CNNIC, the total number of Internet users in the PRC was approximately 538 million at the end of June 2012. There is expected to be significant potential for growth as the Internet penetration rate in the PRC is relatively low compared to some other developed markets.

Over the past few years, PRC Internet users have increased the amount of time they spend online, while at the same time diversifying their Internet activities, including into areas such as IM, SNS, online games, online shopping and mobile Internet:

- IM, for example, has become one of the most popular Internet applications in the PRC. The number of IM users is estimated to grow from approximately 420 million in 2011 to approximately 630 million in 2014, according to iResearch.
- SNS has also been increasingly popular, particularly in relation to usage of social networking sites and microblog services. The number of users in the SNS market was estimated at 289 million in 2011 and is forecasted to reach 481 million in 2014, according to Strategy Analytics.
- Online game population has increased from approximately 64 million in 2009 to approximately 86 million in 2011 and is expected to grow to 114 million in 2014, according to IDC. Online game revenue in the PRC is expected to increase from approximately US$5.8 billion in 2011 to approximately US$8.2 billion in 2014, according to IDC.
- Online advertising expenditure was approximately US$5.3 billion in 2011 and is expected to grow to US$11.8 billion in 2014, according to eMarketer.

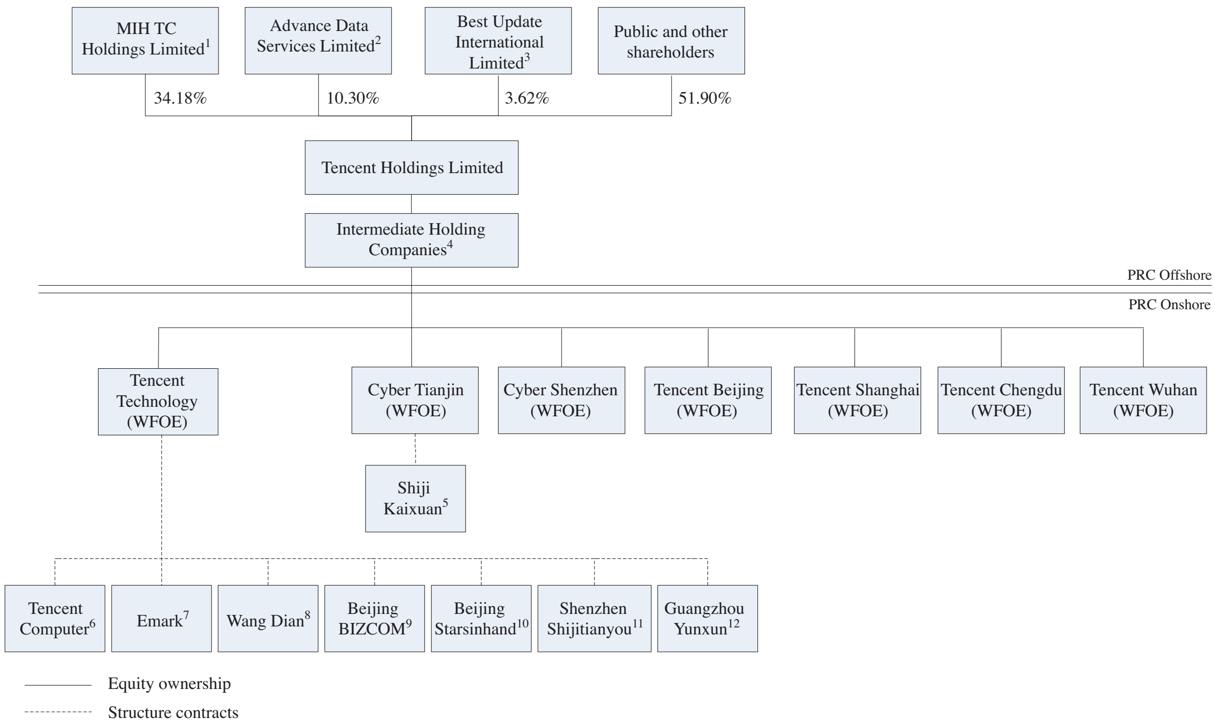
- The online shopping market was approximately US$120.7 billion by GMV in 2011 and is expected to grow to approximately US$316.8 billion by 2014, according to iResearch.

- The number of mobile Internet users in the PRC was approximately 360 million in 2011 and is expected to grow to approximately 600 million in 2014, according to iResearch.

We believe there will be significant growth in each of these areas in the future, driven by continuing growth in Internet and mobile Internet usage, together with general economic growth in the PRC.

CORPORATE STRUCTURE

The following diagram illustrates our principal corporate and share ownership structure as of June 30, 2012.



Notes:

(1) MIH TC Holdings Limited is controlled by Naspers Limited through its wholly owned intermediary companies, MIH (Mauritius) Limited and MIH Holdings Limited

(2) Wholly owned by Mr. Ma Huateng

(3) Wholly owned by Mr. Zhang Zhidong

(4) Intermediate Holding Companies include various Group companies established for the purpose of holding interests in various WFOEs as well as other investments of the Group

(5) The shareholders are Mr. Ma Huateng, Mr. Zhang Zhidong, Mr. Xu Chenye and Mr. Chen Yidan

(6) The shareholders are Mr. Ma Huateng, Mr. Zhang Zhidong, Mr. Xu Chenye and Mr. Chen Yidan

(7) Emark: Beijing Emark Information Technology Company Limited 北京驛碼神通信息技術有限公司

(8) Wang Dian: Nanjing Wang Dian Technology Company Limited 南京網典科技有限公司

(9) Beijing BIZCOM: Beijing BIZCOM Technology Company Limited 北京英克必成科技有限公司

(10) Beijing Starsinhand: Beijing Starsinhand Technology Company Limited 北京市掌中星天下信息技術有限公司

(11) Shenzhen Shijitianyou: Shenzhen Shijitianyou Technology Company Limited 深圳市世紀天游科技有限公司

(12) Guangzhou Yunxun: Guangzhou Yunxun Technology Company Limited 廣州雲訊信息科技有限公司

GENERAL INFORMATION

The Company was incorporated in the BVI on November 23, 1999 as an international business company with limited liability, with a registration number of 353466. The Company was redomiciled to the Cayman Islands on February 27, 2004 and is continued as an exempted company with limited liability under the Companies Law. On June 16, 2004, the Company publicly offered its shares for listing on the Main Board of the SEHK under stock code 00700. It became one of the then 43 constituents of the Hang Seng Index on June 10, 2008. Its principal place of business in the PRC is located at Tencent Building, Kejizhongyi Avenue, Hi-tech Park, Nanshan District, Shenzhen, 518057, the PRC. Its registered office is located at Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands.

Our website is www.tencent.com. Information contained on our website does not constitute part of this document.

SUMMARY CONSOLIDATED FINANCIAL AND OTHER DATA

The summary consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011 have been derived from the Company's audited consolidated financial statements for the years ended December 31, 2010 and 2011 included elsewhere in this document. The summary condensed consolidated interim financial information as of and for the six months ended June 30, 2011 and 2012 have been derived from the Company's unaudited condensed consolidated interim financial information as of and for the six months ended June 30, 2012 included elsewhere in this document.

The summary financial data below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the audited consolidated financial statements and the unaudited condensed consolidated interim financial information included elsewhere in this document. The financial and operating information for the six months ended June 30, 2012 is not necessarily indicative of the results that may be expected for the year ending December 31, 2012 and should not be used as the basis of, or prediction of, an annualized calculation.

SUMMARY CONSOLIDATED INCOME STATEMENT FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011 AND FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2012

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(Audited)	(Audited)	(Audited)	(Unaudited)	(Unaudited)	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Revenue:						
Internet value-added services	9,530,711	15,482,301	23,042,758	10,637,860	15,168,246	2,387,572
Mobile and telecommunications value-added services	1,905,599	2,715,931	3,270,841	1,571,631	1,842,849	290,075
Online advertising	962,171	1,372,522	1,992,216	793,206	1,419,804	223,486
e-Commerce transactions [(1)]	—	—	—	—	1,610,343	253,478
Others	41,479	75,277	190,257	74,767	133,860	21,070
Total revenue	12,439,960	19,646,031	28,496,072	13,077,464	20,175,102	3,175,681
Cost of revenue	(3,889,468)	(6,320,200)	(9,928,308)	(4,525,366)	(8,147,696)	(1,282,496)
Gross profit	8,550,492	13,325,831	18,567,764	8,552,098	12,027,406	1,893,185
Interest income	136,014	255,922	468,990	207,208	363,539	57,223
Other (losses)/gains, net	(58,213)	38,056	420,803	341,878	(66,861)	(10,523)
Selling and marketing expenses	(581,468)	(945,370)	(1,920,853)	(669,944)	(1,078,872)	(169,821)
General and administrative expenses	(2,026,347)	(2,836,226)	(5,283,154)	(2,260,838)	(3,616,239)	(569,218)
Operating profit	6,020,478	9,838,213	12,253,550	6,170,402	7,628,973	1,200,846
Finance (costs)/income, net	(1,953)	(838)	35,505	(2,098)	(185,238)	(29,158)
Share of profit/(losses) of associates	22,206	72,359	(24,255)	61,308	(4,342)	(683)
Share of profit/(losses) of jointly controlled entities	—	3,399	(165,731)	(64,986)	(7,995)	(1,259)
Profit before income tax	6,040,731	9,913,133	12,099,069	6,164,626	7,431,398	1,169,746
Income tax expense	(819,120)	(1,797,924)	(1,874,238)	(937,146)	(1,358,497)	(213,835)
Profit for the year/period	5,221,611	8,115,209	10,224,831	5,227,480	6,072,901	955,911

Note:

(1) We began treating e-Commerce transactions business as a separate reportable segment on January 1, 2012. No comparative figures for the comparative periods were presented since an insignificant amount of revenue was generated from e-Commerce transactions in the periods prior to January 1, 2012.

SUMMARY CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2009, 2010 AND 2011 AND AS OF JUNE 30, 2012

	As of December 31,			As of June 30,	
	2009	2010	2011	2012	
	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(US$ in thousands)
Cash and cash equivalents	6,043,696	10,408,257	12,612,140	10,602,451	1,668,889
Restricted cash[(1)]	200,000	1,036,457	4,942,595	2,317,431	364,777
Term deposits with initial term of over three months	5,310,168	11,725,743	13,716,040	17,014,730	2,678,220
Total current assets	13,156,942	25,373,741	35,503,488	35,912,893	5,652,903
Total assets	17,505,765	35,830,114	56,804,365	61,731,822	9,716,956
Short-term borrowings	202,322	5,298,947	7,999,440	3,609,323	568,129
Total current liabilities	4,563,079	13,022,045	21,183,348	19,981,134	3,145,149
Long-term notes payable	—	—	3,733,331	3,751,839	590,562
Long-term borrowings	—	—	—	948,735	149,336
Total non-current liabilities	644,033	967,211	6,532,673	7,036,316	1,107,558
Total liabilities	5,207,112	13,989,256	27,716,021	27,017,450	4,252,707
Total equity	12,298,653	21,840,858	29,088,344	34,714,372	5,464,249
Total liabilities and equity	17,505,765	35,830,114	56,804,365	61,731,822	9,716,956

Note:

(1) Includes, among others, restricted cash pledged for secured bank borrowings which amounted to RMB200.0 million, RMB1,014.5 million, RMB3,071.6 million and RMB324.3 million (US$51.1 million) as of December 31, 2009 and 2010 and 2011 and as of June 30, 2012, respectively.

SUMMARY CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011 AND FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2012

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(US$ in thousands)
Net cash flows generated from operating activities	8,398,365	12,319,293	13,358,107	5,434,115	8,945,857	1,408,131
Net cash flows used in investment activities[(1)]	(5,024,795)	(12,014,997)	(15,354,758)	(9,547,558)	(6,455,778)	(1,016,178)
Net cash flows (used in)/generated from financing activities[(2)]	(397,110)	4,112,146	4,373,024	1,741,476	(4,506,408)	(709,335)
Net increase in cash and cash equivalents	2,976,460	4,416,442	2,376,373	(2,371,967)	(2,016,329)	(317,382)
Cash and cash equivalents at beginning of year/period	3,067,928	6,043,696	10,408,257	10,408,257	12,612,140	1,985,226
Exchange (losses)/gains on cash and cash equivalents	(692)	(51,881)	(172,490)	(73,200)	6,640	1,045
Cash and cash equivalents at end of year/period	6,043,696	10,408,257	12,612,140	7,963,090	10,602,451	1,668,889

Notes:

(1) Includes, among others, payment for capital expenditures and game and other content licenses. Payment for capital expenditure represents the amount paid for purchase of fixed assets, construction in progress and investment properties, payments for land use rights and payments for intangible assets (excluding game and other content licenses), which amounted to RMB820.2 million, RMB2,034.4 million and RMB4,209.5 million for the years ended December 31, 2009, 2010 and 2011 and RMB1,567.4 million and RMB2,083.6 million (US$328.0 million) for the six months ended June 30, 2011 and 2012, respectively.

(2) Includes, among others, dividends paid to the Company's shareholders and non-controlling interest owners, which amounted to RMB586.7 million, RMB706.0 million and RMB894.8 million for the years ended December 31, 2009, 2010 and 2011 and RMB894.8 million and RMB1,126.1 million (US$177.3 million) for the six months ended June 30, 2011 and 2012, respectively.

OTHER FINANCIAL DATA

	Year ended December 31,			Six months ended June 30,		
	2009	**2010**	**2011**	**2011**	**2012**	
	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(US$ in thousands, except for %)
EBITDA(1)	6,480,450	10,323,506	13,298,239	6,392,021	8,585,869	1,351,467
Adjusted EBITDA(1)	6,801,872	10,819,278	14,030,930	6,726,473	9,020,172	1,419,829
Adjusted EBITDA margin(2)	55%	55%	49%	51%	45%	45%
Net Cash(3)	11,351,542	17,849,546	17,667,030	15,749,917	19,631,631	3,090,136

	As of and for the year ended December 31,			As of and for the twelve months ended June 30,
	2009	**2010**	**2011**	**2012**
	(RMB in thousands, except for ratios)			
Adjusted EBITDA(1)	6,801,872	10,819,278	14,030,930	16,324,629
Interest Expense	—	35,027	72,537	179,642
Ratios:				
Adjusted EBITDA(1) to Interest Expense	N/A	309x	193x	91x
Total Debt(4) to Adjusted EBITDA(1)	0.03x	0.49x	0.84x	0.51x

Notes:

(1) EBITDA for any year/period consists of operating profit less interest income, and plus other losses/(gains), net, depreciation of fixed assets and investment properties and amortization of intangible assets. Other losses/(gains), net consist primarily of the gains on disposal/deemed disposal of associates, government subsidies, donation to the Tencent Charity Fund, losses from derivative financial instruments and impairment provision for available-for-sale financial assets, associates and jointly controlled entities. Adjusted EBITDA consists of EBITDA plus equity-settled share-based compensation expenses. EBITDA and Adjusted EBITDA are not standard measures under IFRS. EBITDA is a widely used financial indicator of a company's ability to service and incur debt. EBITDA and Adjusted EBITDA should not be considered in isolation or construed as alternatives to cash flows, net income or any other measure of performance or as indicators of our operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. In evaluating EBITDA and Adjusted EBITDA, we believe that you should consider, among other things, the components of EBITDA such as sales and operating expenses and the amount by which EBITDA exceeds capital expenditures and other charges. We have included EBITDA and Adjusted EBITDA because we believe they are

a useful supplement to cash flows data as a measure of our performance and our ability to generate cash flows from operations to cover debt service and taxes. EBITDA and Adjusted EBITDA presented herein may not be comparable to similarly titled measures presented by other companies. You should not compare our EBITDA or Adjusted EBITDA to the EBITDA or Adjusted EBITDA presented by other companies because not all companies use the same definition.

(2) Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by the revenue for the relevant year/period.

(3) Net cash is calculated as restricted cash pledged for secured bank borrowings, cash and cash equivalents, and term deposits with initial term of over three months, minus total debt.

(4) Total debt consists of our short-term borrowings, which comprise our borrowings accounted for as RMB borrowings (both secured and unsecured), our U.S. dollar borrowings (which are all unsecured), our U.S. dollar denominated unsecured bonds (which were issued in March 2011 and matured and were fully paid off in March 2012), our long-term borrowings, which comprise our borrowings accounted for as offshore U.S. dollar borrowings (which are all unsecured), and the 4.625% Senior Notes.

The following table reconciles our operating profit under IFRS to our EBITDA and Adjusted EBITDA for the year/period indicated.

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Operating profit	6,020,478	9,838,213	12,253,550	6,170,402	7,628,973	1,200,846
Less: Interest income	(136,014)	(255,922)	(468,990)	(207,208)	(363,539)	(57,223)
Add: Other losses/(gains), net(1)	58,213	(38,056)	(420,803)	(341,878)	66,861	10,524
Add: Depreciation of fixed assets and investment properties	405,876	669,860	1,208,261	494,844	869,000	136,786
Add: Amortization of intangible assets	131,897	109,411	726,221	275,861	384,574	60,534
EBITDA	6,480,450	10,323,506	13,298,239	6,392,021	8,585,869	1,351,467
Equity-settled share-based compensation expenses	321,422	495,772	732,691	334,452	434,303	68,362
Adjusted EBITDA	6,801,872	10,819,278	14,030,930	6,726,473	9,020,172	1,419,829

Note:

(1) Other losses/(gains), net primarily consist of the gains on disposal/deemed disposal of associates, government subsidies, donation to the Tencent Charity Fund, losses from derivative financial instruments and impairment provision for available-for-sale financial assets, associates and jointly controlled entities.

OPERATING DATA

The following data sets forth certain operating statistics relating to our Internet platforms and value-added services as of the dates and for the periods presented:

	As of December 31,			As of June 30,
	2009	2010	2011	2012
	(in millions)			
Monthly active IM user accounts(1)	522.9	647.6	721.0	783.6
Average daily IM user hours(2)	1,382.4	1,885.9	2,363.9	2,775.8
Monthly active Qzone user accounts(3)	405.8	509.8	552.1	597.6
Fee-based IVAS registered subscriptions	51.6	65.7	77.2	74.7
Fee-based MVAS registered subscriptions	20.3	24.6	31.4	34.6

Notes:

(1) Monthly active IM user accounts figures denote the total number of user accounts logged in at least once during the last calendar month prior to the relevant date.

(2) Average daily IM user hours figures denote the average daily user hours of IM for the last 15/16 days to the relevant date.

(3) Monthly active Qzone user accounts figures denote the total number of user accounts that logged into Qzone at least twice during the last calendar month prior to the relevant date. Prior to the fourth quarter of 2011, we had periodically disclosed historical monthly active Qzone user accounts based on the total number of user accounts that either updated content or accessed social applications at least once during the last calendar month prior to the relevant date. All operating data presented in this document have been adjusted to reflect the new definition for fair comparison. The definition of monthly active Pengyou user accounts has also been revised in the same manner.

	For the three months ended December 31,			For the three months ended June 30,
	2009	**2010**	**2011**	**2012**
	(in millions)			
IM PCU[(1)]	93.0	127.5	152.7	166.6
QQ Game Platform PCU[(2)]	6.2	6.8	8.4	8.8

Notes:

(1) IM PCU figures denote the highest number of simultaneous online user accounts of our IM platform during the period.

(2) QQ Game Platform PCU figures denote the highest number of simultaneous online user accounts of our QQ Game Platform during the period.

You should consider carefully the following information about the risks described below, together with the other information contained in this document. If any of the following risks actually occurs, our business, financial condition, results of operations or prospects could be materially and adversely affected. Additional risks or uncertainties not presently known to us, or that we currently deem immaterial, may also impair our business operations. There can be no assurance that any of the events discussed in the risk factors below will not occur.

RISKS RELATING TO OUR BUSINESS

We operate in a very competitive market. If we fail to compete effectively, we may lose users to competitors and our future results of operations and prospects could be materially and adversely affected.

We face significant competition in almost every aspect of our business, particularly from companies that provide Internet communication tools, online games, social networking, microblog, search, online advertising, e-Commerce as well as other Internet and mobile value-added services and products. We compete directly with other major PRC Internet portals and vertical websites to provide comprehensive Internet and mobile value-added services to customers. In addition, we face increased competition from international competitors that may establish joint venture companies with domestic PRC companies to provide services based on the foreign investors' technology and experience developed in their home markets. Some of our competitors have widely recognized brand names in the PRC and may have greater financial resources than we do. Moreover, present or future competitors may offer services and products that provide more favorable technology, performance and pricing than we can provide, with the result that their services and products could achieve greater market acceptance than our services and products.

In particular, the online game market in the PRC is increasingly competitive. We expect more companies to enter into this sector and a wider range of online games to be introduced into the PRC market. Competition from other online game operators, both based in the PRC as well as overseas, is likely to increase in the future and may make it more challenging for us to retain existing users and attract new users.

We also face increasing competition in our community and open platform services, where we compete with both PRC-based and global SNS and microblog operators (including international operators seeking to enter the PRC market) to attract users that may in turn subscribe for our premium services or other fee-based products. Our business also generally competes with other forms of entertainment, such as television and movies.

The e-Commerce industry in the PRC is rapidly evolving and intensely competitive. Our current and potential competitors may secure better terms from merchants and suppliers, adopt more aggressive pricing and discounting tactics, engage in pricing wars, devote more resources to marketing and invest more heavily in warehousing and logistics networks. As we develop our e-Commerce platforms, we will face increasing challenges to attract and retain high quality third-party merchants. Further, new and enhanced Internet search functions may facilitate a higher level of comparison shopping and increase competition, which may adversely affect our e-Commerce transactions business. In addition to other e-Commerce companies, we compete with physical retailers, in-house e-Commerce solutions and other distributors of products and services engaged by our merchants and suppliers.

Furthermore, some of our competitors may adopt various unilateral measures to target our business, such as by preventing users of their products from using some or all of our products at the same time (for example, by programming their products in a way that disables the use of our products) or by attacking our platforms with spam or other virus-like programs. Any of these measures taken by our competitors could affect our number of users, reduce our market shares, and negatively affect our brand and reputation.

If we are unable to compete effectively in our business, it could result in decreases in user numbers and user traffic over our platforms, and lead to increased spending for marketing and development, any of which could materially and adversely affect our business, results of operations and prospects.

If we fail to keep up with the technological developments and users' changing requirements, we may not be able to increase the size and level of engagement of our user base and our business and prospects could be materially and adversely affected.

Our business and prospects will depend on our ability to respond to rapidly changing technologies, adapt our services to evolving industry standards and improve the performance and reliability of our services. Our failure to adapt to such changes could harm our business. In addition, changes in user behavior resulting from technological developments may also adversely affect us. For example, the number of people accessing the Internet through devices other than personal computers, including mobile phones and other hand-held devices, has increased in recent years, and we expect this trend to continue while 3G, 4G and more advanced mobile communications technologies are broadly implemented. The increased use of mobile devices as a substitute for use of personal computers may reduce website user traffic and we may incur substantial expenditures to adapt to this trend. If we are not able to successfully monetize this increasing rate of mobile usage, our business, results of operations and growth prospects may be materially and adversely affected.

If we fail to develop services and products that are compatible with current and future mobile devices, or if the services and products we develop are not widely accepted and used by mobile device users, we may not be able to increase our mobile user base. If we fail to anticipate and meet the needs of our users, the size, engagement and loyalty level of our user base may decrease, which may render our platforms less attractive to advertisers and users. In addition, the widespread adoption of new Internet, networking or telecommunications technologies or other technological changes could require substantial expenditures to modify or integrate our products, services or technologies. If we fail to anticipate and adapt to material technological changes, our market share could suffer, which in turn could materially and adversely affect our business and prospects.

We operate in a rapidly evolving environment and our existing offerings may become less popular as we launch new services and products or they may become incompatible with new technologies and devices.

We operate in a dynamic and evolving industry with the rapid emergence of new technologies and new services and products. To remain competitive, we must introduce new services and products to diversify our portfolio, adapt to new technologies, appeal to changing consumer trends and preferences, and generate additional revenue. The e-Commerce and retail industries are subject to rapidly changing consumer preferences. Although we have a dedicated team that studies emerging lifestyle and consumer trends and anticipate trends that will appeal to existing and potential customers, if our customers cannot find their desired products on our e-Commerce platforms, this may result in reduced consumer traffic and transaction volume.

Further, some of our new services and products may attract users from our existing offerings. Some of our existing services and products may also become incompatible with emerging technologies and new devices. For example, our legacy voice value-added services have become less popular with the expansion of the 3G technology platform in the PRC and increased usage of smartphones and other Internet-enabled mobile devices. If we are unable to continue to launch new services and products that can offset the loss of popularity of our maturing services and products, our market share could erode, which in turn could materially and adversely affect our financial condition and results of operations.

If we fail to maintain and enhance our brand recognition, or if we incur excessive expenses in this effort, our business, results of operations and prospects may be materially and adversely affected.

It is critical for us to maintain and develop our brands so as to effectively expand our user base, maintain and increase our business partnerships, and grow our revenue. Well-recognized brands are critical to increasing the number and engagement of our users and, in turn, enhancing our attractiveness to advertisers. Since we operate in a highly competitive market, maintaining and enhancing our brands directly affects our ability to maintain our market position. Our main competitors also have established brands and are continuing to take steps to increase their brand recognition and we must continue to maintain and enhance the recognition and value of our brands in this highly competitive market. In order to attract and retain users, we may need to substantially increase our expenditures for creating and maintaining brand loyalty. As a result, our sales and marketing expenses may increase significantly, which may impact our profitability. Our success in promoting and enhancing our brands, as well as our ability to remain competitive, will also depend on our success in offering high quality content, features and functionality. In addition, the use of words or branding similar to our brands by third parties in other industries could dilute the brand recognition for our brands. If we are unable to maintain and enhance our brand recognition, our business, results of operations or prospects could be materially and adversely affected.

We work closely with telecommunications operators in a number of ways with respect to our MVAS businesses, including the billing of and collection from our users. If our service agreements with telecommunications operators were to be terminated, altered or not renewed, or if such operators do not provide continuous or adequate service, our results of operations could be materially and adversely affected.

Substantially all of the revenue from our MVAS business and a small portion of the revenue from our IVAS business are derived from service agreements with China Mobile, China Unicom and China Telecom. Pursuant to such service agreements, the telecommunications operators bill and collect fees from mobile subscribers for the value-added services we provide through their networks. Our business relies materially on fees collected through these operators from our subscribers. Further, we rely on telecommunications operators in various ways including:

- using telecommunications operators' networks and gateways to deliver our services and products;
- using and relying on telecommunications operators' billing systems to charge our users through their mobile phone bills; and
- relying on telecommunications operators' collection proxy services to collect payments from subscribers.

We have limited control over the usage fees that the telecommunications operators charge their end customers and we have limited access to alternative networks to deliver our services and products or collect fees from our mobile phone users. If the telecommunications operators' usage fees or other charges to their end customers increase, our user traffic may reduce. Further, if our relationships with telecommunications operators are terminated, curtailed or renewed on terms that are unfavorable to us, including increases in service fees for using their networks, our ability to deliver services and products to users may be affected, which could have a material and adverse effect on our results of operations.

Significant changes in the policies or guidelines of the PRC telecommunications operators with respect to services provided by us could result in lower revenue or additional costs for us and materially and adversely affect our business and results of operations.

From time to time, PRC telecommunications operators issue policy or guideline changes stating their preferences for certain actions to be taken by service providers using their networks. Due to our reliance on these telecommunications operators, a significant change in their policies or guidelines could cause our revenue to decrease or operating costs to increase. For example, on November 30, 2009, China Mobile implemented a series of measures targeted at eliminating offensive or unauthorized content, including pornographic content, on PRC-based WAP sites. As a result, China Mobile suspended billing for their customers for all WAP services, including those services that do not contain offensive or unauthorized content. In 2010, China Mobile implemented a policy requiring service providers to conduct "double confirmation plus reminder services" and in early 2011 China Mobile implemented a new policy on service cancellation, both of which have negatively impacted our MVAS revenue. We cannot assure you that PRC telecommunications operators will not introduce additional requirements or adopt other policies which may require significant changes in the way we promote and sell our MVAS and IVAS, any of which could have a material and adverse effect on our financial condition and results of operations.

We face uncertainties regarding the growth of the online game industry and continuous market acceptance of our online games and in-game items.

We have derived a significant portion of our revenue from the online game industry, which is rapidly evolving. Revenue from online games constituted 55.5% of our total revenue for the year ended December 31, 2011 and 54.0% of our total revenue for the six months ended June 30, 2012. The growth of the online game industry is subject to a high degree of uncertainty. Our future results of operations associated with this industry will depend on numerous factors, including:

- Internet infrastructure, growth of personal computer, Internet and broadband penetration in the PRC;
- whether the PRC online game industry continues to grow and the rate of any such growth;
- laws, rules, regulations and policies affecting the online game industry, including those affecting Internet cafes in the PRC, where a substantial portion of our game players access online games;
- general economic conditions, particularly economic conditions that impact the level of discretionary consumer spending;
- the availability and popularity of other forms of entertainment;
- changes in consumer demographics, public tastes and preferences;
- our ability to develop or acquire new online games and related products to meet market demand and user preferences;
- the popularity and price of new online games and in-game items that we and our competitors launch and distribute; and
- our ability to timely upgrade and improve our existing games to extend their lifespans and to maintain their competitive positions in the online game market.

Due to these challenges and uncertainties, we cannot assure you that our online game business will continue to grow at the rates it has in the past. Our failure to successfully develop this business could have a material adverse effect on our results of operations and prospects.

If we are unable to consistently develop, acquire, co-develop, or license additional successful online games, our business and results of operations may be materially and adversely affected.

In order to maintain our long-term profitability and operational success, we must continue to develop, acquire, co-develop or license new online games that are attractive to users before our existing online games reach the end of their commercial lifespans. This requires us to maintain and grow our in-house online game development capability to anticipate changing consumer tastes and preferences, adopt new technologies, attract, retain and motivate talented online game developers and effectively execute online game development plans. There is no assurance that we can successfully maintain or develop our in-house online game development capability in such manner.

We may also acquire online game development and operational companies from time to time. The selection of acquisitions depends on the availability and commercial potential of suitable acquisition targets and may be subject to governmental approvals. Future acquisitions may also expose us to potential risks, including risks associated with the assimilation of new operations, technologies and personnel, unforeseen or hidden liabilities and potential loss of, or harm to, our relationships with customers, licensors and other suppliers as a result of integration of new businesses.

We may also enter into co-development arrangements with key players in the game industry from time to time. These arrangements depend on the availability of suitable game titles and co-development partners and our ability to implement the co-development on planned schedules.

Licensing successful online games has been, and will continue to be, an important part of our strategy to provide market leading IVAS. The success of such licensing arrangements depends on our ability to identify games that will appeal to users and to obtain government approvals required for the licensing and operation of such games. However, it is difficult to determine which online games will appeal to users. In addition, many of the games that are licensed by overseas developers were not designed specifically for the PRC online game market, further complicating the task of identifying or implementing games that will appeal to users. Moreover, due to increased competition among online game operators in the PRC, upfront license fees for licensed games have increased and most licensors are demanding guaranteed minimum royalty payments. Increased competition or potential commercial disputes with or among our overseas licensors of our existing or future online games may have an adverse impact on our online games business.

There is no assurance that the online games which we have developed, acquired, co-developed or licensed from third parties, will be attractive to users and will always comply with relevant content restrictions such as government regulations. If we are not able to mitigate the potential adverse impact as a result of competition or disputes of or among our overseas licensors and consistently develop, acquire, co-develop or license online games with continuing appeal to users, our financial condition and results of operations could be materially and adversely affected.

We may not be successful in implementing our growth strategies or sustaining our historical growth rate.

We are pursuing a number of growth strategies, including building collaborative open platforms, diversifying our game portfolio, increasing search engine partnerships and developing and expanding our e-Commerce platforms. We are also pursuing opportunities for growth through acquisitions and investments. Although we have achieved significant growth in the past, we cannot be assured that this level of significant growth will be sustainable or achieved at all in the future. Further, we cannot assure you whether all or any of these strategies will be successful. If we are unable to implement our growth strategies, our competitiveness may be materially and adversely affected, which would have a material impact on our revenue.

Our past and future acquisitions and investments could have a material and adverse effect on our ability to manage our business.

As part of our strategy to further expand our business, we may continue to acquire additional products, assets, technologies or businesses that are complementary to our existing business if and when appropriate opportunities arise. Future acquisitions and the subsequent integration of new products, assets, technologies and businesses into our existing business would require attention from our management and result in diversion of resources from our existing business. The areas where we face risks include:

- diversion of management time and focus from operating our business to address acquisition integration challenges;
- implementation or remediation of controls, procedures, and policies at the acquired company;
- integration of the acquired company's accounting, human resource, and other administrative systems, and coordination of product, engineering, and sales and marketing functions;
- transition of operations, users, and customers onto our existing platforms;
- cultural challenges associated with integrating employees from the acquired company into our organization, and retention of employees from the businesses we acquire;
- liability for activities of the acquired company before the acquisition, including patent and trademark infringement claims, violations of laws, commercial disputes, tax liabilities, and other known and unknown liabilities;

- litigation or other claims in connection with the acquired company, including claims from terminated employees, customers, former stockholders, or other third parties;
- in the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political, and regulatory risks associated with specific countries; and
- failure to successfully further develop the acquired technology.

Also, acquired products, assets, technologies or businesses may not yield the results that we anticipate. In addition, acquisitions could result in the use of substantial amounts of cash, significant amortization expenses related to identifiable intangible assets and exposure to potential impairment or write-offs of such investments, the relevant goodwill and/or identified intangible assets or potential unknown liabilities of any such acquired business. Moreover, the costs of identifying and consummating acquisitions may be significant. In addition to possible regulatory or shareholders' approval in Hong Kong, we may also have to obtain approval from the relevant government authorities for the acquisitions and have to comply with any applicable laws and regulations, which could result in increased costs and delay. Further, the value of our investments are subject to market or non-market fluctuations which are attributable to factors beyond our control.

Our failure to properly and timely address these risks or other problems encountered in connection with our past or future acquisitions and investments could cause us to fail to realize the anticipated benefits of such acquisitions or investments, incur unanticipated liabilities and harm our business generally.

Future acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, amortization expenses, write-offs of goodwill, or even provisions for prolonged impairment in value, any of which could have a material and adverse effect on our results of operations and prospects.

Our growth may not be sustainable due to limitations in our infrastructure or resources and any expansion or upgrades of our infrastructure or resources may require significant costs.

We have limited operational, administrative and financial resources and these resources may be inadequate to sustain the growth we want to achieve. As our user base increases and as we diversify into other business segments, we will need to increase our investment in our technological infrastructure and facilities; improve existing operational and financial systems, procedures and controls; and expand, train and manage our growing employee base. Further, our management will be required to maintain, and expand, our relationships with telecommunications operators, Internet and other online service providers, content providers and other third parties necessary to the growth of our business. Almost all Internet and mobile access in the PRC is maintained through state-owned telecommunications operators under the control and supervision of MIIT, and we use a limited number of telecommunications operators to provide us with data communications capacity through local telecommunications lines and Internet data centers to host our servers. With the expansion of our business, we may be required to upgrade our technology and infrastructure to keep up with the increasing traffic on our websites and increasing user levels on our platform. We cannot assure you that the Internet infrastructure and the fixed and mobile telecommunications networks in the PRC will be able to support the demands associated with the continued growth in our Internet usage. If we are unable to manage our growth and expansion effectively, including through investments in our internal systems and structures, the quality of our service could deteriorate, our business may suffer and our results of operations could be materially and adversely affected.

We rely on a number of third parties to provide content to our websites and various services and technologies. Any disruption in the provision of these third-party content, services or technologies could materially and adversely affect our business and results of operations.

One of our principal strengths is our ability to create a distinct online community through our services and content. We rely on a number of third parties to create traffic and provide content in order to make our websites and services more attractive to consumers and advertisers, through which we may sustain and grow our online community. Third parties that provide content for our websites and services include both commercial content providers with which we have contractual relationships and our registered community members who post articles and other content on our websites. If these third parties fail to develop and maintain high quality content, our websites could lose viewers and advertisers. Most of our contractual arrangements with third-party content providers are not exclusive and are short term, or may be terminated at any time for any reason by either party. Recently, many content providers have increased the fees they charge us for their content. This trend could increase our costs and operating expenses and could adversely affect our ability to obtain content at an economically acceptable cost. There can be no assurance that our existing relationships with third-party content providers, if maintained, will result in sustainable business partnerships, successful service offerings and an acceptable level of traffic on our websites or revenue, or will not be terminated. Also, a majority of this third-party content is also available from other sources or may be provided to other Internet companies. If other Internet companies present the same or similar content in a superior manner, this could reduce our visitor traffic, which could have a material and adverse effect on our business and prospects.

In addition, our business also depends upon services provided by, and relationships with, third parties service and technology providers such as the telecommunications operators, advertising agencies that represent advertisers, game developers and online payment vendors. We generally do not have long-term cooperation agreements or exclusive arrangements with these third parties and they may elect to direct business opportunities to our competitors. With respect to telecommunications operators and online game developers, we have revenue sharing arrangements that require periodic renewals. If we fail to retain and enhance our business relationships with these third parties, or renew our business arrangements with these third parties on the same or more favorable terms to us, our business and results of operations may be materially and adversely affected.

We face uncertainties regarding the legal liability for providing third-party services, products, content and applications on our platforms.

One of our strategies is to pursue an open platform strategy that focuses on SNS, microblog, IM platforms, online games, search and e-Commerce. A number of third-party services, products, content and applications have been, and will continue to be, provided on or through our platforms through commercial cooperation agreements we entered into with third parties. It is also possible that third parties may engage in illegal, obscene or incendiary conversations or activities that may be deemed unlawful under PRC laws and regulations on our platform. If any content on our platform is deemed illegal, obscene or incendiary, or if appropriate licenses and third-party consents of such services, products, content and applications as required have not been obtained, claims may be brought against us for defamation, libel, negligence, copyright, patent or trademark infringement, other unlawful activities or other theories and claims based on the nature and content of such objectionable information. Although such commercial agreements provide general contractual provisions to limit or exclude our legal liabilities, we cannot assure you that we may not incur any liability caused by providing these third-party services, products, content or applications on our platforms if they are found in breach of the relevant rules and regulations in the PRC or any intellectual property rights, especially in light of the fact that the current PRC laws remain uncertain about our liability in connection with any third-party content and applications. Any regulatory actions or liability incurred by these third parties may disrupt our business and cause damage to our reputation.

We have been and may continue to be exposed to liability for copyright or trademark infringement and other claims based on the nature and content of the materials that are delivered, shared or otherwise accessed through or published or posted on our platform. Defending of any such actions could be costly and involve significant time and attention of our management and other resources. In addition, if we are found to have not adequately monitored the content on our platform, PRC authorities may impose legal and administrative sanctions on us, including, in serious cases, suspending or revoking the licenses necessary to operate our platform.

We may face additional risks as we expand our business to new international markets.

From time to time we evaluate opportunities to expand our business, services and product offerings to markets outside the PRC. Expanding our business, services and product offerings into new overseas markets may expose us to risks that are additional to or different from those that we currently face, including:

- difficulties in identifying and maintaining good relationships with business counterparties or partners;
- uncertainties in developing products and services catering to overseas markets and in renewing the license agreements with licensees upon their expiration;
- our ability to maintain our brand name and the reputation of our products and services in situations where our products and services are operated by licensees or partners in the overseas markets pursuant to their own standards;
- difficulties and costs associated with protecting and enforcing our intellectual property rights overseas;
- difficulties and costs relating to compliance with the different commercial and legal requirements of the overseas markets, such as licensing and certification requirements, import regulatory procedures, taxes and other restrictions and expenses;
- exposure to claims and litigations in markets where the laws and overall environment are unfamiliar to us;
- fluctuations in currency exchange rates; and
- interruptions in cross-border Internet connections or other system failures.

Our inability to expand our business internationally or any risks associated with conducting business in new overseas markets may have a material and adverse effect on our business, financial condition and results of operations.

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

We regard our intellectual property rights as critical to our success. We seek to protect our intellectual property rights by relying on a combination of patent, copyright and trademark protection and contract laws. Despite our precautions, it may be possible for third parties to use such intellectual property without authorization. The validity, enforceability and scope of protection of intellectual property in Internet-related industries are uncertain and still evolving in the PRC and protection and enforcement of our intellectual property rights may not be as effective as in other countries with established legal regimes. Moreover, policing and enforcing against unauthorized use of proprietary technologies is difficult and expensive in the PRC. Any unauthorized use of our intellectual property could have a material and adverse impact on our business and results of operations. From time to time, we have, and may have to resort to, litigation to enforce our intellectual property rights, which could result in substantial costs and diversion of resources.

We may be subject to intellectual property claims, which may force us to incur substantial legal expenses and, if determined adversely against us, may materially disrupt our business.

As an Internet content distributor and publisher and an e-Commerce platform provider, we may face liability for defamation, negligence, copyright, misappropriation, patent or trademark infringement or other intellectual property rights violations of third parties. See "Business—Legal Proceedings". We may receive notices of claims of infringement of third parties' proprietary rights or claims for indemnification resulting from infringement claims arising from our use of technology, content offered on our Internet portals, internally developed or licensed online games or merchandise and services sold on our e-Commerce platforms. We could also be subject to claims based upon content that is accessible on our websites or through our services, such as content and materials posted by users on message boards, online communities, voting systems, email or chat rooms. With respect to games and applications developed by third parties, we have procedures designed to reduce the likelihood of infringement. However, such procedures might not be effective in preventing third-party games and applications from infringing other parties' rights.

Intellectual property claims and litigation are expensive and time-consuming to investigate and defend, and may divert resources and management attention from the operation of our business. Such claims, even if they do not result in liability, may harm our reputation. Any resulting liability or expenses, or changes required to our websites to reduce the risk of future liability, could also have a material adverse effect on our business, financial condition and prospects.

Online communications among our users may lead to personal conflicts and improper usages of our services, which may damage our reputation, lead to litigation or government investigation and have a material and adverse effect on our business.

Our users engage in highly personalized exchanges over our platforms. Users who have met online through our services may become involved in emotionally charged situations and could suffer adverse moral, emotional or physical consequences. Such occurrences could be highly publicized and have a significant negative impact on our reputation. Users who have suffered such adverse consequences may bring litigation against us to claim compensation in such events. Government authorities may also require us to discontinue or restrict those services that have led, or may lead, to such events. As a result, our business and results of operations could be materially and adversely affected.

As our patents may expire and may not be extended, our patent applications may not be granted and our patent rights may be contested, circumvented, invalidated or limited in scope, our patent rights may not protect us effectively. In particular, we may not be able to prevent others from developing or exploiting competing technologies. As a result, there could be material and adverse effects on our business operations, financial condition and results of operations.

In the PRC, the valid period of utility model patent right or design patent right is ten years, and the valid period of invention patent right is twenty years. None of such patent rights is extendable. Currently, we have patent applications pending in the PRC, but we cannot assure you that we will be granted patents pursuant to our pending applications. Even if our patent applications succeed and we are issued patents in accordance with them, it is still uncertain whether these patents will be contested, circumvented or invalidated in the future. The rights granted under any issued patents may not provide us with proprietary protection or competitive advantages. Further, the claims under any patents that issue from our patent applications may not be broad enough to prevent others from developing technologies that are similar or that achieve results similar to ours. It is also possible that the intellectual property rights of others will bar us from licensing and from exploiting any patents that issue from our pending applications. Numerous U.S. and foreign issued patents and pending patent applications owned by others exist in the fields in which we have developed and are developing our technology. These patents and patent applications might have priority over our patent applications and could subject our patent applications to invalidation. Finally, in addition to those who may claim priority, any of our existing or pending patents may also be challenged by others on the basis that they are otherwise invalid or unenforceable.

Our quarterly revenue and operating results may be subject to significant fluctuations.

We may experience significant fluctuations in our quarterly operating results due to a variety of factors, many of which are beyond our control. Significant fluctuations in our quarterly operating results could be caused by factors including seasonality, regulatory changes or the macroeconomic environment. Any of these factors or other factors could cause our results of operations to fluctuate from quarter to quarter. For these reasons, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. Our quarterly and annual revenue and costs and expenses as a percentage of our revenue may significantly differ from our historical or projected rates. Our results of operations may be below our expectations or the expectations of public market analysts in one or more future quarters.

We depend on our key personnel, and our business and growth prospects may be severely disrupted if we lose their services.

Our success depends on the continuous effort and services of our current executive team and other key personnel and we rely on their expertise in business operations, including the development of new value-added services and products and maintenance of our relationships with other strategic partners. If one or more of our key personnel are unable or unwilling to continue in their present positions, we may not be able to easily replace them and may incur additional expenses to recruit and train new personnel, which could severely disrupt our business. Our present and future success will continue to depend on our ability to attract and retain highly skilled technical, managerial, editorial, marketing and customer service personnel. There is no assurance that we may be able to successfully attract, assimilate or retain the personnel we need to succeed. As competition for talent in the Internet and telecommunications industries intensifies, it may be more difficult for us to hire, motivate and retain highly skilled personnel. If we are unable to attract additional highly skilled personnel or retain or motivate our existing personnel, we may not be able to grow effectively.

Legal proceedings or allegations of impropriety against us or our key personnel could have a material adverse impact on our reputation, results of operations and financial condition.

From time to time, we have been, and may be in the future, involved in lawsuits or subject to allegations brought by our competitors, individuals or other entities against us or our key personnel, including claims of unfair, unethical or otherwise inappropriate business practices. See "Business — Legal Proceedings". Any such lawsuit or allegation, with or without merit, or any perceived unfair, unethical or inappropriate business practice by us could generate negative publicity about us, harm our reputation and divert resources and management attention from the operation of our business. We cannot assure you that we will not be involved in lawsuits or subject to allegations of similar nature in the future. In addition, we could incur substantial costs, divert the attention of our management in dealing with these claims, and suffer reputational damage, even if we are successful in our defense or counterclaims.

Undetected programming errors or defects in our games and the proliferation of cheating programs could harm our reputation and increase user dissatisfaction, which could materially and adversely affect our business.

Our games may contain undetected programming errors or other defects. In addition, parties unrelated to us may independently develop online cheating programs that enable users to acquire superior features for our games that they would not have otherwise. Furthermore, certain cheating software programs created independently by parties unrelated to us could allow users to eliminate superior features for our games that have been acquired by other users. The occurrence of undetected errors or defects in our games, and our failure to discover and disable cheating programs affecting the fairness of the game environment for our games, could disrupt our operations, damage our reputation and detract from the game experience of our users. As a result, such errors, defects and cheating programs could materially and adversely affect our business, financial condition and results of operations.

Unexpected network interruptions caused by system failures, security breaches or computer viruses may disrupt our business operations, harm our reputation, and may require us to expend significant capital and other resources to protect our websites.

We may experience unexpected system interruptions and delays (including those caused by natural disasters such as earthquakes and floods) or security breaches, which may expose us or our users to a risk of loss or misuse of user information, prevent us from efficiently providing services or efficiently fulfilling orders, or cause significant harm to our reputation and our ability to attract and maintain users and advertisers. We maintain a distributed server network architecture hosting servers across the PRC. We have limited backup systems and have experienced system failures and electrical outages from time to time in the past, which have disrupted our operations. Although we have a certain number of disaster recovery plans in place in the event of damage from fire, floods, typhoons, earthquakes, power loss, telecommunications failures, break-ins, war, terrorist acts and similar events and will continue to develop additional plans, our existing back-up systems and disaster recovery plans may not be effective for such events. If any of the foregoing occurs, we may experience system failures and electrical outages, which could have a material and adverse effect on our business.

In 2010, we experienced a significant security attack by a program, which we believe to be a malware, called "Kou Kou Bodyguard" that caused material security risks to our users. The risks subsided after government authorities ordered the creator of the malware to withdraw the program. Nevertheless, the security attack caused substantial disruption to our users and business and the publicity surrounding the attack temporarily affected our user relations and reputation. We may be required to expend significant capital and other resources to protect our websites against the threat of such computer viruses and hackers and to alleviate any problems caused by them and there is no assurance that these measures will be adequate and prevent potential future attacks. In addition, any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could have a material adverse effect on our business, financial condition and results of operations.

Our users may use our products or services for critical transactions and communications, especially business communications. As a result, any system failures could result in damages to such users' businesses. These users may seek significant compensation from us for their losses. We could incur substantial costs and divert the attention of our management in defending ourselves against these claims even if we are successful in such defense.

We may not be able to effectively manage our expansion of e-Commerce transactions business and it is difficult to evaluate the performance and growth of our e-Commerce transactions business as a separate business segment.

The business of selling goods and services over the Internet in the PRC is still relatively new and evolving. Revenue from our e-Commerce transactions segment constituted 8.0% of our total revenue for the six months ended June 30, 2012. Revenue generated from our e-Commerce transactions business, to a large extent, depends on the number of users who shop on our platforms and order fulfillment volume. Therefore, our ability to attract new customers and retain existing spending users and our fulfillment capacities are important to the growth of our e-Commerce transactions business. We also need to attract and retain high quality third-party merchants to diversify our product offerings and sustain the continuous growth of our platforms. In order to expand our customer base and increase transaction volume, we must appeal to merchants and customers who historically have used traditional means of commerce or our competitors' platforms to sell and purchase goods and services to use our e-Commerce platforms to transact businesses. If we are unable to increase the number of merchants on our e-Commerce platforms, grow our customer base and increase transaction volume, our business and growth prospects could be materially and adversely impacted.

The transaction-processing systems and our network infrastructure for our e-Commerce transactions business are critical to our success and our ability to attract and retain customers and to maintain adequate customer service levels. Any system interruptions caused by telecommunications failures, computer viruses, hacking or other attempts to harm our systems could result in the unavailability or slowdown of our e-Commerce platforms or reduced order volume, which could have an adverse effect on the performance of our e-Commerce transactions business.

In addition, we began treating e-Commerce transactions business as a separate business segment on January 1, 2012, which makes it difficult to compare the results of this segment with prior periods and to analyze, compare and estimate the performance and growth prospects of the new segment. The performance of our new segment may fluctuate significantly or differ significantly from its historical performance.

We may incur significant capital expenditures as we grow our e-Commerce transactions business.

As we develop our e-Commerce transactions business, we will need to devote more resources to fund capital expenditures for additional facilities to warehouse increased inventory, expanding our logistics and warehousing system and may need to secure financing for future significant acquisitions of e-Commerce or related businesses or assets. If we are unable to secure sufficient funds to finance our capital expenditures and acquisitions, our business, financial condition and results of operations could be materially and adversely affected. Additionally, actual capital expenditures may significantly exceed our estimated budgets because of various factors beyond our control. If our actual capital expenditures significantly exceed estimated budgets, we may not be able to achieve the intended economic benefits of these investments, which in turn may materially and adversely affect our financial condition, results of operations and growth prospects.

Product liability claims and product recalls may adversely affect our e-Commerce transactions business.

Some of the merchandise we sell on our e-Commerce platforms may expose us to product liability claims relating to merchandise quality, personal injury, death, or environmental or property damage, and may require product recalls or other actions. Although our agreements with third parties require vendors on our e-Commerce platform to indemnify us against losses arising from product liability, certain third parties may not have sufficient protection from such claims which may increase our exposure to product liability claims if users decide to bring claims directly against us.

We are exposed to inventory risk for merchandise that we directly offer and sell on our e-Commerce platforms.

In relation to the merchandise we directly offer and sell to our users on our e-Commerce platforms, we are exposed to inventory risk that may adversely affect our operating results as a result of seasonality, price wars, new product launches, rapid changes in product cycles and pricing, defective merchandise, changes in consumer demand and spending patterns, changes in consumer tastes with respect to our merchandise and other factors. While we endeavor to accurately predict these trends and avoid overstocking or understocking merchandise we sell, demand for merchandise can change significantly between the time when inventory is ordered and the date of sale. In addition, when we begin selling a new item of merchandise, it may be difficult to establish a supplier relationship, determine appropriate merchandise selection, and accurately forecast demand. The acquisition of certain types of inventory may require significant lead-time and prepayment and they may not be returnable. We carry a broad selection and significant inventory levels of certain merchandise, such as consumer electronics, and we may be unable to sell them in sufficient quantities or during the relevant selling seasons. Any one of the inventory risk factors set forth above may adversely affect our results of operations, liquidity and cash flow.

We generally do not enter into long-term arrangements with most of our suppliers to guarantee availability of merchandise, services, particular payment terms, or the extension of credit limits. If our current suppliers were to stop selling or licensing merchandise or services to us on acceptable terms, or delay delivery, including as a result of one or more supplier bankruptcies due to poor economic conditions, as a result of natural disasters or for other reasons, we may not be able to procure alternatives from other suppliers in a timely and efficient manner and on acceptable terms, or at all.

Our reputation could be harmed and our customer experience may be negatively affected if our courier team and third-party logistics companies do not adhere to our standards of quality.

Currently we mainly use our own courier team and a network of regional third-party inter-city logistics companies and local third-party logistics companies to deliver merchandise that we directly offer and sell to our customers. Interacting with and coordinating the activities of our courier team and different logistics companies is complicated. Interruptions to or failures in our and the third parties' delivery services could prevent the timely or successful delivery of our merchandise. These interruptions may be due to unforeseen events that are beyond our control or the control of these third-party logistics companies, such as inclement weather, natural disasters or labor unrest. If our merchandise are not delivered on time or are delivered in a damaged state, customers may refuse to accept them and lose confidence in our services. As a result, we may lose customers, and our financial condition and market reputation could be adversely affected. In addition, as local courier companies tend to be small companies with limited capital resources, they may be more likely to go bankrupt, close down or encounter financial difficulties, in which case we may not be able to retrieve our merchandise in their possession, arrange for delivery of those merchandise by an alternative carrier, receive the payments these third-party logistics companies collect for us, or hold them accountable for the losses they cause us. The occurrence of any of these problems, alone or together, could damage our reputation and may materially and adversely affect our business and results of operations. Some of our sales are of payment-on-delivery nature and we rely on our third-party logistics companies to complete a small portion of these transactions. We may encounter cash collection issues with these third-party logistics companies.

We may fail to collect payment from third-party online payment service providers for our e-Commerce transactions.

A portion of online payments for merchandise we sell on our e-Commerce platforms is currently settled through online payment service systems, including our online payment service and online payment services provided by third parties. While a small portion of the sales from our principal-based transactions and most of the sales from our agent-based transactions are settled through third-party payment systems, which historically have not constituted a material amount of our total revenue, it is possible that as we expand our e-Commerce transactions business, an increasing amount of online payments may be settled through third-party payment systems. We may be exposed to delay or partial or complete loss of our payment for merchandise sold by us due to third-party payment service providers' potential technical failure, administration error, incomplete record keeping, deficiencies in internal control, illegal activities, insolvency or liquidation, or other reasons or incidents that are beyond our control or cannot be reasonably foreseeable. This could have a material adverse effect on our business, financial condition and results of operations.

We could be liable for fraudulent or unlawful activities of sellers.

We may be unable to prevent users from selling unlawful or stolen goods or unlawful services, or selling goods or services in an unlawful manner, and we may be subject to allegations of civil or criminal liability for unlawful activities carried out by users through our services. Although we have prohibited the listing of illegal and stolen goods and implemented other protective measures, we may be required to spend substantial resources to take additional protective measures or discontinue certain service offerings, any of which could harm our business.

Our e-Commerce platforms are also susceptible to potentially illegal or improper use, including fraudulent sales of goods or services, illicit sales of controlled substances, restricted or unlawful items, piracy of software, movies, music and other copyrighted or trademarked goods, money laundering, terrorist financing, bank fraud, child pornography, drug trafficking, online securities fraud, identity theft and encouraging, promoting, facilitating or instructing others to engage in illegal activities. We have implemented policies to restrict these activities on our e-Commerce platforms. For example, we conduct routine keyword searches on all products (including their titles and descriptions) that are made available for sale on our e-Commerce platforms to ensure that the sale of these merchandise comply with our policies, relevant laws, rules and regulations. In addition, our policies forbid all vendors from selling any restricted or unlawful items on our e-Commerce platforms. Further, our e-Commerce transactions are subject to employee fraud or other internal security breaches and we may be required to reimburse users for any funds stolen as a result of such breaches.

Negative publicity and customer sentiment generated as a result of fraudulent or deceptive conduct through our e-Commerce platforms and transactions could damage our reputation, reduce our ability to attract new users or retain existing users and adversely impact our brands. Any costs incurred as a result of potential liability relating to the alleged or actual sale of unlawful goods or the unlawful sale of goods could harm our business. In addition, governmental agencies could require us to modify our business practices and discontinue or restrict our services.

We may not be able to maintain existing or establish new arrangements with device manufacturers.

We derive value and benefits from cooperative arrangements with device manufacturers, including mobile phone manufacturers, and we work with these device manufacturers to install our Internet and mobile applications onto their devices for use by purchasers of their devices. Although we currently have contracts with a number of domestic and international device manufacturers operating in the PRC, including mobile phone manufacturers, an interruption in our relationships with such manufacturers could have an adverse impact on our business, including our profitability and ability to deliver IVAS and MVAS services and products to our users.

We may need additional capital but may not be able to obtain it.

We may require additional cash resources due to future growth and developments of our business, including any investments or acquisitions we may decide to pursue, or for other business changes. If the cash resources are insufficient to satisfy our cash requirements, we may seek to issue additional equity or debt securities or obtain credit facilities. Our ability to obtain external financing in the future is subject to a variety of uncertainties, including our future financial condition, results of operations, cash flows, share price performance, the liquidity of international capital and lending markets, PRC governmental regulations over foreign investment and the Internet industry in the PRC. In addition, incurring indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. There can be no assurance that financing will be available in a timely manner or in amounts or on terms acceptable to us, if at all.

If we are unable to raise additional funds on terms favorable to us, or at all, this could have a material adverse effect on our business, financial condition and results of operations. For example, we may not be able to carry out parts of our growth strategy or invest in technology infrastructures necessary to maintain our growth and competitiveness.

We have limited business insurance coverage.

Insurance companies in the PRC offer limited business insurance products. As a result, although we have insurance for property damage, we do not have any product liability, business liability or disruption insurance coverage for our operations in the PRC, and our coverage may not be adequate to compensate for all losses that may occur, particularly with respect to loss of business and reputation. Any business disruption, litigation or natural disaster could expose us to substantial costs and diversion of resources.

RISKS RELATING TO OUR INDUSTRY

The laws and regulations governing the Internet and telecommunications and other related industries in the PRC are developing and subject to future changes. If we fail to adhere to applicable regulations, or if we fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

The Internet and telecommunications and other related industries in the PRC are highly regulated by the PRC government. See “Regulation”. Various regulatory authorities of the PRC government, including, but not limited to State Council, MIIT, SAIC, MOC, GAPP, MOFCOM and MPS, are empowered to promulgate and implement regulations governing various aspects of the Internet and telecommunications and other related industries and we are thus required to obtain applicable licenses, permits and approvals from a number of these regulatory authorities in order to conduct our business. Although we have obtained the licenses essential to operating our business, these licenses are subject to periodical government review and we cannot assure you that we can successfully renew these licenses.

As the Internet and telecommunications and other related industries mature, the PRC government authorities are likely to continue to issue new regulations governing these industries and hence require new and additional licenses, permits and approvals. As we further develop and expand our product and services offerings and functions, including new services and products, we and our users may in the future become subject to additional or new regulations (such as stricter regulations relating to content publication, user identity, privacy, consumer and data protection and the provision of online payment services and e-Commerce business), and we may also need to obtain additional qualifications, permits, approvals or licenses. There is no assurance that we can obtain and renew those licenses, permits and approvals in a timely or cost-effective manner. Failure to obtain them could materially and adversely affect our business and results of operations.

The PRC government has promulgated a series of rules, regulations and policies that may have negative impact on the online game industry, and we cannot assure you that the PRC government will not promulgate similar rules, regulations or policies in the future.

The online game industry is highly regulated in the PRC. The PRC government has adopted a series of rules, regulations and policies to monitor and control the online game industry in response to, among other things, perceived addiction to online games and its perceived negative social effects, particularly for minors. For example, PRC governmental authorities issued a notice in April 2007 requiring all PRC online game operators to adopt an "anti-fatigue system" in an effort to curb addiction to online games by minors, under which game operators are required to reduce the value of game benefits for minor game players as their continuous playing time reaches certain thresholds. Online game players in the PRC are also required to register their identity numbers before they can play so game operators are able to identify which game players are minors. In addition, PRC governmental agencies have issued a series of rules and regulations limiting the use of virtual currencies in online games, which may result in higher costs for the operation of our online games and lowers sales of virtual items in our online games. Furthermore, online games licensed by overseas developers are subject to approvals from various PRC governmental authorities before we may commercially operate those games. We cannot assure you that we will be able to obtain such approvals in a timely fashion in line with our business plan, or that we will be able to obtain such approvals at all.

We cannot assure you that the PRC government will not promulgate similar rules, regulations or policies in the future, particularly during periods when public opinion does not favor online games. Such rules, regulations and policies could significantly reduce our revenue and materially and adversely affect our business, financial condition, results of operations and prospects.

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

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

Based on recent PRC court judgments, the courts have typically held online game operators liable for losses of virtual property by game players, and in some cases have allowed online game operators to return the lost virtual property to game players in lieu of paying damages. If we are sued by our game players or users and held liable for damages, our financial condition and results of operations may be negatively affected.

Compliance with the laws or regulations governing virtual currency may result in us having to obtain additional approvals or licenses or change our current business model.

The issuance and use of "virtual currency" in the PRC has been regulated since 2007 in response to the growth of the online game industry in the PRC. In January 2007, the MPS, MOC, MIIT and GAPP jointly issued a circular regarding online gambling which has implications for the use of virtual currency. To curtail online games that involve online gambling, as well as address concerns that virtual currency could be used for money laundering or illicit trade, the circular (a) prohibits online game operators from charging commissions in the form of virtual currency in relation to winning or losing of games; (b) requires online game operators to impose limits on use of virtual currency in guessing and betting games; (c) bans the conversion of virtual currency into real currency or property; and (d) prohibits services that enable game players to transfer virtual currency to other players. On June 4, 2009, MOC and MOFCOM jointly issued a notice regarding strengthening the administration of online game virtual currency, ("**Virtual Currency Notice**") (關於加強網絡遊戲虛擬貨幣管理工作的通知). On July 20, 2009, MOC promulgated the Filing Guidelines on Online Game Virtual Currency Issuing Enterprises and Online Game Virtual Currency Trading Enterprises ("網絡遊戲虛擬貨幣發行企業"和"網絡遊戲虛擬貨幣交易企業"申報指南), which specifically define "issuing enterprise" and "trading enterprise" and stipulate that a single enterprise may not operate both types of business. MOC issued the Interim Measures for Online Game Administration (網絡遊戲管理暫行辦法), which provides, among other things, that virtual currency issued by online game operators may be only used to exchange its own online game products and services and may not be used to pay for the products and services of other entities.

We issue game tokens to game players and our users use them to purchase various virtual items or time units to be used in our online games. We believe we only offer game tokens for in-game consumption, which are not transferrable among our user accounts and are not convertible into real currency. In addition, we do not offer secondary trading services of the game tokens. Nonetheless, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours and that we may not be subject to certain penalties, including mandatory corrective measures and fines. The occurrence of any of the foregoing could have a material adverse effect on our business and results of operations. In addition, the Virtual Currency Notice prohibits online game operators from 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. The notice also prohibits game operators from issuing currency to game players through means other than purchases with legal currency. It is unclear whether these restrictions would apply to certain aspects of our online games. Although we believe that we do not engage in any of the above-mentioned prohibited activities, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours and deem such feature as prohibited by the Virtual Currency Notice, thereby subjecting us to penalties, including mandatory corrective measures and fines. The occurrence of any of the foregoing could materially and adversely affect our business and results of operations.

Regulation and censorship of information disseminated over the Internet in the PRC may adversely affect our business and subject us to liability for content displayed on or linked to our websites.

The PRC government has adopted 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 content over the Internet that, among other things, violates PRC laws and regulations, impairs the national dignity of the PRC, or is reactionary, obscene, superstitious, fraudulent or defamatory. Further, MIIT or its local branches may shut down the website of any local Internet service provider that violates such content restrictions, suspend its operations or revoke its ICP license. If the Chinese government takes any action to limit or prohibit the distribution of information through our network or any of our platforms, or to limit or regulate any current or future content or services available to users on our network, our business could be adversely impacted. Failure to comply with the applicable requirements may result in the revocation of licenses to provide Internet content and other licenses, the closure of the concerned websites and may subject the website operator to potential liabilities for such censored information displayed on or linked to the website.

We are also subject to potential liability for content on our websites that is deemed inappropriate by the PRC government and for any unlawful actions of our users or website visitors. Although we attempt to monitor the content in our online communities, we are not 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 other online communities by our users. If third-party websites linked to or accessible through our websites operate unlawful activities such as online gambling on their websites, PRC regulatory authorities may require us to report such unlawful activities to relevant authorities and to remove the links to such websites, or they may suspend or shut down the operation of such websites. To the extent that the PRC regulatory authorities find any content displayed on our websites objectionable, they may require us to limit or eliminate the dissemination of such information on our websites. For example, on March 31, 2012, leading microblog operators in the PRC, including Tencent Microblog, were required by the PRC government to disable their comment features for three days and remove comments related to certain rumors that were posted by users on their microblog websites. If in the future the PRC government authorities decide to restrict the dissemination of information via microblog services or online postings in general, they may temporarily block access to certain websites for a period of time, require us to discontinue or restrict certain services and websites or levy penalties or fines for violations of relevant rules and regulations arising from content displayed on or linked to our websites. We may also be required to delete content that violates the PRC laws and report content that we suspect to violate PRC law. Any of these actions may adversely affect user confidence in our services and lead to reduced user traffic, which in turn may materially and adversely affect our reputation, business and results of operations.

We also need to monitor the advertising content shown on our websites to ensure that such content is true, accurate and in full compliance with applicable PRC laws and regulations. In addition, certain advertisements need to go through a special government review for approval before website posting. Failure to implement those monitoring functions and comply with the relevant laws and regulations may subject us to penalties, including fines, confiscation of any advertising income, orders to cease dissemination of the advertisements and orders to publish an announcement correcting any misleading information. In circumstances involving serious breaches, PRC governmental authorities may force us to terminate our advertising operations or revoke our licenses.

The online advertising market includes many uncertainties, which could cause our advertising revenue to be materially and adversely affected.

Online advertising revenue represented 7.0% of our total revenue for the year ended December 31, 2011 and 7.0% for the six months ended June 30, 2012. The growth of our advertising revenue relies on increased revenue from the sale of advertising inventory on our platforms, which could be affected by the following factors:

- growth of the online advertising market;
- acceptance of online advertising as an effective marketing channel;
- our development of tailored advertising solutions to meet advertising clients' needs;
- changes in government rules and regulations impacting the advertising industry;
- alternative methods and strategies available to advertising clients to promote their brand; and
- development and acceptance of an independent and reliable standard for measuring the effectiveness of online advertising.

We also may be unable to respond adequately to changing trends in online advertising or advertiser demands or preferences or keep up with technological innovations and improvements in the measurement of user traffic and online advertising. If the online advertising market size does not increase from current levels or we are unable to capture and retain a sufficient share of that market, our ability to maintain or increase our current level of online advertising revenue could be materially and adversely affected.

Privacy concerns or inaccurate information about our users may prevent us from selling demographically targeted advertising, which could make our advertising inventory less attractive to advertisers.

Concerns about our practices with regard to the collection, use or disclosure of personal information or other privacy-related matters, even if unfounded, could damage our reputation and results of operations. User and regulatory attitudes towards privacy are evolving, and future regulatory or user concerns about the extent to which personal information is shared with advertisers, may cause the advertising inventory generated by the QQ software client, our websites and other services to be less attractive to advertisers. In addition, we have limited ability to validate or confirm the accuracy of information provided during the user registration process. If the information that we collect for targeted advertising is materially inaccurate or false, this may also cause the advertising inventory generated by the QQ software client, our websites and other services to become less attractive to advertisers.

RISKS RELATED TO OUR CORPORATE STRUCTURE

If the PRC government finds that the agreements that establish the structure for operating our services in the PRC do not comply with PRC governmental restrictions on foreign investment in value-added telecommunications businesses or other related businesses, or if these regulations or the interpretation of existing regulations change in the future, we could be subject to severe penalties or be forced to relinquish our interests in those operations.

The PRC government regulates foreign investment in value-added telecommunications businesses and other related businesses heavily through strict licensing requirements and other laws and regulations, which also include limitations on foreign ownership in PRC companies that provide value-added telecommunications services. Specifically, foreign investors are not allowed to own more than a 50% equity interest in any Internet content provider or any other value-added telecommunications service provider. In addition, foreign and foreign-invested enterprises are currently not able to apply for the required licenses for operating online games in the PRC.

The Circular on Strengthening the Administration of Foreign Investment in and Operation of Value-added Telecommunications Business, or the ("**MIIT Circular**") (關於加強外商投資經營增值電信業務管理的通知) issued by the MIIT, in July 2006, reiterated the regulations on foreign investment in telecommunications businesses, which requires foreign investors to set up foreign-invested enterprises and obtain a license for value-added telecommunications services, to conduct any value-added telecommunications business in the PRC. Under the MIIT Circular, a domestic company that holds a 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 that conduct value-added telecommunications business illegally in the PRC. The MIIT Circular also includes additional requirements and restrictions on a domestic company that holds a license when it cooperates with a foreign investor. See "Regulations — Regulations on Foreign Investment in the Value-added Telecommunications Services". However, due to a lack of further interpretative materials from the regulator, it is unclear what impact the MIIT Circular will have on us or the other PRC Internet companies that have adopted the same or similar corporate and contractual structures as ours.

On September 28, 2009, GAPP, the National Copyright Administration and the National Office of Combating Pornography and Illegal Publications, jointly issued a Notice on Further Strengthening the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games ("**Circular 13**"). Circular 13 restates that foreign investors are not permitted to invest in online game-operating businesses in the PRC via wholly owned, equity joint venture or cooperative joint venture investments and expressly prohibits foreign investors from gaining control over or participating in domestic online game operators through indirect ways such as establishing other joint venture companies or entering into contractual or technical arrangements. However, Circular 13 does not provide any interpretation of the term "foreign investors" or make a distinction between foreign online game companies and companies under a corporate structure similar to ours. Thus, it is unclear whether the GAPP will deem our corporate structure and operations to be in violation of these provisions.

We and our WFOEs are considered foreign persons or foreign-invested enterprises under applicable PRC law. As a result, we operate our IVAS, MVAS, online and mobile games, online advertising, e-Commerce platforms and other Internet and wireless portals in the PRC through affiliated PRC entities that hold the necessary licenses for our existing lines of businesses. We do not own any equity interest in these affiliated entities, which are considered to be our consolidated affiliated entities, but through a series of contractual arrangements between our WFOEs and these affiliated entities, we exercise control over these affiliated entities and obtain substantially all of the revenue in the form of technical support, consulting, licensing, revenue sharing and other fees. Since the contractual arrangements transfer the economic risks and benefits of the affiliated entities to us, we have concluded that it is appropriate to treat these affiliated entities as our consolidated affiliated entities and consolidate their financial results.

Based on the advice of our PRC legal counsel, the corporate structure of our WFOEs and the consolidated affiliated entities comply with applicable existing PRC laws and regulations, however, the relevant PRC regulators have substantial discretion to review, interpret and apply these laws and regulations from time to time, and it is possible that they may interpret these laws and regulations in ways that are different from our PRC legal counsel's understanding. Therefore, we cannot assure you that our contractual arrangements will be deemed by the relevant government authorities to be in compliance with current PRC laws and regulations or that the relevant government authorities will not in the future reassess or reinterpret existing laws, regulations or policies in this area, or issue new laws, regulations or policies in this area, with the result that all or some of these arrangements would be deemed to be in violation of PRC law.

If the PRC government determines that we do not comply with applicable laws and regulations, including any laws and regulations that may be introduced, it could:

- levy fines and/or confiscate our income;
- revoke our WFOEs' business licenses and/or affiliate entities' business and operating licenses;
- require us to discontinue or restrict our operations;
- restrict our right to collect revenue;
- block our websites;
- require us to restructure our ownership and organizational structure and operations;
- impose additional requirements which we may not be able to comply; or
- take other regulatory or enforcement actions against us that could be harmful to our business.

Any of these or other similar actions could potentially disrupt substantially all of our business operations, divert our management attention and restrict us from conducting our business operations in the same way as we currently conduct it, which could materially and adversely affect our business, financial condition and results of operations.

The contractual arrangements with the consolidated affiliated entities and their shareholders, which relate to critical aspects of our operations, may not be as effective in providing operational control as direct ownership. In addition, these arrangements may be difficult and costly to enforce under PRC law.

We rely and expect to continue to rely on contractual arrangements with the consolidated affiliated entities and their shareholders in the PRC to operate our business and hold our licenses, permits and certain other assets. These contractual arrangements may not be as effective as direct ownership in providing us control over the consolidated affiliated entities.

If (i) the consolidated affiliated entities and their shareholders fail to perform their obligations under these contractual arrangements, (ii) the consolidated affiliated entities and their shareholders terminate the contractual arrangements, (iii) the consolidated affiliated entities undergo corporate or other changes that affect their rights over assets held by them or (iv) these contractual arrangements are invalid or defective due to violation of PRC laws and regulations or other reasons, our business operations in the PRC would be materially and adversely affected. Further, if we fail to renew these contractual arrangements prior to their expiration, we would not be able to continue our business operations in the PRC.

A majority of these contractual arrangements are governed by PRC law. Accordingly, these contracts would be interpreted in accordance with PRC laws. The legal environment in the PRC is not as developed as in certain other jurisdictions and as a result, operations of the PRC legal system could limit the enforcement of these contractual arrangements. These contractual arrangements, which relate to critical aspects of our operations, will be invalid or unenforceable if they are found in violation of PRC laws and regulations. We may be unable to exert effective control over the consolidated affiliated entities and our business and financial condition could be materially and adversely affected.

The shareholders of our consolidated affiliated entities may have potential conflicts of interest with us, which may materially and adversely affect our business and financial condition.

Our consolidated affiliated entities are owned by their respective registered shareholders. Conflicts of interests between these individuals' roles as shareholders of our consolidated affiliated entities and their duties to the Company may arise. There is currently no specific and clear guidance under PRC laws that addresses the resolution of any conflict between PRC laws and Cayman Islands laws in respect of any conflict relating to corporate governance regime. If we cannot resolve any conflicts of interest or disputes between us and the shareholders of our consolidated affiliated entities, we would have to rely on legal proceedings to resolve these disputes and/or enforce our contractual arrangements with our consolidated affiliated entities, which could result in disruption of our business, and there would be substantial uncertainty as to the outcome of any such legal proceedings.

Contractual arrangements we have entered into with our consolidated affiliated entities may be subject to scrutiny by the PRC tax authorities, and a finding that we or our consolidated affiliated entities owe additional taxes could reduce our net income.

As required by applicable PRC laws and regulations, arrangements and transactions among related parties may be subject to audit or challenge by the PRC tax authorities. We could face adverse tax consequences if the PRC tax authorities determine that the contractual arrangements between our WFOEs in the PRC on the one hand, and our consolidated affiliated entities on the other, do not represent an arm's-length transaction and adjust our consolidated affiliated entities' income in the form of a transfer pricing adjustment. A transfer pricing adjustment could, among other things, result in a reduction, for PRC tax purposes, of expense deductions recorded by our consolidated affiliated entities, which could in turn increase its tax liabilities. In addition, the PRC tax authorities may impose late payment surcharges and other penalties on our consolidated affiliated entities for underpaid taxes. Our results of operations may be adversely affected if our consolidated affiliated entities' tax liabilities increase or if it is found to be subject to late payment surcharges or other penalties.

RISKS RELATING TO THE PRC

Interpretation of PRC laws and regulations involves significant uncertainties.

The PRC legal system is based on written statutes, while People's Courts of all levels carry out trials of similar cases with reference to guiding cases issued by the Supreme People's Court. Since 1979, the PRC government has been developing a comprehensive system of commercial laws, and considerable progress has been made in introducing laws and regulations dealing with economic matters such as foreign investment, competition and anti-trust, corporate organization and governance, commerce, taxation and trade. However, as these laws and regulations are relatively new, and due to the limited volume of guiding cases, interpretation and enforcement of these laws and regulations involve significant uncertainties. As the PRC legal system develops, changes in such laws and regulations, or in their interpretation or enforcement, could have a material and adverse effect on our business operations. For example, we may be subject to competition and anti-trust investigations by the PRC government from time to time in the future. The outcomes of such investigations may prevent us from offering certain features, functions, services or products; requiring a change in our business practices or requiring development of non-infringing services, products or technologies, which could have a material and adverse effect on our business operations.

Furthermore, the administration of PRC laws and regulations may be subject to a certain degree of discretion by the executive authorities. This has resulted in the outcome of dispute resolutions not being as consistent or predictable compared to more developed jurisdictions. In addition, it may be difficult to obtain a swift and equitable enforcement of laws in the PRC or the enforcement of judgments by a court in another jurisdiction.

PRC economic, political and social conditions as well as government policies could adversely affect our business and financial condition.

The PRC economy differs from the economies of most developed countries in many respects, including government involvement, level of development, economic growth rate, control of foreign exchange, and allocation of resources. In recent years, the PRC economy has been transitioning from a planned economy to a more market-oriented economy and the PRC government has implemented measures emphasizing economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises. There can be no assurance that the PRC government will continue to pursue a policy of economic reform or that any such reforms will not have an adverse effect on the way we operate our business. Our business and financial condition could also be materially and adversely affected by any changes in PRC laws and regulations (or the interpretation thereof), as well as changes in the political, economic and social conditions of the PRC.

We may be adversely affected by a severe or prolonged downturn of the global or PRC economy.

The ongoing Eurozone debt crisis, the unprecedented downgrade of the U.S. credit rating and increasing concerns about a global recession, could materially and adversely affect the PRC economy and currently PRC-focused businesses like us. The effects of the Eurozone debt crisis could be even more significant if it leads to a partial or complete break-up of the European Monetary Union. There is also considerable uncertainty over the long term effects of the expansionary monetary and fiscal policies adopted by the central banks and financial authorities of the world's leading economies. The grim economic outlook has negatively affected business and consumer confidence and contributed to significant market volatility. The stimulus plans and other measures implemented by the PRC government may not avert an economic downturn amid a severe and prolonged global economic recession. Any prolonged slowdown in the PRC economy may lead to reduced Internet-related activities and consumer spending and have an adverse impact on companies with which we do business, which in turn could have a negative impact on our business, results of operations and prospects.

If the PRC tax authorities determine that we are a "resident enterprise", we may face unfavorable tax consequences.

Under the 2008 CIT Law, enterprises established outside of the PRC whose "de facto management bodies" are located in the PRC are considered "resident enterprises". The Regulation on the Implementation of the Corporate Income Tax Law ("**Implementation Rules**") (企業所得稅法實施條例) defines "de facto management body" as an organization that exercises substantial and overall management and control over an enterprise's manufacturing, or business operation, personnel, accounting and property. In addition, SAT has promulgated the Circular on Identification of China-controlled Overseas-registered Enterprises as Resident Enterprises on the Basis of Actual Management Organization ("**Circular 82**") (Guo Shui Fa 2009 No. 82) (國家稅務總局關於境外注冊中資控股企業依據實際管理機構標準認定為居民企業有關問題的通知), which further provides certain specific criteria for determining whether the "de facto management body" of a PRC-controlled offshore incorporated enterprise is located in the PRC. The criteria include whether: (i) the premises where the senior management and the senior management bodies responsible for the routine production and business management of the enterprise perform their functions are mainly located within the PRC, (ii) decisions relating to the enterprise's financial and human resource matters are made or subject to approval by organizations or personnel in the PRC, (iii) the enterprise's primary assets, accounting books and records, company seals, and board and shareholders' meeting minutes are located or maintained in the PRC and (iv) 50% or more of voting board members or senior executives of the enterprise habitually reside in the PRC. Although the Circular 82 only applies to offshore enterprises controlled by enterprises or enterprise group located within the PRC, not including those controlled by PRC individuals, the determining criteria set forth in the Circular 82 may reflect the SAT's general position on how the "de facto management body" test may be applied in determining the tax resident status of offshore enterprises.

As the tax resident status of an enterprise is subject to determination by the PRC tax authorities and uncertainties remain with respect to the interpretation of the term "de facto management body" as applicable to our offshore entities, we cannot assure you that we will not be considered as a PRC tax resident enterprise. In the event that we are determined to be a PRC tax resident enterprise, we will consequently be subject to a 25% corporate income tax on our worldwide taxable income. In addition, we may be subject to PRC corporate income tax reporting obligations.

The PRC government's pilot plan to replace business tax with value-added tax ("VAT") may subject us to more taxes, which could adversely affect our financial condition and results of operations.

Pursuant to the PRC Provisional Regulations on Business Tax (中華人民共和國營業稅暫行條例), taxpayers providing taxable services falling under the category of service industry in China are required to pay a business tax at a normal tax rate of 5% of their revenues. In November 2011, the Ministry of Finance and the SAT promulgated the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax (營業稅改征增值稅試點方案). Pursuant to this pilot plan and relevant notices, from January 1, 2012, VAT will replace business tax in the transport and shipping industry and some of the modern service industries in Shanghai. In July 2012, the Ministry of Finance and the SAT promulgated the Circular concerning Implementing the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax for Transport and Shipping Industry and Certain Modern Service Industries in Eight Provinces and Municipalities (including Beijing) (關於在北京等8省市開展交通運輸業和部分現代服務業營業稅改征增值稅試點的通知), which expanded the pilot regions to other eight provinces and municipalities including Beijing, Tianjin, and Shenzhen. Under the pilot plan, a VAT rate of 6% applies to certain modern service industries. Most of our WFOEs and consolidated affiliated entities are located in these pilot regions, and if this plan is extended to apply to our businesses, we may be subject to a VAT rate which is higher than the business tax rate that currently applies to us, which could harm our financial condition and results of operations.

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

The National People's Congress passed the 2008 CIT Law and the State Council passed its implementation rules, both of which became effective on January 1, 2008. The 2008 CIT Law significantly curtails tax incentives granted to foreign-invested enterprises under the PRC Income Tax Law concerning Foreign-Invested Enterprises and Foreign Enterprises (中華人民共和國外商投資企業和外國企業所得稅法) effective prior to January 1, 2008. The 2008 CIT Law, however, (i) reduces the statutory rate of the corporate income tax from 33% to 25%, (ii) permits companies established before March 16, 2007 to continue to enjoy their existing tax incentives, adjusted by certain transitional phase-out rules promulgated by the State Council on December 26, 2007 and (iii) introduces new tax incentives, subject to various qualification criteria.

The 2008 CIT Law and its implementing rules permit certain "high/new technology enterprises" to enjoy a reduced 15% corporate income tax rate subject to certain new qualification criteria. Pursuant to the Circular on Certain Corporate Income Tax Preferential Treatments jointly issued by the PRC Ministry of Finance and SAT on February 22, 2008, a qualified software enterprise is eligible to be exempted from income tax for its first two profitable years, followed by a 50% reduction of income tax for the subsequent three years. Pursuant to the Measures for the Administration of Key Software Enterprise Accreditation within National Programming Layout (國家規劃布局內重點軟件企業認定管理辦法) issued by, amongst others, SAT on December 20, 2005, a qualified national key software enterprise is entitled to a reduced 10% corporate income tax rate. Certain of our WFOEs and consolidated affiliated entities have been recognized by the relevant authorities as "national key software enterprises," "software production enterprises" and "high/new technology enterprises", and therefore are eligible for the preferential tax treatments upon their filing with and approved by the relevant tax authorities. Preferential tax treatment granted to our WFOEs and consolidated affiliated entities by the local governmental authorities are subject to review and may be adjusted or revoked at any time. We cannot assure you that we will be able to maintain our current effective tax rate in the future. If any of the WFOEs and consolidated affiliated entities, which has enjoyed such preferential tax treatments fails to maintain their qualification status or renew their qualifications when the relevant term expires, their applicable corporate income tax rate may increase to 25%, which could have a material adverse effect on our financial condition and results of operations.

We may rely on dividends and other distributions on equity paid by the WFOEs to fund any cash and financing requirements we may have. Any limitation on the ability of our WFOEs to pay dividends to us could materially and adversely affect our business and results of operations.

We are a holding company, and we may rely on dividends and other distributions on equity to be paid by our WFOEs to meet our cash and financing requirements, including the funds necessary to pay dividends and other cash distributions to our shareholders and service any debt we may incur. If any of our WFOEs incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us.

Under PRC laws and regulations, our WFOEs may pay dividends only out of their accumulated profits as determined in accordance with PRC accounting standards and regulations. In addition, each of our WFOEs in the PRC is required to set aside at least 10% of its accumulated after-tax profits each year, if any, to fund certain statutory reserve funds, until the aggregate amount of such a fund reaches 50% of its registered capital. With approval by its shareholders in accordance with its articles of association, the WFOE may allocate a portion of its after-tax profits based on PRC accounting standards to staff welfare and bonus funds. These reserve funds and staff welfare and bonus funds are not distributable as cash dividends.

Any limitation on the ability of our WFOEs in the PRC to pay dividends or make other distributions to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends, or otherwise fund and conduct our business.

In addition, under the 2008 CIT Law and the Implementation Rules, dividends generated from the business of our WFOEs in the PRC on or after January 1, 2008 and payable to the WFOEs' immediate holding companies incorporated in Hong Kong may be subject to a withholding tax rate of 10% if the PRC tax authorities determine that we are a non-resident enterprise. If certain conditions and requirements under the Tax Arrangement are met, the withholding tax rate could be reduced to 5% from 10%.

PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident beneficial owners or our PRC subsidiaries to liability or penalties, limit our ability to inject capital into our PRC subsidiaries, limit our PRC subsidiaries' ability to increase their registered capital or distribute profits to us, or may otherwise adversely affect us.

Pursuant to SAFE's Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Inbound Investment via Overseas Special Purpose Vehicles ("**Circular 75**") (國家外匯管理局關於境內居民通過境外特殊目的公司融資及返程投資外匯管理有關問題的通知), issued on October 21, 2005, PRC residents and PRC corporate entities must register with local branches of SAFE in connection with their direct or indirect offshore investment in an overseas "special purpose company", for the purposes of overseas equity financing activities.

In order to further clarify the implementation and application of Circular 75, SAFE issued Circular 106 on May 29, 2007 and the Circular on Operating Rules Concerning Financing and Round-Trip Investment Undertaken by Domestic Residents through Overseas Special-Purpose Vehicles (國家外匯管理局關於印發《境內居民通過境外特殊目的公司融資及返程投資外匯管理操作規程》的通知) ("**Circular 19**") on May 20, 2011.

Under these SAFE regulations, PRC residents who make, or have previously made, direct or indirect investments in a special purpose company are required to register those investments. In addition, any PRC resident who is a direct or indirect shareholder of a special purpose company is required to update the previously filed registration with the local branch of SAFE, with respect to that special purpose company, to reflect any material change involving its round-trip investment, capital variation, such as an increase or decrease in capital, transfer or swap of shares, merger, division, long-term equity or debt investment or creation of any security interest. Moreover, the PRC subsidiaries of that special purpose company are required to urge the PRC resident shareholders to update their SAFE registration with the local branch of SAFE when such updates are required under applicable SAFE regulations. If any PRC shareholder fails to make the required SAFE registration or update the previously filed registration, the PRC subsidiaries of that special purpose company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation, to their parent company, and the special purpose company may also be prohibited from injecting additional capital into their PRC subsidiaries or extending shareholder loans to their PRC subsidiaries. Moreover, failure to comply with the various SAFE registration requirements described above could result in liability under PRC laws for evasion of applicable foreign exchange restrictions.

We have notified substantial holders of ordinary shares of the Company whom we know are PRC residents to register with the local SAFE branch and update their registrations as required under the SAFE regulations described above. We, however, cannot provide any assurances that all of our shareholders who are PRC residents will file all applicable registrations or update previously filed registrations as required by these SAFE regulations. The failure or inability of our PRC resident shareholders to comply with the registration procedures set forth therein may subject such PRC resident shareholders to fines and legal sanctions, restrict our cross-border investment activities, or limit our PRC subsidiaries' ability to distribute dividends to us or restrict us in injecting additional capital or extending loans to our PRC subsidiaries.

As it is uncertain how the SAFE regulations described above will be interpreted or implemented, we cannot predict how these regulations will affect our business operations or future strategy. For example, we may be subject to more stringent review and approval process with respect to our foreign exchange activities, such as remittance of dividends and foreign currency-denominated borrowings, which may adversely affect our results of operations and financial condition. In addition, if we decide to acquire a PRC domestic company, we cannot assure you that we or the owners of such company, as the case may be, will be able to obtain the necessary approvals or complete the necessary filings and registrations required by the SAFE regulations. This may restrict our ability to implement our acquisition strategy and could adversely affect our business and prospects.

Governmental control of currency conversion may limit our ability to obtain sufficient foreign currency to satisfy our currency demands.

The PRC government imposes controls on the convertibility of the RMB into foreign currencies and, in certain cases, the remittance of currency out of the PRC. We receive substantially all of our revenues in RMB and substantially all of our cash inflows and outflows are denominated in RMB. Under our current corporate structure, our income is primarily derived from dividend payments from our PRC operating subsidiaries. We may convert a portion of our revenues into other currencies to meet our foreign currency obligations, such as payments of dividends declared in respect of our ordinary shares, if any. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiaries to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy its foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies generally without prior approval from SAFE by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of the PRC to pay capital expenses such as the repayment of loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions.

PRC laws and regulations establish more complex procedures for some acquisitions of PRC companies by foreign investors, which could make it more difficult for us to pursue growth through acquisitions in the PRC.

PRC laws and regulations, such as the Regulations on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("**M&A Rules**") (關於外國投資者併購境內企業的規定) adopted in September of 2006 and amended on June 22, 2009, the Anti-Monopoly Law (反壟斷法) which became effective on August 1, 2008, and Notice of the General Office of the State Council on the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (國務院辦公廳關於建立外國投資者併購境內企業安全審查制度的通知) effective from March 3, 2011, established additional procedures and requirements that are expected to make merger and acquisition activities in the PRC by foreign investors more time-consuming and complex, including requirements in some instances that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise, or that the approval from the MOFCOM be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies. PRC laws and regulations also require certain merger and acquisition transactions to be subject to merger control review or security review. Provisions of the MOFCOM on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (商務部實施外國投資者併購境內企業安全審查制度的規定), effective from September 1, 2011, further provide that, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to the security review by the MOFCOM, the principle of substance over form should be applied and foreign investors are prohibited from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. If the business of any target company that we plan to acquire falls into the ambit of security review, we may not be able to successfully acquire such company either by equity or asset acquisition, capital contribution or through any contractual arrangement. We may grow our business in part by acquiring other companies operating in our industry. Complying with the requirements of the relevant regulations to complete such transactions could be time-consuming, and any required approval processes, including approval from the MOFCOM, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

We face uncertainties with respect to indirect transfers of equity interests in PRC resident enterprises by their non-PRC holding companies.

Pursuant to the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises, ("**Circular 698**") (國家稅務總局關於加強非居民企業股權轉讓所得企業所得稅管理的通知), issued by the SAT, on December 10, 2009 with retroactive effect from January 1, 2008, where a non-resident enterprise conducts an "indirect transfer" by transferring the equity interests of a PRC resident enterprise indirectly via disposing of the equity interests of an overseas holding company, and such overseas holding company is located in a tax jurisdiction that: (i) has an effective tax rate less than 12.5% or (ii) does not tax foreign income of its residents, the non-resident enterprise, being the transferor, shall report to the relevant tax authority of the PRC resident enterprise this indirect transfer. 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%. 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 fair market value, the relevant tax authority has the power to make a reasonable adjustment to the taxable income of the transaction.

There is uncertainty as to the application of 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 the PRC. Moreover, the relevant authority has not yet promulgated any formal provisions or formally declared or stated how to calculate the effective tax rates in foreign tax jurisdictions, and the process and format of the reporting of an indirect transfer to the relevant tax authority of the PRC resident enterprise. In addition, there are not any formal declarations with regard to how to determine whether a foreign investor has adopted an abusive arrangement in order to reduce, avoid or defer PRC tax. Circular 698 may be determined by the tax authorities to be applicable to our private equity financing transactions where non-resident investors were involved, if any of such transactions were determined by the tax authorities to be in absence of reasonable commercial purpose. As a result, we and our non-resident investors in such transactions may become at risk of being taxed under Circular 698 and we may be required to expend valuable resources to comply with Circular 698 or to establish that we should not be taxed under the general anti-avoidance rule of the 2008 CIT Law, which may have a material adverse effect on our financial condition and results of operations or such non-resident investors' investments in us.

Fluctuations in exchange rates may have a material adverse effect on our ability to convert RMB into foreign currency.

The value of the RMB against the U.S. dollar and other currencies is affected by, among other things, changes in the PRC political and economic conditions and the PRC foreign exchange policies. The conversion of RMB into foreign currencies, including U.S. dollars, has been based on exchange rates set by the PBOC. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB solely to the U.S. dollar. Under this revised policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. Following the removal of the U.S. dollar peg, the RMB appreciated more than 20% against the U.S. dollar over the following six years. Since July 2008, however, the RMB has traded within a narrow range against the U.S. dollar. As a consequence, the RMB has fluctuated significantly since July 2008 against other freely traded currencies, in tandem with the U.S. dollar. On June 19, 2010, the PBOC announced that the PRC government would further reform the RMB exchange rate regime and increase the flexibility of the exchange rate and on April 14, 2012, PBOC announced that it would allow the RMB to fluctuate against the U.S. dollar by up to 1.0% above or below the central parity rate published by the PBOC.

We mainly operate in the PRC with most of our transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government. We hold some financial assets denominated in U.S. dollars or H.K. dollars subject to certain thresholds stated in our treasury mandate and borrow some bank loans denominated in U.S. dollars from time to time. This exposes us to foreign exchange risk.

Any significant revaluation of RMB may materially and adversely affect our revenue, earnings and financial position. For example, an appreciation of RMB against the U.S. dollar would reduce the amount of RMB we would receive if we need to convert U.S. dollars into RMB. Conversely, a significant depreciation of the RMB against the U.S. dollar may significantly reduce the U.S. dollar equivalent of our earnings. It is difficult to predict how this new policy may impact the RMB exchange rate.

We have entered into certain foreign exchange forward contract arrangements to manage our foreign exchange risk in relation to bank loans denominated in U.S. dollars. However, the availability and effectiveness of these current and future arrangements may be limited and we may not be able to adequately hedge our exposure or at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into foreign currency.

Implementation of the new labor laws and regulations in the PRC may adversely affect our business and results of operations.

Pursuant to a new labor contract law that became effective in January 2008 and its implementation rules that became effective in September 2008, employers are subject to stricter requirements in terms of signing labor contracts, minimum wages, paying remuneration, determining the term of employees' probation and unilaterally terminating labor contracts. Due to the limited period since its effectiveness, and lack of detailed interpretation rules and uniform implementation practice and possible penalties, it is uncertain as to how it would affect our current employment policies and practices. Our employment policies and practices may violate the labor contract law or its implementation rules, and we may thus be subject to related penalties, fines or legal fees. Compliance with the labor contract law and its implementation rules may increase our operating expenses, in particular our personnel expenses. In the event that we decide to terminate some of our employees or otherwise change our employment or labor practices, the labor contract law and its implementation rules may also limit our ability to effect those changes in a desirable or cost-effective manner, which could adversely affect our business and results of operations. On October 28, 2010, the Standing Committee of the National People's Congress promulgated the PRC Social Insurance Law (中華人民共和國社會保險法), which became effective on July 1, 2011. According to the PRC Social Insurance Law, employees must participate in pension insurance, work-related injury insurance, medical insurance, unemployment insurance and maternity insurance and the employers must, together with their employees or separately, pay the social insurance premiums for such employees.

We expect our labor costs to increase due to the implementation of these new laws and regulations. As the interpretation and implementation of these new laws and regulations are still evolving, we cannot assure you that our employment practice will at all times be deemed in full compliance with labor-related laws and regulations in the PRC which may subject us to labor disputes or government investigations. If we are deemed to have violated relevant labor laws and regulations, we could be required to provide additional compensation to our employees and our business, financial condition and results of operations could be materially and adversely affected. Further, labor disputes, work stoppages or slowdowns at our offices and facilities or any of our clients or suppliers could significantly disrupt our daily operation or our expansion plans and have material adverse effects on our business.

Inflation in the PRC and measures to contain inflation may negatively affect our profitability and growth.

While the PRC economy has experienced rapid growth, such growth has been uneven among various sectors of the economy and in different geographical areas of the country and among different demographic sectors in the community. If prices for our services and products rise at a rate that is insufficient to compensate for the rise in the costs, our business may be materially and adversely affected. In order to control inflation in the past, the PRC government has imposed controls on bank credits, limits on loans for fixed assets, and restrictions on state bank lending. Such austerity measures can lead to a slowing of economic growth in the PRC, which could materially and adversely affect our business and financial condition.

The outbreak, or threatened outbreak, of any severe epidemics in the PRC could materially and adversely affect our business and results of operations.

The outbreak, or threatened outbreak, of any severe epidemics (such as severe acute respiratory syndrome or avian influenza) in the PRC could materially and adversely affect the overall business sentiment and environment in the PRC, particularly if such outbreak is inadequately controlled. This, in turn, could materially and adversely affect domestic consumption, labor supply and, possibly, the overall gross domestic product growth of the PRC. Labor shortages on contraction or slowdown in the growth of domestic consumption in the PRC could materially and adversely affect our business and results of operations. In addition, if any of our employees are affected by any severe epidemics, it could adversely affect or disrupt operations and may also involve a closure of our offices and facilities to prevent the spread of the disease. The spread of any severe epidemics in the PRC may also affect the operations of our customers and suppliers, which could materially and adversely affect our business and results of operations.

EXCHANGE RATE INFORMATION

The PBOC sets and publishes daily a central parity exchange rate with reference primarily to the supply and demand of the Renminbi against a basket of currencies in the market during the previous day. The PBOC also takes into account other factors, such as the general conditions existing in the international foreign exchange markets. Since 1994, the conversion of the Renminbi into foreign currencies, including H.K. dollars and U.S. dollars, has been based on rates set by the PBOC, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates in the world financial markets. From 1994 to July 20, 2005, the official exchange rate for the conversion of the Renminbi to U.S. dollars was generally stable. Although Chinese governmental policies were introduced in 1996 to reduce restrictions on the convertibility of the Renminbi into foreign currency for current account items, conversion of the Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of SAFE and other relevant authorities. On July 21, 2005, the PRC government introduced a managed floating exchange rate system to allow the value of the Renminbi to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the value of the Renminbi appreciated by 2% against the U.S. dollar. On May 18, 2007, the PBOC announced that the floating band for the trading prices in the inter-bank foreign exchange market of the Renminbi against the U.S. dollar would be expanded from 0.3% to 0.5% around the central parity rate, effective on May 21, 2007 and on April 14, 2012, the PBOC announced that the floating board would be further expanded to 1.0% around the central parity rate, effective on April 16, 2012. This allows the Renminbi to fluctuate against the U.S. dollar by up to 1.0% above or below the central parity rate published by the PBOC. The PRC government may, in the future, make further adjustments to the exchange rate system. The PBOC announces the closing price of a foreign currency traded against the Renminbi in the inter-bank foreign exchange market after the closing of the market on each working day, and makes it the central parity for trading against the Renminbi on the following working day.

The following table sets forth information concerning exchange rates between the Renminbi and the U.S. dollar for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this document or will use in the preparation of our periodic reports or any other information to be provided to you:

	Exchange Rate			
Period	**Period End**	**Average(1)**	**Low**	**High**
2006	7.8041	7.9579	8.0702	7.8041
2007	7.2946	7.5806	7.8127	7.2946
2008	6.8225	6.9193	7.2946	6.7800
2009	6.8259	6.8295	6.8470	6.8176
2010	6.6000	6.7603	6.8330	6.6000
2011	6.2939	6.4475	6.6364	6.2939
2012				
March	6.2975	6.3125	6.3315	6.2975
April	6.2790	6.3043	6.3150	6.2790
May	6.3684	6.3242	6.3684	6.3052
June	6.3530	6.3633	6.3703	6.3530
July	6.3610	6.3717	6.3879	6.3487
August (through August 17)	6.3580	6.3640	6.3738	6.3579

Source: Federal Reserve Statistical Release

(1) Annual averages are calculated from month-end rates. Monthly averages are calculated using the average of the daily rates during the relevant period

On June 29, 2012, the U.S. dollar/Renminbi exchange rate was US$1.00 to RMB6.3530.

Unless otherwise noted, all translations from Renminbi to U.S. dollars and from U.S. dollars to Renminbi in this document were made at a rate of RMB6.3530 to US$1.00, the exchange rate set forth in the H.10 statistical release of the Federal Reserve Board on June 29, 2012, and all translations from H.K. dollars to U.S. dollars and from U.S. dollars to H.K. dollars were made at a rate of HK$7.8 to US$1.00, the official exchange rate set by the Hong Kong Monetary Authority. We make no representation that any U.S. dollar, Renminbi, or H.K. dollar amounts could have been, or could be, converted into U.S. dollars, Renminbi or H.K. dollars, as the case may be, at any particular rate, at the rates stated above, or at all.

CAPITALIZATION

The following table sets forth our debt and capitalization as of June 30, 2012

Except as otherwise disclosed herein, there has been no material adverse change in our capitalization since June 30, 2012.

This table should be read in conjunction with the "Selected Consolidated Financial and Other Data", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial information included elsewhere in this document.

	As of June 30, 2012	
	Actual	
	(RMB)	(US$)[2]
	(in thousands)	
Cash and cash equivalents	10,602,451	1,668,889
Current liabilities:		
Short-term borrowings	3,609,323	568,129
Non-current liabilities:		
Long-term notes payable[3]	3,751,839	590,562
Long-term borrowings[4]	948,735	149,336
	4,700,574	739,898
Total debt	8,309,897	1,308,027
Capital and reserves attributable to equity shareholders of the Company		
Share capital	198	31
Share premium	2,488,779	391,749
Shares held for share award scheme	(609,657)	(95,964)
Other reserves	532,264	83,782
Retained earnings	31,652,090	4,982,227
	34,063,674	5,361,825
Non-controlling interests	650,698	102,424
Total equity	34,714,372	5,464,249
Total capitalization[5]	43,024,269	6,772,276

Notes:

(2) All items in this table have been translated from Renminbi to US$ at the rate of RMB6.3530 to US$1.00.

(3) The amount represents the amortized cost of the 4.625% Senior Notes as of June 30, 2012 by using the effective interest method.

(4) In July 2012, we obtained an unsecured long-term borrowing in the amount of US$200.0 million, which is not reflected in these actual and adjusted long-term borrowing figures.

(5) Total capitalization represents the sum of the total debt under current and non-current liabilities and total equity.

SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

The selected consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011 have been derived from our audited consolidated financial statements for the years ended December 31, 2010 and 2011 included elsewhere in this document. The selected condensed consolidated interim financial information as of and for the six months ended June 30, 2011 and 2012 have been derived from our unaudited condensed consolidated interim financial information for the six months ended June 30, 2012 included elsewhere in this document.

The selected financial data below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the audited consolidated financial statements and the unaudited condensed consolidated interim financial information included elsewhere in this document. The financial and operating information for the six months ended June 30, 2012 is not necessarily indicative of the results that may be expected for the year ending December 31, 2012 and should not be used as the basis of, or prediction of, an annualized calculation.

SELECTED CONSOLIDATED INCOME STATEMENT FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011 AND FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2012

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(US$ in thousands)
Revenue:						
Internet value-added services ..	9,530,711	15,482,301	23,042,758	10,637,860	15,168,246	2,387,572
Mobile and telecommunications value-added services	1,905,599	2,715,931	3,270,841	1,571,631	1,842,849	290,075
Online advertising	962,171	1,372,522	1,992,216	793,206	1,419,804	223,486
e-Commerce transactions[(1)]	—	—	—	—	1,610,343	253,478
Others....................................	41,479	75,277	190,257	74,767	133,860	21,070
Total revenue	12,439,960	19,646,031	28,496,072	13,077,464	20,175,102	3,175,681
Cost of revenue	(3,889,468)	(6,320,200)	(9,928,308)	(4,525,366)	(8,147,696)	(1,282,496)
Gross profit	8,550,492	13,325,831	18,567,764	8,552,098	12,027,406	1,893,185
Interest income	136,014	255,922	468,990	207,208	363,539	57,223
Other (losses)/gains, net	(58,213)	38,056	420,803	341,878	(66,861)	(10,523)
Selling and marketing expenses ..	(581,468)	(945,370)	(1,920,853)	(669,944)	(1,078,872)	(169,821)
General and administrative expenses	(2,026,347)	(2,836,226)	(5,283,154)	(2,260,838)	(3,616,239)	(569,218)
Operating profit	6,020,478	9,838,213	12,253,550	6,170,402	7,628,973	1,200,846
Finance (costs)/income, net..........	(1,953)	(838)	35,505	(2,098)	(185,238)	(29,158)
Share of profit/(losses) of associates	22,206	72,359	(24,255)	61,308	(4,342)	(683)
Share of profit/(losses) of jointly controlled entities	—	3,399	(165,731)	(64,986)	(7,995)	(1,259)
Profit before income tax	6,040,731	9,913,133	12,099,069	6,164,626	7,431,398	1,169,746
Income tax expense	(819,120)	(1,797,924)	(1,874,238)	(937,146)	(1,358,497)	(213,835)
Profit for the year/period	5,221,611	8,115,209	10,224,831	5,227,480	6,072,901	955,911

Note:

(1) We began treating e-Commerce transactions business as a separate reportable segment on January 1, 2012. No comparative figures for the comparative periods were presented since an insignificant amount of revenue was generated from e-Commerce transactions in periods prior to January 1, 2012.

SELECTED CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2009, 2010 AND 2011 AND AS OF JUNE 30, 2012

	As of December 31,			As of June 30,	
	2009	2010	2011	2012	
	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(US$ in thousands)
Cash and cash equivalents	6,043,696	10,408,257	12,612,140	10,602,451	1,668,889
Restricted cash[1]	200,000	1,036,457	4,942,595	2,317,431	364,777
Term deposits with initial term of over three months	5,310,168	11,725,743	13,716,040	17,014,730	2,678,220
Total current assets	13,156,942	25,373,741	35,503,488	35,912,893	5,652,903
Total assets	17,505,765	35,830,114	56,804,365	61,731,822	9,716,956
Short-term borrowings	202,322	5,298,947	7,999,440	3,609,323	568,129
Total current liabilities	4,563,079	13,022,045	21,183,348	19,981,134	3,145,149
Long-term notes payable	—	—	3,733,331	3,751,839	590,562
Long-term borrowings	—	—	—	948,735	149,336
Total non-current liabilities	644,033	967,211	6,532,673	7,036,316	1,107,558
Total liabilities	5,207,112	13,989,256	27,716,021	27,017,450	4,252,707
Total equity	12,298,653	21,840,858	29,088,344	34,714,372	5,464,249
Total liabilities and equity	17,505,765	35,830,114	56,804,365	61,731,822	9,716,956

Note:

(1) Includes, among others, restricted cash pledged for secured bank borrowings which amounted to RMB200.0 million, RMB1,014.5 million, RMB3,071.6 million and RMB324.3 million (US$51.1 million) as of December 31, 2009 and 2010 and 2011 and as of June 30, 2012, respectively.

SELECTED CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011 AND FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2012

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Audited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(Unaudited) (RMB in thousands)	(US$ in thousands)
Net cash flows generated from operating activities	8,398,365	12,319,293	13,358,107	5,434,115	8,945,857	1,408,131
Net cash flows used in investment activities[1]	(5,024,795)	(12,014,997)	(15,354,758)	(9,547,558)	(6,455,778)	(1,016,178)
Net cash flows (used in)/generated from financing activities[2]	(397,110)	4,112,146	4,373,024	1,741,476	(4,506,408)	(709,335)
Net increase in cash and cash equivalents	2,976,460	4,416,442	2,376,373	(2,371,967)	(2,016,329)	(317,382)
Cash and cash equivalents at beginning of year/period	3,067,928	6,043,696	10,408,257	10,408,257	12,612,140	1,985,226
Exchange (losses)/gains on cash and cash equivalents	(692)	(51,881)	(172,490)	(73,200)	6,640	1,045
Cash and cash equivalents at end of year/period	6,043,696	10,408,257	12,612,140	7,963,090	10,602,451	1,668,889

Notes:

(1) Includes, among others, payment for capital expenditures and game and other content licenses. Payment for capital expenditure represents the amount paid for purchase of fixed assets, construction in progress and investment properties,

payments for land use rights and payments for intangible assets (excluding game and other content licenses), which amounted to RMB820.2 million, RMB2,034.4 million, RMB4,209.5 million, RMB1,567.4 million and RMB2,083.6 million (US$328.0 million) for the years ended December 31, 2009, 2010 and 2011 and for the six months June 30, 2011 and 2012, respectively.

(2) Includes, among others, dividends paid to the Company's shareholders and non-controlling interest owners, which amounted to RMB586.7 million, RMB706.0 million and RMB894.8 million for the years ended December 31, 2009, 2010 and 2011 and RMB894.8 million and RMB1,126.1 million (US$177.3 million) for the six months ended June 30, 2011 and 2012, respectively.

OTHER FINANCIAL DATA

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(RMB in thousands, except for %)	(US$ in thousands, except for %)
EBITDA[1]	6,480,450	10,323,506	13,298,239	6,392,021	8,585,869	1,351,467
Adjusted EBITDA[1]	6,801,872	10,819,278	14,030,930	6,726,473	9,020,172	1,419,829
Adjusted EBITDA margin[2]	55%	55%	49%	51%	45%	45%
Net Cash[3]	11,351,542	17,849,546	17,667,030	15,749,917	19,631,631	3,090,136

	As of and for the year ended December 31,			As of and for the twelve months ended June 30,
	2009	2010	2011	2012
	(RMB in thousands, except for ratios)			
Adjusted EBITDA[1]	6,801,872	10,819,278	14,030,930	16,324,629
Interest Expense	—	35,027	72,537	179,642
Ratios:				
Adjusted EBITDA[1] to Interest Expense	N/A	309x	193x	91x
Total Debt[4] to Adjusted EBITDA[1]	0.03x	0.49x	0.84x	0.51x

Notes:

(1) EBITDA for any year/period consists of operating profit less interest income, and plus other losses/(gains), net, depreciation of fixed assets and investment properties and amortization of intangible assets. Other losses/(gains), net consist primarily of the gains on disposal/deemed disposal of associates, government subsidies, donation to the Tencent Charity Fund, losses from derivative financial instruments and impairment provision for available-for-sale financial assets, associates and jointly controlled entities. Adjusted EBITDA consists of EBITDA plus equity-settled share-based compensation expenses. EBITDA and Adjusted EBITDA are not standard measures under IFRS. EBITDA is a widely used financial indicator of a company's ability to service and incur debt. EBITDA and Adjusted EBITDA should not be considered in isolation or construed as alternatives to cash flows, net income or any other measure of performance or as indicators of our operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. In evaluating EBITDA and Adjusted EBITDA, we believe that you should consider, among other things, the components of EBITDA such as sales and operating expenses and the amount by which EBITDA exceeds capital expenditures and other charges. We have included EBITDA and Adjusted EBITDA because we believe they are a useful supplement to cash flows data as a measure of our performance and our ability to generate cash flows from operations to cover debt service and taxes. EBITDA and Adjusted EBITDA presented herein may not be comparable to similarly titled measures presented by other companies. You should not compare our EBITDA or Adjusted EBITDA to the EBITDA or Adjusted EBITDA presented by other companies because not all companies use the same definition.

(2) Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by the revenue for the relevant year/period.

(3) Net cash is calculated as restricted cash pledged for secured bank borrowings, cash and cash equivalents, and term deposits with initial term of over three months, minus total debt.

(4) Total debt consists of our short-term borrowings, which comprise our borrowings accounted for as RMB borrowings (both secured and unsecured), our U.S. dollar borrowings (which are all unsecured) and our U.S. dollar denominated unsecured bonds (which were issued in March 2011 and matured and were fully paid in March 2012), our long-term borrowings, which comprise our borrowings accounted for as offshore U.S. dollar borrowings (which are all unsecured), and the 4.625% Senior Notes.

The following table reconciles our operating profit under IFRS to our EBITDA and Adjusted EBITDA for the year/period indicated.

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Operating profit	6,020,478	9,838,213	12,253,550	6,170,402	7,628,973	1,200,846
Less: Interest income	(136,014)	(255,922)	(468,990)	(207,208)	(363,539)	(57,223)
Add: Other losses/(gains), net[1]	58,213	(38,056)	(420,803)	(341,878)	66,861	10,524
Add: Depreciation of fixed assets and investment properties	405,876	669,860	1,208,261	494,844	869,000	136,786
Add: Amortization of intangible assets	131,897	109,411	726,221	275,861	384,574	60,534
EBITDA	6,480,450	10,323,506	13,298,239	6,392,021	8,585,869	1,351,467
Equity-settled share-based compensation expenses	321,422	495,772	732,691	334,452	434,303	68,362
Adjusted EBITDA	6,801,872	10,819,278	14,030,930	6,726,473	9,020,172	1,419,829

Note:

(1) Other losses/(gains), net primarily consist of the gains on disposal/deemed disposal of associates, government subsidies, donation to the Tencent Charity Fund, losses from derivative financial instruments and impairment provision for available-for-sale financial assets, associates and jointly controlled entities.

OPERATING DATA

The following data sets forth certain operating statistics relating to our Internet platforms and value-added services as of the dates and for the periods presented:

	As of December 31,			As of June 30,
	2009	2010	2011	2012
	(in millions)			
Monthly active IM user accounts[1]	522.9	647.6	721.0	783.6
Average daily IM user hours[2]	1,382.4	1,885.9	2,363.9	2,775.8
Monthly active Qzone user accounts[3]	405.8	509.8	552.1	597.6
Fee-based IVAS registered subscriptions	51.6	65.7	77.2	74.7
Fee-based MVAS registered subscriptions	20.3	24.6	31.4	34.6

Notes:

(1) Monthly active IM user accounts figures denote the total number of user accounts logged in at least once during the last calendar month prior to the relevant date.

(2) Average daily IM user hours figures denote the average daily user hours of IM for the last 15/16 days.

(3) Monthly active Qzone user accounts figures denote the total number of user accounts that logged into Qzone at least twice during the last calendar month prior to the relevant date. Prior to the fourth quarter of 2011, we had periodically

disclosed historical monthly active Qzone user accounts based on the total number of user accounts that either updated content or accessed social applications at least once during the last calendar month prior to the relevant date. All operating data presented in this document have been adjusted to reflect the new definition for fair comparison. The definition of monthly active Pengyou user accounts has also been revised in the same manner.

	For the three months ended December 31,			For the three months ended June 30,
	2009	**2010**	**2011**	**2012**
		(in millions)		
IM PCU[(1)]	93.0	127.5	152.7	166.6
QQ Game Platform PCU[(2)]	6.2	6.8	8.4	8.8

Notes:

(1) IM PCU figures denote the highest number of simultaneous online user accounts of our IM platform during the period.

(2) QQ Game Platform PCU figures denote the highest number of simultaneous online user accounts of our QQ Game Platform during the period.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition and results of operations as of and for the years ended December 31, 2009, 2010 and 2011 and as of and for the six months ended June 30, 2011 and 2012 and of the material factors that we believe are likely to affect our financial condition and results of operations. You should read this section in conjunction with our audited consolidated financial statements and unaudited condensed consolidated interim financial information included in this document beginning on page F-2. Our consolidated financial statements have been prepared in accordance with IFRS.

In addition, the following discussion contains certain forward-looking statements that reflect our plans, estimates and beliefs. Our actual results may differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this document, including "Risk Factors".

OVERVIEW

We are a leading integrated Internet services company in the PRC, operating the largest IM community in the country with over 783.6 million monthly active IM user accounts as of June 30, 2012. We are also the largest SNS provider in terms of monthly time spent by users and our QQ.com is the No. 1 portal by user traffic in terms of daily unique visitors in the PRC, both according to iResearch in June 2012. Tencent Microblog has become one of the leading microblogs in the PRC with 468.7 million registered user accounts and 81.6 million daily active user accounts as of June 30, 2012. Leveraging our IM platform and our massive IM user base, we aim to become the hub for fulfilling Internet users' online lifestyle needs, encompassing communication, social networking, entertainment, content, search and e-Commerce. The breadth of our highly popular services extends to: QQ IM, QQ Mail, Qzone, Pengyou, Tencent Microblog, QQ Game Platform, QQ.com, our integrated e-Commerce platform, Buy.qq.com, our wireless portal, 3G.QQ.com and our mobile communication service, WeChat (Weixin).

At the beginning of 2012, we began categorizing our business into five lines of business: IVAS, MVAS, online advertising, e-Commerce transactions and others. No comparative segment information was provided for e-Commerce transactions prior to 2012 since an insignificant amount of revenue was generated from e-Commerce transactions, which was not a reportable segment prior to January 1, 2012. As a result, discussions of our results of operations as of and for the six months ended June 30, 2012 in this document are based on our current segmentation, and discussions of our results of operations as of and for the years ended 2009, 2010 and 2011 and as of and for the six months ended June 30, 2011 in this document are based on our previous segmentation.

Our IVAS business mainly consists of online games, community and open platforms. Our game portfolio includes web games, MCGs, ACGs and MMOGs. We provide a variety of community services such as Qzone, QQ Membership and QQ Show. We also operate multiple open platforms across different sectors of the Internet market in the PRC, including Qzone, Pengyou, Tencent Microblog, Q+ and QQ Game Platform. As of June 30, 2012, we had 74.7 million fee-based IVAS registered subscriptions. Our IVAS revenue accounted for 80.8% of our total revenue for the year ended December 31, 2011 and 75.2% of our total revenue for the six months ended June 30, 2012.

Our MVAS business includes bundled SMS packages, mobile games, mobile books and mobile music services. These services are operated on mobile networks and are integrated with QQ IM and our other platforms. As of June 30, 2012, we had 34.6 million fee-based MVAS registered subscriptions. Our MVAS revenue accounted for 11.5% of our total revenue for the year ended December 31, 2011 and 9.1% of our total revenue for the six months ended June 30, 2012.

Our online advertising business primarily comprises brand display advertising on IM clients, portals and other platforms, performance display advertising primarily on SNS platforms; and search advertising through our self-developed search engine. Online advertising revenue accounted for 7.0% of our total revenue for the year ended December 31, 2011 and 7.0% of our total revenue for the six months ended June 30, 2012.

Our e-Commerce transactions business primarily includes sales of merchandise and services on our B2C open platform, SME2C marketplaces and other open platforms providing lifestyle services and offline-to-online e-Commerce. Our e-Commerce transactions business contributed an insignificant amount as a percentage of our total revenue for the year ended December 31, 2011 and accounted for 8.0% of our total revenue for the six months ended June 30, 2012.

Our others segment mainly comprises the provision of trademark licensing, software development services and software sales. Our others segment accounted for 0.7% of our total revenue for the year ended December 31, 2011 and 0.7% of our total revenue for the six months ended June 30, 2012.

Our total revenue increased from RMB12,440.0 million for the year ended December 31, 2009 to RMB19,646.0 million for the year ended December 31, 2010 and to RMB28,496.1 million for the year ended December 31, 2011. For the six months ended June 30, 2012, our total revenue increased to RMB20,175.1 million (US$3,175.7 million) from RMB13,077.5 million for the six months ended June 30, 2011. Our profit for the year increased from RMB5,221.6 million for the year ended December 31, 2009 to RMB8,115.2 million for the year ended December 31, 2010 and to RMB10,224.8 million for the year ended December 31, 2011. For the six months ended June 30, 2012, our profit for the period increased to RMB6,072.9 million (US$955.9 million) from RMB5,227.5 million for the six months ended June 30, 2011. As of June 30, 2012, our cash and cash equivalents and term deposits with initial term of over three months amounted to RMB27,617.2 million (US$4,347.1 million).

Recent Developments

In July 2012, we purchased 49% of issued share capital of Level Up! International Holdings Pte. Ltd. ("**Level Up**") from a related party (the "**Level Up Acquisition**"). In addition, we have an option to acquire, within a two-year period after closing, certain additional number of shares in Level Up which together with the shares acquired in the Level Up Acquisition, will represent 67% of the issued share capital of Level Up as at the date when the option is fully exercised. See "Related Party Transactions" for further details.

In May 2012, we entered into a sales and purchase agreement, pursuant to which, we agreed to purchase certain equity interest in Epic Games, Inc. ("**Epic**"). This acquisition was completed in July 2012. Epic is principally engaged in developing game engine technology, as well as game titles for personal computers, consoles and mobile devices. Upon completion of the acquisition, Epic has been accounted for as an associate.

SIGNIFICANT FACTORS AFFECTING OUR RESULTS OF OPERATIONS

We believe that the most significant factors that have affected or are expected to affect our results of operations and financial condition include, among others:

Ability to increase our user base and monetize our user traffic

The growth of our business and revenue depends on our ability to maintain and expand our highly engaged user community. As of June 30, 2012, we reached over 783.6 million monthly active IM user accounts, an increase of 11.6% from 701.9 million as of June 30, 2011 and an increase of 8.7% from 721.0 million as of December 31, 2011. In addition, Tencent Microblog, which was launched in April 2010, has become one of the leading microblogs in the PRC with 468.7 million registered user accounts and 81.6 million daily active user accounts as of June 30, 2012.

We continuously seek to leverage the size of our user base and integrated nature of our platforms to build up user traffic for our new services and products, as well as drive revenue growth from our online advertising and e-Commerce transactions. Users of our QQ services, for example, would naturally be our target users for Tencent Microblog. We have leveraged our in-depth knowledge of our users' interests and spending habits to develop and expand our e-Commerce transactions business and strengthened our presence in various e-Commerce formats, such as B2C, SME2C, lifestyle services, offline-to-online e-Commerce. In addition, our large and logged-in user base and existing payment platform also makes our platforms more attractive to online advertisers and merchant partners.

We believe that the size of our user base also serves as the foundation for turning non-paying users into paying users. We have had success in cross-marketing our services and products and have been able to migrate a large number of our users for QQ IM, QQ Mail and other free services to fee-based services and products for privileges such as Qzone, QQ Membership, bundled SMS packages, online and mobile games and our e-Commerce platforms. This in turn helps to grow our overall fee-based subscription numbers and revenue. Our fee-based IVAS registered subscriptions were 51.6 million, 65.7 million, 77.2 million and 74.7 million as of December 31, 2009, 2010 and 2011 and as of June 30, 2012, respectively. For the years ended December 31, 2009, 2010 and 2011 and for the six months ended June 30, 2012, our IVAS revenue was RMB9,530.7 million, RMB15,482.3 million, RMB23,042.8 million and RMB15,168.2 million (US$2,387.6 million), respectively. Our fee-based MVAS registered subscriptions were 20.3 million, 24.6 million, 31.4 million and 34.6 million as of December 31, 2009, 2010 and 2011 and as of June 30, 2012, respectively. For the years ended December 31, 2009, 2010 and 2011 and for the six months ended June 30, 2012, our MVAS revenue was RMB1,905.6 million, RMB2,715.9 million, RMB3,270.8 million and RMB1,842.8 million (US$290.1 million), respectively. For the six months ended June 30, 2012, revenue from e-Commerce transactions was RMB1,610.3 million (US$253.5 million). Cross-selling of our fee-based services and products to our existing IVAS and MVAS users will continue to be a significant driver of our future revenue and profit growth.

Ability to maintain our market position and brand recognition

We have capitalized on our early-mover advantage and have established a strong market position and built a brand name widely recognized by PRC consumers and industry participants. Users may select our platforms, products and services because of our existing market position and brand reputation. For example, QQ is a widely recognized brand in the PRC and users seeking to join an IM platform will likely consider QQ IM as their primary choice because of the brand recognition and market leading position. Our ability to compete effectively and to maintain our leading brand and market position is key to our ability to grow our user community, attract and expand relationships with our advertising customers and, in turn, grow our revenue.

Ability to develop, acquire and license content and applications

In order to attract and maintain usage of our platforms, we need to develop, acquire and license relevant content and applications for our users. Our ability to maintain existing license arrangements, procure new license arrangements and develop relevant content and applications will affect our users' engagement and usage of our platforms. We have devoted significant resources to the research and development of content and applications in order to keep our existing platforms relevant and attractive to users. Due to competition for third-party content and applications, content and application providers have been increasing their demands for upfront license fees and/or royalty payments. As we seek to expand our business lines and diversify our portfolio of services and products, our ability to manage and control our third-party content and applications acquisition costs while maintaining the high quality and attractiveness of our content and applications will continue to affect our results of operations going forward.

Ability to maintain relationships with strategic partners

We derive value and benefits from our cooperative arrangements with a number of telecommunications operators, online game developers, content providers, application developers, device manufacturers, merchants, suppliers and advertising agencies. Substantially all of the fees for our MVAS, and a small portion of the fees for our IVAS, are collected through the networks of China Mobile, China Unicom and China Telecom through revenue-sharing arrangements that are periodically renewed. We have adopted an open platform strategy and many of our platforms, including Qzone, Pengyou, Tencent Microblog, Q+ and QQ Game Platform, support third-party applications. We also have arrangements with third-party content providers and advertising agencies. The fee and costs paid for Mobile and Telecom Charges (as defined below) and bandwidth and server custody fees, plus content and advertising agency fees paid to third parties, were RMB3,014.6 million, RMB4,887.1 million, RMB7,470.9 million and RMB4,733.8 million (US$745.1 million) for the years ended December 31, 2009, 2010 and 2011 and for the six months ended June 30, 2012, respectively. Our ability to develop and foster new strategic partnerships will enable us to meet the increasingly complex demands of our users and customers, expand our distribution channels and diversify our revenue streams.

Ability to continue offering services and products that are attractive to users and ability to manage cash flow, including working capital and capital expenditures

Our financial condition and results of operations depend on the attractiveness and demand for our service and product offerings. The rapid evolution of available technologies and infrastructure in the Internet and telecommunications industries, such as the expansion of the 3G platform, may allow us to provide more innovative product and service offerings to our users, such as integrated IVAS across our users' personal computers and mobile devices.

In particular, online games represent one of the key growth drivers for our IVAS business. We must continue to diversify our game portfolio and broaden our user base through the introduction of new expansion packs and new play-modes that can increase the lifespans of our popular game titles, such as Cross Fire, QQ Dancer, Dungeon and Fighter, League of Legends and QQ Speed. We must also identify new game genres that can capture the growth potential of the industry in order to achieve sustainable growth of our online game business.

As we have recently increased our presence in the e-Commerce transactions business, we will continuously invest to offer more goods and services sold through our e-Commerce platforms. Further, we will need to devote more resources to fund capital expenditures for additional facilities to warehouse increased inventory and expanding our logistics and warehousing system in connection with the expansion of our e-Commerce transactions business.

PRC regulations affecting the Internet and telecommunications industries

As a majority of our operations are located in the PRC, our results of operations, financial condition and prospects are subject to regulatory developments in the PRC. The Internet, telecommunications and other related industries of the PRC are highly regulated. Regulations issued or implemented by the State Council, MIIT, MOC, GAPP and other relevant government authorities cover many aspects of our telecommunications, Internet information and other related services, including entry into the telecommunications industry, the scope of permissible business activities, licenses and permits for various business activities and foreign investment. See "Regulations" for further description. For example, because a significant portion of our revenue from online games and other products and services rely on large Internet user communities, any regulations that affect Internet access and usage, such as those relating to online game addiction, operations of Internet cafes and other establishments, Internet privacy, imported games, mobile subscriber cancellation policies and other regulations will affect the ways we operate and provide our services and products.

In addition, because certain of our PRC subsidiaries and consolidated controlled entities qualified as "high/new technology enterprises" received preferential tax treatment or exemptions as of June 30, 2012, any changes in the status of such preferential tax treatment or exemptions would increase the costs of our business.

Macroeconomic conditions in the markets where we operate

Our results of operations and financial condition are affected by economic conditions in the PRC and, to a lesser extent, the economic conditions of the rest of the world. The PRC has experienced rapid economic growth over the past three decades. According to the National Bureau of Statistics in China, the nominal GDP of the PRC increased from RMB21.6 trillion in 2006 to RMB47.2 trillion in 2011, representing a CAGR of 16.9% compared to a CAGR of 7.2% for global nominal GDP during the same period. In 2010, the PRC surpassed Japan to become the second largest economy in the world. The growth of the PRC economy has led to significant increases in personal wealth, evidenced by the per capita annual disposable income of the PRC urban residents increasing from RMB11,759 in 2006 to RMB21,810 in 2011, a CAGR of 13.2%. This increase in disposable income has in turn increased demand for value-added services and products that we provide in our various business segments.

Since the second half of 2008, the global economic slowdown has resulted in an adverse impact on the overall PRC economy. The World Bank forecasts that the PRC economy will grow 8.2% in 2012, down from 10.0% in 2010 and 9.0% in 2011. Although we price most of our products and services at an affordable level for average users, which also results in our earnings and cash flows being more resilient to economic cycles, macroeconomic conditions such as the Eurozone sovereign debt crisis, the unprecedented downgrade of the U.S. credit rating and increasing concerns about a global recession, may impact the growth of the PRC economy and PRC-focused businesses like us. The advertising and retail industries are particularly sensitive to economic downturns and a negative economic outlook could cause expenditures for Internet access, infrastructure improvements, and consumer discretionary spending to decrease, thereby affecting our e-Commerce transactions and online advertising businesses. Further, it is unclear how PRC economic conditions could impact PRC regulations, taxation or monetary policies, which could also affect our growth strategies, business operations and access to additional capital.

Recruitment, compensation and retention of employees

The performance of our employees has a significant effect on our business. For example, our senior management team uses its experience and understanding of the PRC Internet and telecommunications industries, local user preferences and key industry players to formulate future growth strategies and respond to industry changes. Skilled research and development personnel are also critical to our development of new services and products (such as new online games) and leverage upon new technologies and infrastructures. As our business continues to grow, we continue to expand our workforce. The number of our full-time employees was 7,515, 10,692, 17,446 and 20,000 as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. Consequently, as our workforce expands we incur additional staff costs as costs of revenue to our business. Our total remuneration costs (including capitalized remuneration cost) were RMB2,136.8 million, RMB3,146.1 million, RMB4,879.1 million and RMB3,597.9 million (US$566.3 million) for the years ended December 31, 2009, 2010 and 2011 and for the six months ended June 30, 2012, respectively. To further our growth, we will need to continue to identify, hire, develop, motivate and retain highly skilled personnel for all areas of our organization and invest in programs such as training, bonus and share options programs, which would further affect our staff costs.

Seasonality

Seasonal fluctuations have affected, and are likely to continue to affect, our business. For example, our online advertising business typically sees less activity in the first quarter, as advertising clients traditionally reduce their activity around the Chinese New Year holiday period in the first quarter of a calendar year.

BASIS OF PRESENTATION AND ACQUISITIONS

During the periods presented in the consolidated financial statements, we derived substantially all of our revenue under a series of contractual arrangements between our WFOEs and our consolidated affiliated entities. These contractual arrangements are designed to provide us and the WFOEs with effective control over, and (to the extent permitted by PRC law) the right to acquire the equity interests in and assets of our consolidated affiliated entities. Based on such contractual arrangements, we have concluded that it is appropriate to consolidate the financial statements of our consolidated affiliated entities, notwithstanding the lack of direct share ownership, because in substance, the contractual arrangements transfer the economic risks and benefits of these consolidated affiliated entities to us. Our consolidated affiliated entities include, among others, Tencent Computer, Shiji Kaixuan, Beijing Emark Information and Technology Company Limited, Nanjing Wang Dian Technology Company Limited, Beijing BIZCOM Technology Company Limited, Beijing Starsinhand Technology Company Limited, Shenzhen Shijitianyou Technology Company Limited and Guangzhou Yunxun Technology Company Limited. See "Risk Factors—Risks Related to our Corporate Structure—If the PRC government finds that the agreements that establish the structure for operating our services in the PRC do not comply with PRC governmental restrictions on foreign investment in value-added telecommunications businesses or other related businesses, or if these regulations or the interpretation of existing regulations change in the future, we could be subject to severe penalties or be forced to relinquish our interests in those operations" and "Risk Factors—Risks Related to our Corporate Structure—The contractual arrangements with the consolidated affiliated entities and their shareholders, which relate to critical aspects of our operations may not be as effective in providing operational control as direct ownership. In addition, these arrangements may be difficult and costly to enforce under PRC law".

DESCRIPTION OF SELECTED INCOME STATEMENT LINE ITEMS

Revenue

We generate our revenue primarily from five lines of business:

- IVAS;
- MVAS;
- online advertising;
- e-Commerce transactions; and
- others.

Our revenue was RMB12,440.0 million, RMB19,646.0 million and RMB28,496.1 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB13,077.5 million and RMB 20,175.1 million (US$3,175.7 million) for the six months ended June 30, 2011 and 2012, respectively. The following table sets forth our revenue by line of business for the periods indicated:

	Year ended December 31,						Six months ended June 30,				
	2009		2010		2011		2011		2012		
	(RMB in thousands)	% of Total Revenue	(RMB in thousands)	% of Total Revenue	(RMB in thousands)	% of Total Revenue	(RMB in thousands)	% of Total Revenue	(RMB in thousands)	% of Total Revenue	(US$ in thousands)
Revenue:											
IVAS	9,530,711	76.6	15,482,301	78.8	23,042,758	80.8	10,637,860	81.3	15,168,246	75.2	2,387,572
MVAS	1,905,599	15.3	2,715,931	13.8	3,270,841	11.5	1,571,631	12.0	1,842,849	9.1	290,075
Online advertising	962,171	7.7	1,372,522	7.0	1,992,216	7.0	793,206	6.1	1,419,804	7.0	223,486
e-Commerce transactions[1]	—	—	—	—	—	—	—	—	1,610,343	8.0	253,478
Others	41,479	0.4	75,277	0.4	190,257	0.7	74,767	0.6	133,860	0.7	21,070
Total Revenue	12,439,960	100.0	19,646,031	100.0	28,496,072	100.0	13,077,464	100.0	20,175,102	100.0	3,175,681

Note:

(1) We began treating e-Commerce transactions business as a separate reportable segment on January 1, 2012. No comparative figures for the comparative periods were presented since an insignificant amount of revenue was generated from e-Commerce transactions in periods prior to January 1, 2012.

IVAS

Revenue from IVAS is primarily derived from the provision of online games, community and open platforms, and accounts for the majority of our total revenue. Our IVAS is primarily provided on a subscription basis or on a per-item basis. We derive a substantial portion of online games revenue from the item-sales and subscription services offered by QQ Game Platform, ACGs such as Cross Fire, QQ Dancer, League of Legends and QQ Speed, as well as our MMOGs such as Dungeon and Fighter. We also derive revenue from item-sales and subscriptions from our community services such as Qzone, QQ Membership and QQ Show. In addition, we generate item-sales revenue within the in-house and third-party applications offered through our open platforms including Qzone, Pengyou, Tencent Microblog, Q+ and QQ Game Platform.

Revenue from IVAS was RMB9,530.7 million, RMB15,482.3 million and RMB23,042.8 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB10,637.9 million, RMB15,168.2 million (US$2,387.6 million) for the six months ended June 30, 2011 and 2012, respectively. Revenue from IVAS has seen substantial growth due to the increasing popularity of our major ACGs and MMOGs, the growth in revenue from our community and open platforms due to the increasing number of subscriptions from our continuing enhancement of these services, the general growth in Internet population and the growth in item-based sales as a result of the significant increase in the number of third-party and in-house applications offered on our SNS platforms.

For a detailed discussion of how revenue from IVAS is recognized in our consolidated financial statements, see "Critical Accounting Policies, Estimates and Judgments—Revenue Recognition—IVAS and MVAS".

MVAS

Revenue from MVAS is primarily derived from providing bundled SMS packages, mobile games and other mobile value-added services such as mobile books, mobile music and voice value-added services. Our MVAS is primarily provided on a subscription basis or on a per-item basis and revenue from MVAS is collected principally through telecommunications operators.

Revenue from MVAS was RMB1,905.6 million, RMB2,715.9 million and RMB3,270.8 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB1,571.6 million and RMB1,842.8 million (US$290.1 million) for the six months ended June 30, 2011 and 2012, respectively. Revenue from MVAS has grown steadily due to growth in our bundled SMS packages, as well as increased revenue from mobile games, mobile books and mobile music services. Certain legacy voice value-added services such as color ringback tones and IVR have seen a decline since 2009 due to the maturity of such services and the advancement of mobile Internet technologies. In addition, there has been a decline in revenue from WAP services due to the suspension of WAP billing by China Mobile, which has been in effect since November 30, 2009.

For a detailed discussion of how revenue from MVAS is recognized in our consolidated financial statements, see "Critical Accounting Policies, Estimates and Judgments—Revenue Recognition—IVAS and MVAS".

Online Advertising

Online advertising revenue is primarily derived from fees for selling brand display advertising inventory on our IM clients, portals and other platforms, performance display advertising inventory on our SNS platforms and other platforms, as well as delivery of our search-based advertising. For brand display advertising, the majority of our fees are determined based on the length of time or the number of impressions of the advertisement and the location of the advertisement. For performance display advertising and search-based advertising, our fees are mainly determined based on the number of clicks generated from the advertisement.

Revenue from online advertising was RMB962.2 million, RMB1,372.5 million and RMB1,992.2 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB793.2 million and RMB1,419.8 million (US$223.5 million) for the six months ended June 30, 2011 and 2012, respectively. Revenue from online advertising has grown due to our growing client base, enhancements in our brand position and media influence and the evolution of new advertising platforms, such as SNS platforms, as well as advertising opportunities created by major events such as the World Expo and the World Cup in 2010 and the 2012 Summer Olympic Games.

For a detailed discussion of how revenue from online advertising is recognized in our consolidated financial statements, see "Critical Accounting Policies, Estimates and Judgments—Revenue Recognition — Online Advertising".

e-Commerce Transactions

Revenue from e-Commerce transactions primarily consists of revenue generated from merchandise sales on our e-Commerce platforms, which are comprised of transactions where we sell our own inventories as a principal and transactions where we act as an agent. For those e-Commerce transactions in which we act as a principal, we report GMV after deducting discounts, return allowances and relevant taxes as revenue. For those e-Commerce transactions in which we act as an agent, we report our commission and fixed fees (after deducting relevant taxes) as revenue.

Revenue for e-Commerce transactions was RMB1,610.3 million (US$253.5 million) for the six months ended June 30, 2012. We have stepped up the scale of our e-Commerce transactions business as a result of the organic growth of the business and strategic acquisitions and treated it as a separate reportable segment since January 1, 2012.

For a detailed discussion of how revenue from e-Commerce transactions is recognized in our consolidated financial statements, see "Critical Accounting Policies, Estimates and Judgments — Revenue Recognition — e-Commerce Transactions".

Others

Revenue from others is primarily from the provision of trademark licensing, software development services and software sales. Revenue from others was RMB41.5 million, RMB75.3 million and RMB190.3 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB74.8 million and RMB134.0 million (US$21.0 million) for the six months ended June 30, 2011 and 2012, respectively.

Cost of Revenue

Our cost of revenue was RMB3,889.5 million, RMB6,320.2 million and RMB9,928.3 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB4,525.4 million and RMB8,147.7 million (US$1,282.5 million) for the six months ended June 30, 2011 and 2012, respectively.

Cost of revenue consists of the direct costs for operating and offering our services and products, which consist primarily of the cost of merchandise sold for transactions where we acted as a principal, sharing costs (mainly including content costs and agency fees), telecommunications operators' portion of revenue for the value-added services provided over their network platforms, bandwidth and server custody fees, depreciation of our equipment and other direct costs. Staff costs that directly relate to the provision of our services and products are also included in cost of revenue.

Sharing costs primarily consist of the content costs paid to game developers and content providers. From time to time, we engage third parties to develop content and we also license and purchase content from third parties. This content is used across our services and products, including content for our online and mobile games, and allows us to expand the range of services we provide to our users.

Agency fees primarily consist of the sales commission paid to the advertising agencies and other intermediaries. We engage advertising agencies and other intermediaries to sell advertising inventory in forms such as banners and links. The commissions paid to advertising agencies and other sales intermediaries are recognized as cost of revenue.

Telecommunications operators' portion of revenue for the value-added services provided over their network platforms includes the commission based on certain percentages of the service fees collected by them and imbalance fees. Imbalance fees are payable by us for the excess of the number of messages sent from our Internet platforms to mobile phones over the number of messages sent from mobile phones to our Internet platforms.

We lease bandwidth from Internet data centers operated by network operators in the PRC. In addition, we have network servers located in Internet data centers operated by network operators in the PRC. We pay custody fees to such operators which are recognized in full as incurred.

Interest Income

Interest income primarily consists of interest income from bank deposits including current deposits, term deposits with initial term of three months or less and term deposits with initial term of over three months.

Other (Losses)/Gains, Net

Other (losses)/gains, net primarily consist of the gains on disposal/deemed disposal of associates, government subsidies, donation to the Tencent Charity Fund, losses from derivative financial instruments and impairment provision for available-for-sale financial assets, associates and jointly controlled entities.

Selling and Marketing Expenses

Selling and marketing expenses primarily consist of costs incurred with our promotional and advertising activities, such as purchasing third-party advertising, holding promotion events and related staff costs. In recent years, our selling and marketing expenses have increased as we continue to launch and promote new services and seek to enhance our brand recognition.

General and Administrative Expenses

General and administrative expenses primarily consist of research and development expenses, related staff costs, office rental, travel and entertainment expenses, consulting fees, office maintenance and other general office expenses.

Finance (Costs)/Income, Net

Finance (costs)/income, net include interest expenses primarily arising from our borrowings, long-term notes payable and our foreign currency exchange gains or losses.

Income Tax Expense

We were not subject to any income tax in the Cayman Islands or the BVI in 2009, 2010 and 2011 and the six months ended June 30, 2012. We did not make any United States corporate income tax provision or Hong Kong profits tax provision in 2009, 2010 and 2011. For the six months ended June 30, 2012, a U.S. corporate income tax provision was made for entities within our Group that are incorporated in the United States and a Hong Kong profits tax provision was provided at the rate of 16.5% on the estimated assessable profits.

Our revenue is primarily derived from our entities incorporated in the PRC. Our entities incorporated in the PRC are subject to income tax in the PRC. Our income tax expense was RMB819.1 million, RMB1,797.9 million, RMB1,874.3 million and RMB1,358.5 million (US$213.8 million) for the years ended December 31, 2009, 2010 and 2011 and the six months ended June 30, 2012, respectively.

According to the 2008 CIT Law, effective January 1, 2008, there is a 25% corporate income tax for domestic and foreign-invested enterprises on their worldwide income. However, the State Council provided certain transitional phase-out rules, which provided for a transition period to enterprises that had preferential tax treatment prior to the promulgation of the 2008 CIT Law. In particular, enterprises that were incorporated prior to March 16, 2007 and entitled to the exemptions or reduced income tax rates for fixed terms under the old foreign invested enterprise tax law would continue to enjoy such treatment until the expiry of such fixed terms provided that, for the enterprises whose preferential tax treatments have not commenced due to lack of taxable profit, the fixed preferential terms shall commence from the year of 2008. Under the 2008 CIT Law and its implementation rules, certain enterprises qualified as "high/new technology enterprises" are subject to a preferential corporate income tax rate of 15%. A number of our PRC subsidiaries and consolidated affiliated entities enjoyed preferential tax treatments under the 2008 CIT Law or other preferential tax treatments in 2009, 2010, 2011 and the six months ended June 30, 2012 as follows:

- Tencent Computer and Shenzhen Domain were approved as high/new technology enterprises, and enjoyed a preferential corporate income tax rate of 15% in 2009, 2010, 2011 and the six months ended June 30, 2012.
- Tencent Beijing enjoyed a preferential corporate income tax rate of 7.5% in 2009 and 11% in 2010. Tencent Beijing was approved as a high/new technology enterprise and enjoyed a preferential corporate income tax rate of 15% in 2011 and the six months ended June 30, 2012.
- Cyber Tianjin was exempt from corporate income tax in 2009 and enjoyed a preferential corporate income tax rate of 12.5% in 2010, 2011 and the six months ended June 30, 2012.
- Beijing Yonghang was recognized as a newly set-up software production enterprise in 2009, and as a result was exempt from corporate income tax in 2009 and enjoyed a preferential income tax rate of 12.5% in 2010, 2011 and the six months ended June 30, 2012.
- Tencent Chengdu was recognized as a newly set-up software production enterprise and was exempt from corporate income tax in 2010 and 2011 and enjoyed a preferential income tax rate of 12.5% in the six months ended June 30, 2012.
- Tencent Technology was approved as a national key software enterprise for 2009 and 2010, and as a result, enjoyed a preferential corporate tax rate of 10% in 2009 and 2010. Tencent Technology was approved as a high/new technology enterprise and enjoyed a preferential corporate income tax rate of 15% in 2011 and the six months ended June 30, 2012.
- Cyber Shenzhen was approved as a high/new technology enterprise and enjoyed a preferential corporate income tax rate of 15% in 2009 and 2010.

According to the applicable PRC tax regulations, dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived on or after January 1, 2008 are subject to a withholding tax rate of 10%. If a foreign investor is incorporated in Hong Kong and meets the conditions or requirements under the Tax Arrangement, the relevant withholding tax rate could be reduced to 5% from 10%.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

We have identified certain accounting policies that are significant to the preparation of our consolidated financial information. The determination of these accounting policies is fundamental to our financial condition and results of operations, and requires management to make subjective and complex judgments about matters that are inherently uncertain based on information and data that may change in future periods. As a result, determinations regarding these items necessarily involved the use of assumptions and subjective judgments as to future events and are subject to change, and the use of different assumptions or data could produce materially different results. In addition, actual results could differ from estimates and may have a material adverse effect on our business, financial condition, results of operations and cash flows.

Certain accounting estimates are particularly sensitive because of their significance to the consolidated financial statements and because of the possibility that future events affecting the estimates may differ significantly from management's current judgments. We believe the following represents our critical accounting policies, judgments and estimates.

Revenue Recognition

We principally derive revenue from the provision of IVAS, MVAS, online advertising services and e-Commerce transactions in the PRC.

IVAS and MVAS

Revenue from IVAS is derived principally from the provision of online games, community and open platforms across various Internet platforms.

Revenue from MVAS is primarily derived from providing bundled SMS packages, mobile games and other MVAS such as mobile books, mobile music and voice value-added services.

IVAS and MVAS are primarily billed on a monthly subscription basis or on a per-item basis. Certain of these services are delivered to our customers through the platforms of various branches, subsidiaries and affiliates of telecommunications operators in the PRC and the operators also collect certain service fees (the "**Internet and Mobile Service Fees**") on behalf of us.

In collecting the Internet and Mobile Service Fees on our behalf, these telecommunications operators are entitled to a fixed commission, which is calculated based on agreed percentages of the Internet and Mobile Service Fees received/receivable by them, plus, in certain cases, applicable imbalance fees (collectively defined as the "**Mobile and Telecom Charges**"). The Mobile and Telecom Charges are withheld and deducted from the gross Internet and Mobile Service Fees collected by the operators from the users, with the net amounts remitted to us.

The Internet and Mobile Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by the operators to us on a monthly basis. We recognize the Internet and Mobile Service Fees as revenue on a gross basis and treat the Mobile and Telecom Charges as cost of revenue.

For the Internet and Mobile Service Fees not yet confirmed or advised by the operators at the time of reporting our financial results, management estimates the amounts receivable based on the historical data. The historical data used in estimating revenue includes the most recent three-month history of the Internet and Mobile Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between our network gateways and the mobile operators. Adjustments are made in subsequent periods in the event that the actual revenue amounts are different from the original estimates.

In addition, IVAS can also be paid by way of prepaid cards and tokens (represented a specific amount of payment unit) sold by us through non-mobile channels such as sales agents appointed by us, telecommunications operators, broadband service providers, Internet cafes and banks. The end users can register the prepaid cards and tokens to their user accounts in our platforms and then access our online products or relevant services. Receipts from the sales of prepaid cards and tokens are deferred and recorded as "Deferred revenue" in the statement of financial position. The amounts are then recognized as revenue based on the actual utilization of the payment unit. When the payment unit is used to purchase services, the revenue is recognized when the related services are rendered, and when the payment unit is used to purchase virtual products/items in our Internet platforms, the revenue is recognized over the estimated lifespan of the respective virtual products/items or over the expected user relationship, whichever is the longer.

In relation to the sharing income derived from third-party games or applications which are available on our platforms and hosted by the developers, we recognize the related revenue on a related net basis because we act as an agent in such arrangements. We defer the related revenue over an estimated period as there is an implicit obligation for us to maintain and allow the users' access to the games or applications through our platforms.

Online advertising

Online advertising revenue is mainly derived from selling advertising inventory on our IM clients, portals, SNS and other platforms, and from search advertising through our self-developed search engine. Commissions payable to advertising agencies are recognized as a component of the cost of revenue.

For brand display advertising contracts based on the actual time period that the advertisements are displayed on our websites, IM clients or other platforms, the revenue is recognized ratably over the period in which the advertisements are displayed. In addition, revenue from some other brand display advertising contracts is recognized based on the number of impressions of the advertisements. For performance display advertising, the pricing of the advertising inventory is determined through a bidding system and the revenue is recognized based on the number of clicks generated from the advertisement.

e-Commerce transactions

Revenue from our e-Commerce transactions is derived from sales of merchandise and provision of services through our e-Commerce platforms. We recognize revenue from merchandise sales and related costs on a gross basis when we act as a principal. When we are not a principal and are instead acting as an agent, revenue is recognized on a net basis based on a pre-determined percentage. Whether we act as a principal or an agent in a transaction is determined based on several criteria, including whether we are a primary obligor, whether we are subject to inventory risk, whether we have latitude in establishing price and selecting suppliers, or whether we have several but not all of these indicators in a transaction.

For merchandise sold under e-Commerce transactions, the customers place their orders online with a commitment made at a fixed selling price. Payment for the purchased merchandise is made either before delivery or upon delivery. When we are acting as a principal, revenue (net of discounts and return allowances and relevant taxes) is recognized when the merchandise is physically delivered to the respective customers. Return allowances, which reduce the gross amount of merchandise revenue, are estimated based on our historical experience.

Research and Development Expenses

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are capitalized as intangible assets when recognition criteria are fulfilled and tests for impairment are performed annually. Other development expenditures that do not meet those criteria are recognized as expenses as incurred. Development expenditures previously recognized as expenses are not recognized as assets in subsequent periods. Capitalized development expenditures are amortized from the point at which the assets are ready for use on a straight-line basis over their useful lives, not exceeding five years.

Share-based Compensation Expenses

We have adopted several share option schemes and a share award scheme as part of our compensation benefits to employees. The fair value of the employee services received in exchange for the grant of options and awarded shares is recognized as an expense and credited to share premium. For grants of share options, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted by using an option-pricing model, the Black-Scholes valuation model, excluding the impact of any service condition and non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become vested. As we use the Black-Scholes valuation model to determine the total fair value of the options granted, which is to be expensed over the vesting period, significant judgment on parameters, such as risk-free rate, dividend yield and expected volatility, is required to be made by the Directors in applying the Black-Scholes valuation model. The fair value of options granted determined using the Black-Scholes valuation model was approximately HK$116.9 million, HK$251.3 million, HK$63.0 million for the years ended December 31, 2009, 2010 and 2011, respectively.

For grant of award shares, the total amount to be expensed over the vesting period is determined by reference to the market price of our shares at the grant date.

For both share options and awarded shares, we must estimate the expected yearly percentage of grantees of share options and awarded shares who will stay within the Group at the end of the vesting periods to determine the amount of share-based compensation expenses charged into the income statement.

Income Taxes

We are subject to income taxes in numerous jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes as there are many transactions and calculations for which the determination of ultimate tax liabilities is uncertain. We recognize liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due and whether the final tax outcome of these matters is different from the amounts that were initially recorded. Such differences, if any, will impact current income tax and deferred income tax liabilities in the period in which such determination is made.

RESULTS OF OPERATIONS

Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011

Revenue. Revenue increased by RMB7,097.6 million, or 54.3%, from RMB13,077.5 million for the six months ended June 30, 2011 to RMB20,175.1 million (US$3,175.7 million) for the six months ended June 30, 2012.

The following table sets forth our revenue by lines of business for the six months ended June 30, 2011 and 2012:

	Six months ended June 30,				
	2011		2012		
	Amount	% of total revenue	Amount		% of total revenue
	(RMB in thousands)		(RMB in thousands)	(US$ in thousands)	
IVAS	10,637,860	81.3	15,168,246	2,387,572	75.2
MVAS	1,571,631	12.0	1,842,849	290,075	9.1
Online advertising	793,206	6.1	1,419,804	223,486	7.0
e-Commerce transactions[(1)]	—	—	1,610,343	253,478	8.0
Others	74,767	0.6	133,860	21,070	0.7
Total revenue	13,077,464	100.0	20,175,102	3,175,681	100.0

Note:

(1) We began treating e-Commerce transactions business as a separate reportable segment on January 1, 2012. No comparative figures for the comparative periods were presented since an insignificant amount of revenue was generated from e-Commerce transactions in periods prior to January 1, 2012.

Revenue from IVAS increased by RMB4,530.4 million, or 42.6%, from RMB10,637.9 million for the six months ended June 30, 2011 to RMB15,168.2 million (US$2,387.6 million) for the six months ended June 30, 2012. Online game revenue grew by RMB3,672.0 million, or 50.9%, from RMB7,213.7 million for the six months ended June 30, 2011 to RMB10,885.7 million (US$1,713.5 million) for the six months ended June 30, 2012. This mainly reflected the increased popularity of our major game titles such as Cross Fire, QQ Dancer, Dungeon and Fighter, and QQ Speed in the PRC market, the growth of our MCGs, as well as contributions from new titles and international markets. Revenue from our community and open platforms increased by 25.1% from RMB3,424.2 million for the six months ended June 30, 2011 to RMB4,282.6 million (US$674.1 million) for the six months ended June 30, 2012, primarily attributable to the growth in our open platforms and QQ Membership. Revenue from our open platforms grew primarily due to a significant increase in item-based sales within applications, including those offered on our SNS platforms. The growth in QQ Membership mainly reflected an expanded subscriber base driven by enhanced privileges and value-added functions. As a percentage of total revenue, revenue from IVAS decreased from 81.3% for the six months ended June 30, 2011 to 75.2% for the six months ended June 30, 2012.

Revenue from MVAS increased by RMB271.2 million, or 17.3%, from RMB1,571.6 million for the six months ended June 30, 2011 to RMB1,842.8 million (US$290.1 million) for the six months ended June 30, 2012. This increase was mainly attributable to an increase in revenue from our bundled SMS packages and mobile games. As a percentage of total revenue, revenue from MVAS decreased from 12.0% for the six months ended June 30, 2011 to 9.1% for the six months ended June 30, 2012.

Revenue from online advertising increased by RMB626.6 million, or 79.0%, from RMB793.2 million for the six months ended June 30, 2011 to RMB1,419.8 million (US$223.5 million) for the six months ended June 30, 2012. In addition to the growth in traditional brand display advertising on our portals, IM clients and other platforms, the business benefited from new revenue contributions from performance display advertising on our social networks, as well as the rapid growth of brand display advertising on our online video platform and search advertising. As a percentage of total revenue, revenue from online advertising increased from 6.1% for the six months ended June 30, 2011 to 7.0% for the six months ended June 30, 2012.

Revenue from e-Commerce transactions was RMB1,610.3 million (US$253.5 million) for the six months ended June 30, 2012. We have stepped up the scale of our e-Commerce transactions business and have presented the business as a new line of segment information starting January 1, 2012. See "Description of selected income statement line items — e-Commerce Transactions" for further details. As a percentage of total revenue, revenue from e-Commerce transactions accounted for 8.0% for the six months ended June 30, 2012.

Revenue from others increased by RMB59.1 million, or 79.0%, from RMB74.8 million for the six months ended June 30, 2011 to RMB134.0 million (US$21.0 million) for the six months ended June 30, 2012.

Cost of revenue. Cost of revenue increased by RMB3,622.3 million, or 80.0%, from RMB4,525.4 million for the six months ended June 30, 2011 to RMB8,147.7 million (US$1,282.5 million) for the six months ended June 30, 2012. This mainly reflected the cost of merchandise sold relating to our e-Commerce transactions business, as well as an increase in sharing costs and staff costs. As a percentage of revenue, cost of revenue increased from 34.6% for the six months ended June 30, 2011 to 40.4% for the six months ended June 30, 2012.

The following table sets forth our cost of revenue by lines of business for the six months ended June 30, 2011 and 2012:

	Six months ended June 30,				
	2011		**2012**		
	Amount	**% of segment revenue**	**Amount**		**% of segment revenue**
	(RMB in thousands)		(RMB in thousands)	(US$ in thousands)	
IVAS	3,530,388	33.2	5,054,197	795,561	33.3
MVAS	619,954	39.4	697,774	109,834	37.9
Online advertising	286,728	36.1	737,471	116,082	51.9
e-Commerce transactions(1)	—	—	1,568,056	246,821	97.4
Others	88,296	118.1	90,198	14,198	67.4
Total cost of revenue	4,525,366	34.6	8,147,696	1,282,496	40.4

Note:

(1) We began treating e-Commerce transactions as a separate reportable segment on January 1, 2012. No comparative figures for the comparative periods were presented since an insignificant amount of revenue was generated from e-Commerce transactions in periods prior to January 1, 2012.

Cost of revenue for IVAS increased by RMB1,523.8 million, or 43.2%, from RMB3,530.4 million for the six months ended June 30, 2011 to RMB5,054.2 million (US$795.6 million) for the six months ended June 30, 2012. This mainly reflected growth in sharing costs driven by increased revenue from licensed games. Other costs also increased as our IVAS business continued to grow. As a percentage of revenue generated from the same segment, cost of revenue was 33.3% for the six months ended June 30, 2012 as compared to 33.2% for the six months ended June 30, 2011 .

Cost of revenue for MVAS increased by RMB77.8 million, or 12.6%, from RMB620.0 million for the six months ended June 30, 2011 to RMB697.8 million (US$109.8 million) for the six months ended June 30, 2012. This was mainly driven by an increase in bandwidth and server custody fees as well as equipment depreciation. Mobile and telecommunications revenue sharing costs also increased in line with our MVAS business growth. As a percentage of revenue generated from the same segment, cost of revenue decreased from 39.4% for the six months ended June 30, 2011 to 37.9% for the six months ended June 30, 2012.

Cost of revenue for online advertising increased by RMB450.7 million, or 157.2%, from RMB286.7 million for the six months ended June 30, 2011 to RMB737.5 million (US$116.1 million) for the six months ended June 30, 2012. The increase was primarily attributable to the allocation of a significant proportion of costs related to our online video platform, which include content costs as well as bandwidth and server custody fees, to the online advertising segment since the fourth quarter of 2011. The increase was also driven by an increase in staff costs, sharing costs for our search advertising business and sales commissions payable to advertising agencies as our online advertising business expanded. As a percentage of revenue generated from the same segment, cost of revenue increased from 36.1% for the six months ended June 30, 2011 to 51.9% for the six months ended June 30, 2012, primarily due to the allocation of costs related to our online video platform.

Cost of revenue for e-Commerce transactions, which primarily consists of cost of merchandise sold through our e-Commerce platforms, was RMB1,568.1 million (US$246.8 million) for the six months ended June 30, 2012.

Cost of revenue for others increased by RMB1.9 million, or 2.2%, from RMB88.3 million for the six months ended June 30, 2011 to RMB90.2 million (US$14.2 million) for the six months ended June 30, 2012.

Gross profit. Gross profit increased by RMB3,475.3 million, or 40.6%, from RMB8,552.1 million for the six months ended June 30, 2011 to RMB12,027.4 million (US$1,893.2 million) for the six months ended June 30, 2012. Our gross margin was 59.6% for the six months ended June 30, 2012 as compared to 65.4% for the six months ended June 30, 2011.

Interest income. Interest income increased by RMB156.3 million, or 75.4%, from RMB207.2 million for the six months ended June 30, 2011 to RMB363.5 million (US$57.2 million) for the six months ended June 30, 2012.

Other (losses)/gains, net. We recorded other losses, net of RMB66.8 million (US$10.6 million) for the six months ended June 30, 2012, compared to other gains, net of RMB341.8 million for the six months ended June 30, 2011. The change mainly reflected the non-recurrence of a deemed disposal gain of RMB459.0 million recognized in February 2011 as a result of the step-up acquisition of a majority stake in Riot Games, Inc., a U.S.-based game developer and publisher in February 2011 (the "**Riot Games Acquisition**"). This was partially offset by a decrease in donations made to the Tencent Charity Fund from RMB100.0 million for the six months ended June 30, 2011 to RMB60.0 million for the six months ended June 30, 2012.

Selling and marketing expenses. Selling and marketing expenses increased by RMB408.9 million, or 61.0%, from RMB669.9 million for the six months ended June 30, 2011 to RMB1,078.9 million (US$169.8 million) for the six months ended June 30, 2012. This primarily reflected an increase in promotion and advertising expenses related to products and platforms such as online games, online security products and mobile applications. Staff costs also increased as our business expanded. As a percentage of total revenue, selling and marketing expenses increased from 5.1% for the six months ended June 30, 2011 to 5.3% for the six months ended June 30, 2012.

General and administrative expenses. General and administrative expenses increased by RMB1,355.4 million, or 60.0%, from RMB2,260.8 million for the six months ended June 30, 2011 to RMB3,616.2 million (US$569.2 million) for the six months ended June 30, 2012. This mainly reflected an increase in research and development expenses, staff costs and other administrative expenses as a result of our business expansion. As a percentage of total revenue, general and administrative expenses increased from 17.3% for the six months ended June 30, 2011 to 17.9% for the six months ended June 30, 2012.

Operating profit. Operating profit increased by RMB1,458.6 million, or 23.6%, from RMB6,170.4 million for the six months ended June 30, 2011 to RMB7,629.0 million (US$1,200.8 million) for the six months ended June 30, 2012.

Finance (costs)/income, net. We recorded finance costs, net of RMB185.2 million (US$29.2 million) for the six months ended June 30, 2012 compared to finance costs, net of RMB2.1 million for the six months ended June 30, 2011. This primarily reflected an increase in interest-bearing debts and the recognition of exchange losses on our foreign currency denominated debts resulting from exchange rate fluctuations in the six months ended June 30, 2012.

Profit before income tax. Profit before income tax increased by RMB1,266.8 million, or 20.5%, from RMB6,164.6 million for the six months ended June 30, 2011 to RMB7,431.4 million (US$1,169.7 million) for the six months ended June 30, 2012.

Income tax expense. Income tax expense increased by RMB421.4 million, or 45.0%, from RMB937.1 million for the six months ended June 30, 2011 to RMB1,358.5 million (US$213.8 million) for the six months ended June 30, 2012. The increase was primarily due to an increase in profit before tax. The increase also reflected a decrease in reversal of deferred tax liabilities arising from the Riot Games Acquisition and lower reversal of income tax expense as a result of the finalization of our corporate income tax assessment.

Profit for the period. As a result of the factors discussed above, profit for the period increased by RMB845.4 million, or 16.2%, from RMB5,227.5 million for the six months ended June 30, 2011 to RMB6,072.9 million (US$955.9 million) for the six months ended June 30, 2012. Our profit margin decreased from 40.0% for the six months ended June 30, 2011 to 30.1% for the six months ended June 30, 2012.

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Revenue. Revenue increased by RMB8,850.0 million, or 45.0%, from RMB19,646.0 million in 2010 to RMB28,496.1 million in 2011.

The following table sets forth our revenue by lines of business for the years ended December 31, 2010 and 2011:

	Year ended December 31,			
	2010		2011	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in thousands)		(RMB in thousands)	
IVAS	15,482,301	78.8	23,042,758	80.8
MVAS	2,715,931	13.8	3,270,841	11.5
Online advertising	1,372,522	7.0	1,992,216	7.0
Others	75,277	0.4	190,257	0.7
Total revenue	19,646,031	100.0	28,496,072	100.0

Revenue from IVAS increased by RMB7,560.5 million, or 48.8%, from RMB15,482.3 million in 2010 to RMB23,042.8 million in 2011. Online game revenue grew by 66.4% from RMB9,509.7 million in 2010 to RMB15,821.4 million in 2011. This increase mainly reflected the growth in existing major game titles such as Cross Fire, Dungeon and Fighter, Qi Xiong Zheng Ba and QQ Speed, the growth of QQ Game Platform, as well as contributions from new game titles such as League of Legends.

Revenue from our community value-added services increased by 20.9% from RMB5,972.6 million in 2010 to RMB7,221.4 million in 2011, mainly attributable to growth in QQ Membership and Qzone. QQ Membership grew on the back of its expanded subscriber base, mainly attributable to continued enhancements in privileges and value-added functions. The increase in revenue from Qzone was mainly driven by growth in its item-based sales as a result of the increase in the number of third-party and in-house applications offered on the platform. As a percentage of total revenue, revenue from IVAS increased from 78.8% in 2010 to 80.8% in 2011.

Revenue from MVAS increased by RMB554.9 million, or 20.4%, from RMB2,715.9 million in 2010 to RMB3,270.8 million in 2011. This increase was mainly attributable to growth in revenue from bundled SMS packages and mobile games. This was partly offset by the negative impact of the new policy on service cancellation introduced by China Mobile in early 2011 which was an extension to the "double confirmation plus reminder service" rule introduced in 2010 and resulted in lower realization rates. As a percentage of total revenue, revenue from MVAS decreased from 13.8% in 2010 to 11.5% in 2011.

Revenue from online advertising increased by RMB619.7 million, or 45.2%, from RMB1,372.5 million in 2010 to RMB1,992.2 million in 2011. Online video advertising and paid search advertising complemented display advertising in driving the revenue growth of our online advertising business. As a percentage of total revenue, revenue from online advertising remained at 7.0%.

Revenue from others increased by RMB115.0 million, or 152.7%, from RMB75.3 million in 2010 to RMB190.3 million in 2011.

Cost of revenue. Cost of revenue increased by RMB3,608.1 million, or 57.1%, from RMB6,320.2 million in 2010 to RMB9,928.3 million in 2011. The increase primarily reflected an increase in sharing costs, staff costs, equipment depreciation as well as bandwidth and server custody fees. As a percentage of revenue, cost of revenue increased from 32.2% in 2010 to 34.8% in 2011.

The following table sets forth our cost of revenue by lines of business for the years ended December 31, 2010 and 2011:

	Year ended December 31,			
	2010		2011	
	Amount	% of segment revenue	Amount	% of segment revenue
	(RMB in thousands)		(RMB in thousands)	
IVAS	4,762,435	30.8	7,633,624	33.1
MVAS	1,010,858	37.2	1,259,756	38.5
Online advertising	441,302	32.2	794,956	39.9
Others	105,605	140.3	239,972	126.1
Total cost of revenue	6,320,200	32.2	9,928,308	34.8

Cost of revenue for IVAS increased by RMB2,871.2 million, or 60.3%, from RMB4,762.4 million in 2010 to RMB7,633.6 million in 2011. This increase was mainly driven by increased sharing costs as a result of the growth in revenue from our licensed games. Equipment depreciation as well as bandwidth and server custody fees also increased due to our expanded business scale. As a percentage of revenue generated from the same segment, cost of revenue increased from 30.8% in 2010 to 33.1% in 2011.

Cost of revenue for MVAS increased by RMB248.9 million, or 24.6%, from RMB1,010.9 million in 2010 to RMB1,259.8 million in 2011. This primarily reflected increased staff costs for the long-term growth of the business. Other costs also increased as our business volume grew. As a percentage of revenue generated from the same segment, cost of revenue increased from 37.2% in 2010 to 38.5% in 2011.

Cost of revenue for online advertising increased by RMB353.7 million, or 80.1%, from RMB441.3 million in 2010 to RMB795.0 million in 2011. This mainly reflected an increase in sharing costs for our search business arising from the significant growth in traffic generated from our search distribution partners and higher sales commissions paid to advertising agencies driven by revenue growth. Bandwidth and server custody fees and staff costs also increased. As a percentage of revenue generated from the same segment, cost of revenue increased from 32.2% in 2010 to 39.9% in 2011.

Cost of revenue for others in 2011 increased by RMB134.4 million, or 127.2%, from RMB105.6 million in 2010 to RMB240.0 million in 2011.

Gross profit. Gross profit increased by RMB5,241.9 million, or 39.3%, from RMB13,325.8 million in 2010 to RMB18,567.8 million in 2011. Our gross margin was 65.2% in 2011 as compared to 67.8% in 2010.

Interest income. Interest income increased by RMB213.1 million, or 83.3%, from RMB255.9 million in 2010 to RMB469.0 million in 2011.

Other gains, net. We recorded other gains, net of RMB420.9 million in 2011, compared to RMB38.1 million in 2010. The change mainly reflected the recognition in 2011 of a deemed disposal gain of RMB459.0 million related to the Riot Games Acquisition and a deemed disposal gain of RMB249.4 million related to the acquisition of an additional stake in Gamegoo Group Limited, an online game developer. This was partially offset in 2011 by an increase in loss on foreign exchange forward contracts, which we entered into for the purpose of managing our foreign currency exposure related to our U.S. dollar denominated borrowings, as well as an increase in donation made to the Tencent Charity Fund. In addition, an impairment provision of RMB243.0 million for selected investee companies was recognized in 2011, whereas no such provision was recognized in 2010.

Selling and marketing expenses. Selling and marketing expenses increased by RMB975.5 million, or 103.2%, from RMB945.4 million in 2010 to RMB1,920.9 million in 2011. This primarily reflected an increase in advertising and promotional spending on products and platforms, including Tencent Microblog, online games, online security products and mobile products, partially offset by a decrease in brand investments. The greater brand investment in 2010 was primarily due to our advertising campaigns for the World Cup and the World Expo in that year. As a percentage of total revenue, selling and marketing expenses increased from 4.8% in 2010 to 6.7% in 2011.

General and administrative expenses. General and administrative expenses increased by RMB2,446.9 million, or 86.3%, from RMB2,836.2 million in 2010 to RMB5,283.2 million in 2011. This mainly reflected the impact of the Riot Games Acquisition, including amortization of identified intangible assets acquired. This also reflected higher research and development expenses, staff costs and administrative expenses as a result of our business growth. Excluding the impact of the Riot Games Acquisition, general and administrative expenses increased by approximately 50.0% in 2011 as compared to 2010. As a percentage of total revenue, general and administrative expenses increased from 14.4% in 2010 to 18.5% in 2011.

Operating profit. Operating profit increased by RMB2,415.3 million, or 24.6%, from RMB9,838.2 million in 2010 to RMB12,253.6 million in 2011.

Finance (costs)/income, net. We recorded finance income, net of RMB35.5 million in 2011 compared to finance costs, net of RMB0.8 million in 2010.

Profit before income tax. Profit before income tax increased by RMB2,185.9 million, or 22.1%, from RMB9,913.1 million in 2010 to RMB12,099.1 million in 2011.

Income tax expense. We recorded income tax expense of RMB1,874.3 million in 2011 compared to RMB1,797.9 million in 2010. The increase was primarily due to growth in profit before income tax, partially offset by the decrease in deferred tax liabilities recognized in relation to withholding taxes applicable on unremitted retained earnings expected to be paid by our PRC subsidiaries to their overseas holding companies. The increase was also partially offset by the reversal of deferred tax liabilities arising from the Riot Games Acquisition.

Profit for the year. As a result of the factors discussed above, profit for the year increased by RMB2,109.6 million, or 26.0%, from RMB8,115.2 million in 2010 to RMB10,224.8 million in 2011. Our profit margin was 35.9% in 2011 compared to 41.3% in 2010.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

Revenue. Revenue increased by RMB7,206.1 million, or 57.9%, from RMB12,440.0 million in 2009 to RMB19,646.0 million in 2010.

The following table sets forth our revenue by lines of business for the years ended December 31, 2009 and 2010:

	Year ended December 31,			
	2009		2010	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in thousands)		(RMB in thousands)	
IVAS	9,530,711	76.6	15,482,301	78.8
MVAS	1,905,599	15.3	2,715,931	13.8
Online advertising	962,171	7.7	1,372,522	7.0
Others	41,479	0.4	75,277	0.4
Total revenue	12,439,960	100.0	19,646,031	100.0

Revenue from IVAS increased by RMB5,951.6 million, or 62.4%, from RMB9,530.7 million in 2009 to RMB15,482.3 million in 2010. Online game revenue grew by 76.6% from RMB5,385.4 million in 2009 to RMB9,509.7 million in 2010. This increase was mainly driven by growth in our online game revenue from our major MMOGs and ACGs including Dungeon and Fighter, Cross Fire, QQ Dancer and QQ Speed. The increase was also driven by revenue contribution from new online games launched during 2010 and growth of QQ Game Platform. Revenue from our community value-added services increased by 44.1% from RMB4,145.3 million in 2009 to RMB5,972.6 million in 2010, mainly attributable to growth in Qzone, QQ Membership and QQ Show. Qzone registered an increase in revenue as we offered more SNS applications, which enhanced user activity and engagement as well as stimulated growth of subscriptions. Revenue from QQ Membership grew as its user base expanded, riding on improved online and offline privileges as well as an increase in subscriptions. The increase in revenue from QQ Show was mainly driven by growth in subscriptions as we focused on enhancing the features and user value of the product. As a percentage of total revenue, revenue from IVAS increased from 76.6% in 2009 to 78.8% in 2010.

Revenue from MVAS increased by RMB810.3 million, or 42.5%, from RMB1,905.6 million in 2009 to RMB2,715.9 million in 2010. This increase was mainly attributable to growth in revenue from our bundled SMS packages as we improved the functionalities and privileges of our products and services.

It also reflected growth in revenue from mobile social games and mobile music services. The increase was partly offset by decline in revenue from WAP services due to the suspension of WAP billing by China Mobile since November 30, 2009, as well as lower revenue from legacy voice value-added services. As a percentage of total revenue, revenue from MVAS decreased from 15.3% in 2009 to 13.8% in 2010.

Revenue from online advertising increased by RMB410.4 million, or 42.6%, from RMB962.2 million in 2009 to RMB1,372.5 million in 2010. The increase mainly reflected growth in our user base, improvements in our advertising platforms, as well as enhancements in our brand position and media influence. This also reflected our focus on leveraging the World Cup and the World Expo to generate business opportunities during the year. Revenue from search advertising declined as we transitioned into our self-developed search engine at the end of the third quarter of 2009. As a percentage of total revenue, revenue from online advertising decreased from 7.7% in 2009 to 7.0% in 2010.

Revenue from others increased by RMB33.8 million, or 81.5%, from RMB41.5 million in 2009 to RMB75.3 million in 2010.

Cost of revenue. Cost of revenue increased by RMB2,430.7 million, or 62.5%, from RMB3,889.5 million in 2009 to RMB6,320.2 million in 2010. The increase primarily reflected an increase in the amount of sharing costs, staff costs and telecommunications operators' revenue share. As a percentage of revenue, cost of revenue increased from 31.3% in 2009 to 32.2% in 2010.

The following table sets forth our cost of revenue by lines of business for the years ended December 31, 2009 and 2010:

	Year ended December 31,			
	2009		2010	
	Amount	% of segment revenue	Amount	% of segment revenue
	(RMB in thousands)		(RMB in thousands)	
IVAS	2,789,225	29.3	4,762,435	30.8
MVAS	727,747	38.2	1,010,858	37.2
Online advertising	297,608	30.9	441,302	32.2
Others	74,888	180.5	105,605	140.3
Total cost of revenue	3,889,468	31.3	6,320,200	32.2

Cost of revenue for IVAS increased by RMB1,973.2 million, or 70.7%, from RMB2,789.2 million in 2009 to RMB4,762.4 million in 2010. This increase was mainly driven by growth in the amount of sharing costs with game developers as a result of a significant increase in revenue from our licensed games, including Cross Fire and Dungeon and Fighter. Other costs such as bandwidth and server custody fees and staff costs also increased due to our business growth. As a percentage of revenue generated from the same segment, cost of revenue increased from 29.3% in 2009 to 30.8% in 2010.

Cost of revenue for MVAS increased by RMB283.1 million, or 38.9%, from RMB727.7 million in 2009 to RMB1,010.9 million in 2010. This primarily reflected an increase in the amount of telecommunications operators' revenue share as a result of revenue growth. Staff costs also increased as we positioned the business for future growth. As a percentage of revenue generated from the same segment, cost of revenue decreased from 38.2% in 2009 to 37.2% in 2010.

Cost of revenue for online advertising increased by RMB143.7 million, or 48.3%, from RMB297.6 million in 2009 to RMB441.3 million in 2010. The increase was primarily due to an increase in sales commissions paid to advertising agencies as a result of the growth of our online advertising business. In addition, staff costs increased due to increasing need of staffing support for the expansion of our online advertising business. As a percentage of revenue generated from the same segment, cost of revenue increased from 30.9% in 2009 to 32.2% in 2010.

Cost of revenue for others in 2010 increased by RMB30.7 million, or 41.0%, from RMB74.9 million in 2009 to RMB105.6 million in 2010.

Gross profit. Gross profit increased by RMB4,775.3 million, or 55.8%, from RMB8,550.5 million in 2009 to RMB13,325.8 million in 2010. Our gross margin was 67.8% in 2010 as compared to 68.7 % in 2009.

Interest income. Interest income increased by RMB119.9 million, or 88.2%, from RMB136.0 million in 2009 to RMB255.9 million in 2010.

Other gains/(losses), net. We recorded other gains, net of RMB38.1 million in 2010, compared to other losses, net of RMB58.2 million in 2009. The change mainly reflected an increase in government subsidies, a decrease in donations made to the Tencent Charity Fund by us from RMB85.0 million in 2009 to RMB70.0 million in 2010, as well as the non-recurring item of the fair value gains on financial assets held for trading recognized in 2009.

Selling and marketing expenses. Selling and marketing expenses increased by RMB363.9 million, or 62.6%, from RMB581.5 million in 2009 to RMB945.4 million in 2010. This primarily reflected an increase in advertising spending on our corporate brand, mainly as a result of our campaigns related to the World Cup and the World Expo. It also reflected higher promotional expenses associated with our online games and an increase in staff costs. As a percentage of total revenue, selling and marketing expenses increased slightly from 4.7% in 2009 to 4.8% in 2010.

General and administrative expenses. General and administrative expenses increased by RMB809.9 million, or 40.0%, from RMB2,026.3 million in 2009 to RMB2,836.2 million in 2010. This mainly reflected an increase in research and development expenses as we expanded our research and development effort to support our growth strategy. Staff costs for supporting functions and other administrative expenses also increased as our business scale grew. As a percentage of total revenue, general and administrative expenses decreased from 16.3% in 2009 to 14.4% in 2010.

Operating profit. Operating profit increased by RMB3,817.7 million, or 63.4%, from RMB6,020.5 million in 2009 to RMB9,838.2 million in 2010.

Finance costs, net. Finance costs, net decreased by RMB1.1 million, or 57.1%, from RMB2.0 million in 2009 to RMB0.8 million in 2010.

Profit before income tax. Profit before income tax increased by RMB3,872.4 million, or 64.1%, from RMB6,040.7 million in 2009 to RMB9,913.1 million in 2010.

Income tax expense. We recorded income tax expense of RMB1,797.9 million in 2010 compared to RMB819.1 million in 2009. The increase was primarily due to growth in profit before income tax as well as an increase in deferred tax liabilities recognized relating to intra-group dividend expected to be paid by our PRC subsidiaries to their overseas parent companies. It also reflected higher tax rates for certain subsidiaries and consolidated affiliated entities of the Company.

Profit for the year. As a result of the factors discussed above, profit for the year increased by RMB2,893.6 million, or 55.4%, from RMB5,221.6 million in 2009 to RMB8,115.2 million in 2010. Our profit margin was 41.3% in 2010 compared to 42.0% in 2009.

QUARTERLY RESULTS OF OPERATIONS

The following table presents our unaudited quarterly results of operations for the most recent eight quarters. You should read the table in conjunction with the consolidated financial information contained elsewhere in this document. This table includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary to fairly present results of operations for the quarters presented. Results of operations for any quarter are not necessarily indicative of results for any future quarters or full year.

	Three months ended							
	Sept. 30, 2010	**Dec. 31, 2010**	**Mar. 31, 2011**	**June 30, 2011**	**Sept. 30 2011**	**Dec. 31, 2011**	**Mar. 31, 2012**	**June 30, 2012**
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)
Revenue:								
Internet value-added services	4,129,008	4,383,940	5,251,282	5,386,578	6,003,135	6,401,763	7,381,621	7,786,625
Mobile and telecommunications value-added services	695,057	728,516	777,792	793,839	844,900	854,310	913,842	929,007
Online advertising	382,542	388,126	280,894	512,312	600,572	598,438	540,113	879,691
e-Commerce transactions[(1)]	—	—	—	—	—	—	752,817	857,526
Others	20,021	23,581	28,452	46,315	47,550	67,940	59,465	74,395
Total revenue	5,226,628	5,524,163	6,338,420	6,739,044	7,496,157	7,922,451	9,647,858	10,527,244
Cost of revenue	(1,676,544)	(1,832,362)	(2,193,729)	(2,331,637)	(2,661,407)	(2,741,535)	(3,836,317)	(4,311,379)
Gross profit	3,550,084	3,691,801	4,144,691	4,407,407	4,834,750	5,180,916	5,811,541	6,215,865
Interest income	65,259	79,467	100,662	106,546	124,159	137,623	166,733	196,806
Other gains/(losses), net	22,479	23,437	339,069	2,809	9,200	69,725	(63,642)	(3,219)
Selling and marketing expenses	(227,817)	(301,796)	(300,453)	(369,491)	(507,252)	(743,657)	(469,200)	(609,672)
General and administrative expenses	(744,092)	(840,407)	(897,466)	(1,363,372)	(1,469,278)	(1,553,038)	(1,754,074)	(1,862,165)
Operating profit	2,665,913	2,652,502	3,386,503	2,783,899	2,991,579	3,091,569	3,691,358	3,937,615
Finance income/(costs), net	3,431	265	(3,869)	1,771	43,097	(5,494)	(69,982)	(115,256)
Share of profit/(losses) of associates	10,985	37,127	37,854	23,454	(21,842)	(63,721)	(9,753)	5,411
Share of profit/(losses) of jointly controlled entities	—	3,399	(4,297)	(60,689)	(59,926)	(40,819)	1,380	(9,375)
Profit before income tax	2,680,329	2,693,293	3,416,191	2,748,435	2,952,908	2,981,535	3,613,003	3,818,395
Income tax expense	(512,013)	(480,011)	(531,983)	(405,163)	(506,760)	(430,332)	(650,673)	(707,824)
Profit for the period	2,168,316	2,213,282	2,884,208	2,343,272	2,446,148	2,551,203	2,962,330	3,110,571

Note:

(1) We began treating e-Commerce transactions business as a separate reportable segment on January 1, 2012. No comparative figures for the comparative periods were presented since an insignificant amount of revenue was generated from e-Commerce transactions in periods prior to January 1, 2012.

We have experienced consistent growth in our quarterly revenue for the eight quarters in the period from July 1, 2010 to June 30, 2012. The growth in our quarterly revenue was primarily attributable to increases in revenue from our IVAS, driven by growth in our online game revenue due to the increased popularity of our existing games, the introduction of new games as well as growth in community and open platforms. In addition, our e-Commerce transactions business experienced significant growth in the first two quarters in 2012 as we enlarged the scale of our e-Commerce transactions business. Our online advertising business was subject to seasonal fluctuation as advertisers usually reduce their advertising spending around the Chinese New Year holidays in the first quarter.

LIQUIDITY AND CAPITAL RESOURCES

On a consolidated basis, we currently fund our operations primarily with cash flows from operating activities. Our cash requirements relate primarily to:

- our working capital requirements, such as sharing costs, staff costs, bandwidth leasing and server custody fees, sales and marketing expenses and research and development expenses; and

- costs associated with the expansion of our business, such as the purchase of servers and network equipment.

We had cash and cash equivalents of RMB6,043.7 million, RMB10,408.3 million, RMB12,612.1 million and RMB10,602.5 million (US$1,668.9 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. Our term deposits with initial term of over three months were RMB5,310.2 million, RMB11,725.7 million and RMB13,716.0 million and RMB17,014.7 million (US$2,678.2 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively.

Our net current assets were RMB8,593.9 million, RMB12,351.7 million, RMB14,320.1 million and RMB15,931.8 million (US$2,507.8 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. Net current assets increased in 2011 as compared to 2010 primarily due to the higher levels of cash and cash equivalents, prepayments, deposits and other receivables, term deposits with initial term of over three months and restricted cash, partially offset by increases in other payables and accruals, short-term borrowings and deferred revenue in the same period. Net current assets increased in 2010 as compared to 2009 primarily due to the higher levels of cash and cash equivalents and term deposits with initial term of over three months in 2010, which was partially offset by the increase in short-term borrowings in the same period.

We bill and collect revenue for our value-added services principally through these channels: prepaid Q-Coin cards, e-sales system, telecommunications operators and online banking. A majority of our revenue from value-added services are prepaid through Q-Coin cards, e-sales system and online banking, allowing us to minimize our credit risk.

Our accounts receivable were RMB1,229.4 million, RMB1,715.4 million, RMB2,020.8 million and RMB2,500.2 million (US$393.5 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. Our accounts receivable days, which are calculated by the average of the amount of accounts receivable at the beginning of the period and the end of the period divided by the amount of revenue for the period multiplied by the number of days in the period, were 32.5 days, 27.4 days, 23.9 days and 20.4 days in 2009, 2010, 2011 and the six months ended June 30, 2012, respectively. While there are no contractual requirements for telecommunications operators to pay amounts owed to us within a specified period of time, these operators usually settle the amounts due by them within a period of 30 to 120 days. Online advertising customers, which are mainly advertising agencies, are usually granted a credit of 90 days after full execution of the contracted advertisement order.

Our accounts payable were RMB696.5 million, RMB1,380.5 million, RMB2,244.1 million and RMB3,368.4 million (US$530.2 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. We normally settle the amount due to us according to the terms of our contracts.

Cash Flows

The following table sets forth our cash flows information for the years ended December 31, 2009, 2010 and 2011 and for the six months ended June 30, 2011 and 2012:

	Year ended December 31,			Six months ended June 30,		
	2009	2010	2011	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Net cash flows generated from operating activities	8,398,365	12,319,293	13,358,107	5,434,115	8,945,857	1,408,131
Net cash flows used in investment activities	(5,024,795)	(12,014,997)	(15,354,758)	(9,547,558)	(6,455,778)	(1,016,178)
Net cash flows (used in)/generated from financing activities	(397,110)	4,112,146	4,373,024	1,741,476	(4,506,408)	(709,335)
Net increase in cash and cash equivalents	2,976,460	4,416,442	2,376,373	(2,371,967)	(2,016,329)	(317,382)
Cash and cash equivalents at beginning of year/period	3,067,928	6,043,696	10,408,257	10,408,257	12,612,140	1,985,226
Exchange (losses)/gains on cash and cash equivalents	(692)	(51,881)	(172,490)	(73,200)	6,640	1,045
Cash and cash equivalents at end of year/period	6,043,696	10,408,257	12,612,140	7,963,090	10,602,451	1,668,889

Cash Flows from Operating Activities

For the six months ended June 30, 2012, we had a cash inflow from operating activities in the amount of RMB8,945.9 million (US$1,408.1 million). This was primarily a result of net cash flows generated from operation before changes in working capital in the amount of RMB8,876.1 million and changes in working capital in the amount of RMB1,173.9 million. Our net cash inflow from operating activities was after deduction of income tax paid of RMB1,104.1 million. The changes in working capital primarily consisted of (i) an increase in deferred revenue of RMB1,844.5 million, (ii) an increase in account payable of RMB1,034.7 million and (iii) an increase in other tax liabilities of RMB113.7 million, partially offset by (i) an increase in prepayments, deposits and other receivables of RMB1,319.1 million, (ii) an increase in accounts receivable of RMB450.8 million and (iii) an increase in restricted cash of RMB122.1 million.

In 2011, we had a cash inflow from operating activities in the amount of RMB13,358.1 million. This was primarily a result of net cash flows generated from operation before changes in working capital in the amount of RMB14,017.1 million and changes in working capital in the amount of RMB1,177.3 million. Our net cash inflow from operating activities was after deduction of income tax paid of RMB1,836.3 million. The changes in working capital primarily consisted of (i) an increase in deferred revenue of RMB2,253.1 million, (ii) an increase in other payables and accruals of RMB1,816.3 million, (iii) an increase in long-term payables of RMB1,057.6 million and (iv) an increase in accounts payable of RMB827.6 million, partially offset by (i) an increase in prepayments, deposits and other receivables of RMB2,630.4 million, (ii) an increase in restricted cash of RMB1,850.6 million, (iii) an increase in accounts receivable of RMB250.7 million and (iv) a decrease in other tax liabilities of RMB45.7 million.

In 2010, we had a cash inflow from operating activities in the amount of RMB12,319.3 million. This was primarily a result of net cash generated from operation before changes in working capital in the amount of RMB10,843.1 million and changes in working capital in the amount of RMB2,348.6 million. Our net cash inflow from operating activities was after deduction of income tax paid of

RMB872.4 million. The changes in working capital primarily consisted of (i) an increase in other payables and accruals of RMB1,551.2 million, (ii) an increase in deferred revenue of RMB1,024.6 million, (iii) an increase in accounts payable of RMB478.3 million and (iv) an increase in other tax liabilities of RMB9.9 million, partially offset by (i) an increase in accounts receivable by RMB483.7 million, (ii) a decrease in long-term payables of RMB179.8 million and (iii) and an increase in prepayments, deposits and other receivables of RMB51.9 million.

In 2009, we had a cash inflow from operating activities in the amount of RMB8,398.4 million. This was primarily a result of net cash generated from operation before changes in working capital in the amount of RMB6,748.8 million and changes in working capital in the amount of RMB2,106.0 million. Our net cash inflow from operating activities was after deduction of income tax paid of RMB456.4 million. The changes in working capital primarily consisted of (i) an increase in deferred revenue of RMB1,053.8 million, (ii) an increase in other payables and accruals of RMB608.8 million, (iii) a decrease in financial assets held for trading of RMB329.8 million, (iv) an increase in accounts payable of RMB247.5 million, (v) an increase in other tax liabilities of RMB113.0 million, (vi) a decrease in prepayments, deposits and other receivables of RMB36.9 million and (vii) a decrease in inventories of RMB5.5 million, partially offset by (i) an increase in accounts receivables of RMB246.0 million and (ii) a decrease in long-term payables of RMB43.3 million.

Cash Flows from Investing Activities

Net cash used in investing activities for the six months ended June 30, 2012 was RMB6,455.8 million (US$1,016.2 million), primarily reflecting the net payment flow for the term deposits with initial term of over three months of RMB3,298.7 million, the prepayment of interest in associates of RMB2,118.9 million and the purchase of fixed assets and construction in progress of RMB1,853.4 million, partially offset by receipt from restricted cash of RMB2,747.3 million.

Net cash used in investing activities for the year ended December 31, 2011 was RMB15,354.8 million, primarily reflecting the purchase of fixed assets, construction in progress and investment properties in the amount of RMB4,046.2 million and payments for investment in associates in the amount of RMB3,427.4 million, payment for restricted cash in the amount of RMB2,055.5 million and the net payment flow for term deposits with initial term of over three months in the amount of RMB1,990.3 million.

Net cash used in investing activities for the year ended December 31, 2010 was RMB12,015.0 million, primarily reflecting the net payment flow for term deposits with initial term of over three months in the amount of RMB6,415.6 million and the purchase of available-for-sale financial assets in the amount of RMB2,179.1 million mainly relating to our investment in Mail.ru, one of the largest Internet companies in the Russian-speaking and Eastern European markets, the IPO of which was completed in November 2010.

Net cash used in investing activities for the year ended December 31, 2009 was RMB5,024.8 million, primarily reflecting the net payment flow for term deposits with initial term of over three months in the amount of RMB3,647.7 million.

Cash Flows from Financing Activities

Net cash used in financing activities for the six months ended June 30, 2012 was RMB4,506.4 million (US$709.3 million), primarily reflecting repayment of short-term bank borrowings of RMB5,358.3 million, dividend paid to the Company's shareholders and the non-controlling interest owners of RMB1,126.1 million, partially offset by proceeds from long-term bank borrowings of RMB950.3 million and proceeds from short-term bank borrowings of RMB942.9 million.

Net cash generated from financing activities for the year ended December 31, 2011 was RMB4,373.0 million, primarily reflecting proceeds from short-term borrowings of RMB6,682.8 million and net proceeds from issuance of long-term notes of RMB3,760.9 million, partially offset by repayment of short-term borrowings of RMB3,765.9 million, payments for repurchase of shares of RMB1,047.0 million and dividend paid to the Company's shareholders and the non-controlling interest owners of RMB894.8 million.

Net cash generated from financing activities for the year ended December 31, 2010 was RMB4,112.1 million, primarily reflecting proceeds from short-term borrowings of RMB5,298.9 million, partially offset by dividends paid to the Company's shareholders and the non-controlling interest owners of RMB706.0 million.

Net cash used in financing activities for the year ended December 31, 2009 was RMB397.1 million, primarily reflecting dividends paid to the Company's shareholders and the non-controlling interest owners of RMB586.7 million.

Capital Expenditure

Our capital expenditures consisted of additions to fixed assets which primarily include computers and servers, construction in progress, land use rights and intangible assets (excluding game and other content licenses) were RMB1,026.5 million, RMB2,007.0 million and RMB4,158.6 million and RMB2,184.4 million (US$343.8 million) for the years ended 2009, 2010 and 2011 and the six months ended June 30, 2012, respectively.

We believe that our existing cash and cash equivalents, cash flows from operations, term deposits with initial term of over three months will be sufficient to meet the anticipated cash needs for our operating activities and capital expenditures for at least the next 12 months.

INDEBTEDNESS

Our total short-term borrowings amounted to RMB202.3 million, RMB5,298.9 million, RMB7,999.4 million and RMB3,609.3 million (US$568.1 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively.

Our total long-term debt amounted to RMB0, RMB0, RMB3,733.3 million and RMB4,700.6 million (US$739.9 million) as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. On December 12, 2011, we completed the issue of the 4.625% Senior Notes. The 4.625% Senior Notes bear an interest at 4.625% per annum from December 12, 2011, payable semi-annually in arrears on June 12 and December 12 of each year, beginning on June 12, 2012. The 4.625% Senior Notes will mature on December 12, 2016. See "Description of Other Material Indebtedness — 4.625% Senior Notes Due 2016".

The following table sets forth our debt as of the dates indicated:

	As of December 31,			As of June 30,	
	2009	2010	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Current:					
RMB bank borrowings					
— secured[(1)]	202,322	990,887	2,958,720	320,375	50,429
— unsecured	—	334,440	—	—	—
	202,322	1,325,327	2,958,720	320,375	50,429
U.S. dollar bank borrowings					
— unsecured[(2)]	—	3,973,620	4,410,630	3,288,948	517,700
Bonds — unsecured[(3)]	—	—	630,090	—	—
	202,322	5,298,947	7,999,440	3,609,323	568,129
Non-current:					
U.S. dollar bank borrowings — unsecured[(4)]	—	—	—	948,735	149,336
Long-term notes — unsecured[(5)]	—	—	3,733,331	3,751,839	590,562
	—	—	3,733,331	4,700,574	739,898
Total	202,322	5,298,947	11,732,771	8,309,897	1,308,027

Notes:

(1) Our secured bank borrowings of RMB320.4 million as of June 30, 2012 were secured by a pledge of bank deposits of RMB324.3 million with the banks.

(2) Unsecured short-term bank borrowings of carrying amount of RMB3,288.9 million as of June 30, 2012 were denominated in USD. The aggregate principal amount was US$520.0 million and the interest rates were LIBOR plus 0.85% to 1.75% per annum. In addition, we entered into foreign exchange forward contracts to purchase the required amount of U.S. dollar with RMB for settling some of the bank borrowings with an aggregate principal amount of US$45.0 million upon the respective borrowing due dates. However, we arranged the bank loans and the forward contracts with different banks, and we did not adopt hedge accounting. As a result, these bank borrowings and the relevant foreign exchange forward contracts were accounted for separately. The bank borrowings were accounted for as U.S. dollar denominated bank borrowings and stated at amortized cost, while the forward contracts were accounted for as derivative financial instruments stated at fair value with their gains or losses recorded in “Other (losses)/gains, net” in the consolidated income statement.

(3) In March 2011, we issued U.S. dollar denominated bonds at par value of US$100.0 million. The bonds were unsecured and bore a floating rate of LIBOR plus 0.25% per annum. The bonds matured and were fully paid off in March 2012. The Group also entered into foreign exchange forward contracts to purchase the required amount of U.S. dollar with RMB for settling the principal amount of the bonds upon their due dates. The accounting treatments for the bonds and related foreign exchange forward contracts are the same as those mentioned in (2) above.

(4) Unsecured long-term bank borrowing of carrying amount of RMB948.7 million as of June 30, 2012, was denominated in USD. The aggregate principal amount was US$150.0 million and the interest rate was LIBOR plus 2.44% per annum.

(5) On December 12, 2011, we issued the 4.625% Senior Notes in an aggregate principal amount of US$600.0 million that will mature on December 12, 2016. The 4.625% Senior Notes bear an interest at 4.625% per annum from December 12, 2011, payable semi-annually in arrears on June 12 and December 12 of each year, beginning on June 12, 2012. The 4.625% Senior Notes were issued at 99.74% of the aggregate principal amount.

CONTRACTUAL OBLIGATIONS

Capital Commitments

The following table sets forth our capital commitments as of the dates indicated:

	As of December 31,			As of June 30,	
	2009	2010	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Contracted:					
Construction/purchase of building and purchase of land use right	36,215	211,558	463,046	589,375	92,771
Purchase of other fixed assets ...	55,606	135,165	132,260	149,685	23,561
Capital investment in investees .	14,335	100,996	816,910	1,075,357	169,268
	106,156	447,719	1,412,216	1,814,417	285,600
Authorized but not contracted:					
Construction/purchase of building and purchase of land use right	247,001	373,277	1,186,867	1,049,033	165,124
Capital investment in investees .	19,802	385,000	651,927	450,772	70,954
	266,803	758,277	1,838,794	1,499,805	236,078
Total	372,959	1,205,996	3,251,010	3,314,222	521,678

Operating Lease Commitments

The following table sets forth the future aggregate minimum lease payments under non-cancellable operating leases in respect of buildings as of the dates indicated:

	As of December 31,			As of June 30,	
	2009	2010	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Contracted:					
Within one year	67,893	236,343	520,396	505,969	79,643
Beyond one year and within five years	86,730	572,818	1,462,788	1,301,742	204,902
Beyond five years	3,242	18,845	286,135	255,295	40,185
Total..	157,865	828,006	2,269,319	2,063,006	324,730

Other Commitments

The following table sets forth the future aggregate minimum payments under non-cancellable bandwidth and server custody leases and online game licensing and content agreements as of the dates indicated:

	As of December 31,			As of June 30,	
	2009	2010	2011	2012	
	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(RMB in thousands)	(US$ in thousands)
Contracted:					
Within one year	357,632	1,064,792	596,031	1,024,238	161,221
Beyond one year and within five years	171,230	1,981,543	768,291	1,333,948	209,971
Total	528,862	3,046,335	1,364,322	2,358,186	371,192

Off-balance Sheet Commitments and Arrangements

Except for the commitments set forth above, we had no material off-balance sheet transactions or arrangements as of June 30, 2012.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT FINANCIAL RISK

Interest Rate Risk

We have interest-bearing assets including loans to associates and a jointly controlled entity, term deposits with initial term of over three months and cash and cash equivalents. Our exposure to market rate risk for changes in interest rates relates primarily to our debt (including short-term borrowings, long-term borrowings and long-term notes issued). Borrowings issued at variable rates expose us to cash flows interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose us to fair value interest rate risk. We have had bank borrowings and issued long-term notes denominated in U.S. dollars having variable and fixed interest rates as of June 30, 2012. Concurrently upon the draw-down of certain short-term borrowings, we entered into forward foreign exchange contracts to buy U.S. dollars by selling RMB at designated future periods which substantially coincide with the respective loan maturity dates.

Price Risk

We are exposed to price risk because of our investments which are classified as available-for-sale financial assets and derivative financial instruments. These investments were made either for improving investment yield, maintaining high liquidity level simultaneously, or were strategic investments. To manage our price risk arising from the investments, we diversify our portfolio. Each investment is managed by our senior management, including the executive Directors, on a case by case basis. These investments are held for strategic rather than trading purposes and we do not actively trade these investments. We are not exposed to commodity price risk.

Credit Risk

We are exposed to credit risk in relation to our cash and deposits (including restricted cash) with banks and financial institutions, financial assets held for trading and other investments, as well as accounts and other receivables. The carrying amount of each class of the above financial assets represents our maximum exposure to credit risk in relation to the corresponding class of financial assets. To manage this risk, deposits are primarily placed with state-owned financial institutions in the PRC and high quality international financial institutions outside the PRC. There was no recent history of default of cash and cash equivalents and term deposits with initial term of over three months in relation to these financial institutions.

We may be also exposed to risks relating to our accounts receivable from telecommunications operators and advertising customers. A large portion of our Internet and Mobile Services Fees are derived from the service agreements with China Mobile, China Unicom and China Telecom. If the strategic relationship with the telecommunications operators is terminated or scaled back, the telecommunications operators alter the service agreements, or these operators experience financial difficulties and are unable to pay us, our MVAS and IVAS might be adversely affected in terms of recoverability of receivables. To manage this risk, we maintain frequent communication with the telecommunications operators to ensure the cooperation is effective. In view of our history of cooperation with the telecommunications operators and the sound collection history of receivables due from them, we believe that the credit risk inherent in our outstanding accounts receivable balances from these telecommunications operators is low.

We manage the risk relating to our accounts receivables from advertising customers by assessing the credit quality of each customer, taking into account their financial position, past experience and other factors, generally required prepayments representing a certain percentage of the total service fees for each advertising service.

Foreign Currency Exchange Risk

We mainly operate in the PRC with most of our transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government. Therefore, to maintain the flexibility in our activities including payment of dividends, share repurchases and offshore investments, we hold some monetary assets denominated in U.S. dollars or H.K. dollars subject to certain thresholds stated in our treasury mandate, borrow some loans denominated in U.S. dollars and issue long-term notes denominated in U.S. dollars from time to time. This exposes us to foreign exchange risk.

There is no other written policy to manage the foreign exchange risk in relation to U.S. dollars and H.K. dollars as management considers that such risk cannot be effectively reduced in a low-cost way. However, we have entered into certain foreign exchange forward contracts arrangements for managing our foreign exchange risk in relation to banks loans denominated in U.S. dollars.

Liquidity Risk

We aim to maintain sufficient cash and cash equivalents and marketable securities. Due to the dynamic nature of our underlying businesses, we maintain flexibility in funding by maintaining adequate cash and cash equivalents. In order to improve liquidity, we also issued long-term notes and entered into long-term borrowings. We will, based on an assessment of relevant future costs and benefits, pursue such funding options as are appropriate.

The information and statistics set out in this section have been derived, in part, from various government publications and databases. This information has not been independently verified by us, or any of our affiliates. The information and statistics set out in this section may not be consistent with other information and statistics compiled within or outside the PRC.

PRC INTERNET MARKET OVERVIEW

The PRC has the world's largest Internet user base measured by the total number of Internet users. According to CNNIC, the Internet population in the PRC grew from 137 million to 538 million between December 2006 and June 2012. The following table sets forth the number of PRC Internet users from December 2006 to June 2012:

	As of December 31,						As of June 30,
	2006	2007	2008	2009	2010	2011	2012
	(in millions)						
PRC Internet Users........	137	210	298	384	457	513	538

Source: CNNIC

Over the past few years, PRC Internet users have spent an increasing amount of time online. According to CNNIC, average user time spent online increased from 16.9 hours per week in 2006 to 19.9 hours per week in the first half of 2012. In parallel with this trend, PRC Internet users' online activities have become more diversified. IM, search, online music, online news, online video, online games, blogs / personalized space and microblog were used by at least 50% of Internet users in the first half of 2012 according to CNNIC. The following tables set forth the hours spent online per week per Internet user and PRC Internet users' online activities:

	2006	2007	2008	2009	2010	2011	1H 2012
	(hours)						
Hours Spent Online per Week per Internet User	16.9	16.2	16.6	18.7	18.3	18.7	19.9

Source: CNNIC

PRC Internet Users' Online Activities	% of Internet Users Participating (in 1H 2012)
IM	82.8
Search	79.7
Online Music	76.4
Online News	73.0
Blogs / Personalized Space	65.7
Online Video	65.1
Online Games	61.6
Microblog	50.9
Email	48.1
SNS	46.6
Online Shopping	39.0
Online Literature	36.2
Online Banking	35.5
Online Payment	34.8
Online Forum / BBS	29.0
Group Buying	11.5
Online Travel Booking	7.9
Online Stock Trading	7.0

Source: CNNIC

It is expected that growth in the PRC Internet user base will continue as Internet penetration levels in the PRC are still significantly lower than developed markets. According to CNNIC, the PRC Internet penetration rate at June 30, 2012 was 40%. This contrasts sharply with developed markets such as the United States and Japan where the Internet penetration rates were 78% and 80% respectively in 2011, according to Internet World Stats. The following table sets forth the number of Internet users and Internet user penetration in the PRC and other developed markets:

	PRC[1]	United States[2]	European Union[2]	Japan[2]	South Korea[2]
	(in millions, except for %)				
Internet Users	538	245	360	101	40
Internet User Penetration over Total Population	40%	78%	72%	80%	83%

Source: CNNIC, www.internetworldstats.com

Notes: 1. As of June 30, 2012

2. As of December 31, 2011

Geographically, the growth of the PRC Internet user population is expected to be driven by lower tier cities and rural areas. According to CNNIC, while first-tier cities have high Internet penetration rates, the Internet penetration of lower tier cities and rural areas has been catching up. Internet penetration rates for rural areas have been steadily increasing and demonstrated higher user growth in 2011. This would suggest there is still significant potential for future growth.

PRC IM SERVICE MARKET

IM services enable Internet users to communicate real-time with one another over the Internet or mobile networks. To use IM services, users download the IM client software on their devices and register for personal user accounts. When the IM application is launched, users are able to add friends as contacts on personal "contact lists", see who is online from each contact list, and send/receive messages with online and offline contacts. IM services offer users the option to communicate with mobile or other terminal devices via text, video, voice, picture or other mediums.

IM has become one of the most popular Internet applications in the PRC. According to iResearch, the number of IM users in the PRC was estimated to increase from 270 million to 420 million between 2009 and 2011. This figure is expected to reach 630 million by 2014. Meanwhile, the number of mobile IM users in the PRC was estimated to increase from 182 million to 335 million between 2009 and 2011. This figure is expected to reach 712 million by 2014. According to CNNIC, 82.8% of Internet users and 83.0% mobile Internet users in the PRC have IM applications as of June 30, 2012. The following table sets forth the total PRC IM and PRC mobile IM users:

	2009	**2010**	**2011E**	**2012E**	**2013E**	**2014E**
				(in millions)		
PRC IM Users	270	350	420	490	560	630
PRC Mobile IM Users	182	202	335	443	576	712

Source: iResearch

The PRC IM service market is highly concentrated. According to iResearch, Tencent enjoyed a 72.7% market share in 2010. The rest of the market is divided amongst a select few players with niche focuses. This market concentration is primarily attributed to the network effect of IM services. The network effect binds existing users and facilitates the acquisition of new users through word of mouth and real world social networks. Most users tend to rely on their existing IM service for day-to-day communication and are reluctant to move existing connections and online content to another platform given the time-consuming and inconvenient nature of the process. The following table sets forth information related to the competitive landscape of the PRC IM market:

	2010 Market Share
	%
QQ	72.7
Ali Wang Wang	7.0
Fetion	5.4
MSN	4.7

Source: iResearch

Note: Market share is measured by user preference of IM services in 2010

IM service providers typically monetize their IM platform and user base by offering fee-based IVAS and premium services, in addition to providing online advertising. Established service providers with larger user bases and more diversified service offerings are better positioned to monetize their user bases given the opportunities for cross selling of products and services to users.

PRC SNS MARKET

SNS enables users to build and reflect their real life social circles and relationships online. Consumers are moving beyond the standardized media formats of content sites and portals and are instead using social media tools such as photo sharing, news feeds, blogs and microblogs to discover, share and consume personalized content.

SNS has become increasingly popular in the PRC. According to Strategy Analytics' Digital Media Strategies Service, the total number of SNS users in the PRC was estimated to increase from 155 million to 289 million between 2009 and 2011. This figure is expected to increase to 481 million by 2014. This represents a five year CAGR of 25% between 2009 and 2014.

Microblog service, a form of social media services, has grown rapidly since their initial emergence in 2010. The microblog service is characterized as an information dissemination platform for users to broadcast news and other updates. Tencent and Sina currently operate the most popular microblog platforms in the PRC. As of June 30, 2012, Tencent had 468.7 million registered user accounts and Sina had over 368 million registered user accounts.

As the user base of social networking platforms continues to grow in size and sophistication, providing new applications is vital to attracting new users and maintaining user engagement. SNS providers with open platforms will be best positioned to capture new customers in an increasingly competitive market. By providing users with access to third-party applications, social networking platforms will be able to offer a more diverse portfolio of services, products and functionalities. With access to large user bases, third-party application developers are incentivized to offer engaging products for increased monetization opportunities. Ultimately, this enhances the users' online experiences, whilst providing the necessary infrastructure for group applications such as social commerce and social games.

The SNS market in the PRC is still young and evolving. Similar to IM service providers, successful SNS providers typically enjoy strong network effects, including brand awareness, and user stickiness derived from the non-transferable nature of content from one network to another. Leading SNS providers in the PRC include Tencent, Sina and Renren. In June 2012, Tencent is the largest SNS provider in the PRC in terms of monthly time spent by users in the PRC according to iResearch.

As the Internet economy continues to evolve in the PRC, new monetization models for SNS are expected to emerge. At present, online advertising and fee-based value-added services facilitated by micro-transactions are the two major monetization models. Examples of paid value-added services include virtual gift items or profile enhancements such as personalized avatars. The following table sets forth information relating to the market size of the PRC SNS market.

	2009	2010	2011E	2012E	2013E	2014E
			(US$ in millions)			
PRC SNS Market Size	183	342	536	761	1,013	1,203

Source: Strategy Analytics' Digital Media Strategies Service

PRC ONLINE GAMES MARKET

Online games are played on PCs or mobile devices that are supported by network game servers through the transmission and storage of data over the Internet. Online games provide users with a highly interactive, immersive, and affordable entertainment experience.

Online games can be categorized as MCGs, ACGs, MMOGs and web games. MCGs generally target the mass market. These games have relatively simple graphics and rules that make them easy to learn and play. They can generally be played to a conclusion in a relatively short duration of time. Examples of MCGs include online trivia games and puzzle/board games such as chess and backgammon. ACGs generally incorporate a story line, offer more elaborate graphics, virtual items and frequent interactions among a few game players, and are also session-based. Examples of ACGs include first-person shooting games, racing games and music games. MMOGs are action adventure-based games that generally draw upon themes such as martial arts, combat, fantasy, adventure or historical events. Each MMOG creates an evolving virtual world within which thousands of game players can play and interact with one another or with "non-playing characters" in real-time over the Internet. Web games are browser-based online games that generally support online multiplayer features and have relatively simpler game rules and more basic graphics compared to client-based games. Web games, which do not require installation of any client software or plug-in before playing the game, have lower entry barriers than client-based games in terms of easier access by users and shorter game development process from developer perspective. Web games are usually monetized through sales of virtual items.

The PRC has a very large online game population. According to IDC, the number of PRC online game players increased from approximately 64 million in 2009 to approximately 86 million in 2011. This figure is expected to increase to approximately 114 million by 2014. The number of paying online game players increased from approximately 36 million in 2009 to approximately 49 million in 2011 and is expected to increase further to approximately 72 million in 2014. The following table sets forth information related to the PRC online game population:

	2009	**2010**	**2011**	**2012E**	**2013E**	**2014E**
			(in millions)			
PRC Online Game Players	64	76	86	95	104	114
PRC Paying Online Game Players	36	43	49	57	64	72

Source: IDC China Online Gaming 2011-2015 Market Analysis and Forecast

There are currently two major online game revenue models in the PRC: the item-based revenue model and the time-based revenue model. Under the item-based revenue model, which is also referred to as the micro-transaction model, game players can play for free, but may choose to pay for virtual items and other value-added services provided by game operators to enhance their game-playing experience. The item-based revenue model is currently the dominant revenue model for online games in the PRC. Under the time-based revenue model, which is also referred to as the subscription model, players are required to pay for online games based on total playing time. According to IDC, online game revenue in the PRC increased from approximately US$3.7 billion to approximately US$5.8 billion between 2009 and 2011. This figure is expected to increase to approximately US$8.2 billion by 2014. The following table sets forth information related to the PRC online games market size and revenue models:

	2009	**2010**	**2011**	**2012E**	**2013E**	**2014E**
			(US$ in millions)			
PRC Online Games Market Size..................	3,743	4,775	5,821	6,611	7,430	8,185
- Virtual Item Sales Market.........................	3,048	3,971	4,922	5,682	6,556	7,367
- Time-based Subscription Market	696	804	899	928	875	818

Source: IDC China Online Gaming 2011-2015 Market Analysis and Forecast

The PRC online games industry remains highly competitive, but leading players have increased their market share over the past five years as users increasingly demand for reliable operation and customer service. New genres such as shooting games, racing games, and multi-player online battle arena games have provided new growth areas. Success in the industry depends on sustaining the popularity of existing game titles through content updates, selectively adding new titles, and tapping users' willingness to pay for in-game items and activities. The following table sets forth information related to market share information for the leading online game operators:

	2010 Market Share
	%
Tencent	29.1
NetEase	15.3
Shanda	13.6
Perfect World	7.8
Sohu	6.7
Giant	4.1

Source: iResearch

Note: Market share in terms of revenue in 2010

PRC ONLINE ADVERTISING MARKET

The PRC is one of the largest advertising markets in the world. According to eMarketer, the total advertising expenditure in the PRC was approximately US$38.7 billion in 2011, or approximately 0.5% of the GDP of the PRC in 2011. By contrast, total advertising expenditure in the United States was approximately US$154.1 billion in 2011, or approximately 1.0% of the GDP of the United States in 2011.

Online advertising has grown rapidly in the PRC. Online advertising expenditure was US$5.3 billion in 2011. This figure is projected to grow to US$14.0 billion by 2015. The share of online advertising in the total advertising market was 14% in 2011 and is expected to increase to 21% by 2015. The growth of the online advertising market is mainly driven by increasing user time spent online, as well as enhanced performance and effectiveness of online advertising. The following table sets forth information related to the size of the PRC online advertising market from 2009 to 2015:

	2010	2011	2012E	2013E	2014E	2015E
	(US$ in billions)					
Total Advertising Expenditure	33.6	38.7	46.3	52.9	59.9	67.1
Online Advertising Expenditure	3.7	5.3	7.4	9.4	11.8	14.0
Online Advertising Expenditure as % of Total Advertising Expenditure	11%	14%	16%	18%	20%	21%

Source: eMarketer

At present, online advertising revolves primarily around display advertising and search advertising. Display advertising can be categorized as brand display advertising and performance display advertising, while search advertising is typically adopted for performance-based advertising.

Display advertising accounted for the majority of revenue in the online advertising market by 2011. The fast growing economy in the PRC has supported an increasingly affluent urban population, and advertisers are willing to invest heavily to establish brand recognition. This branding economy, combined with the increasing consumption of content online, has been the driving force behind the growth of display advertising in the past few years. Meanwhile, innovative new website types, such as online video sites, social networking sites and microblogs, have opened up additional display advertising options for brand advertisers and small- and medium-sized enterprise advertisers.

Small- and medium-sized enterprises and e-Commerce advertisers tend to spend more on search advertising as they look for performance-based advertising services that can be measured by effective clicks. Spending by these businesses is expected to continue to drive the growth of search advertising.

The PRC online advertising market is expected to continue to grow as advertisers shift an increasing proportion of their advertising budget from offline to online. This is expected to be largely driven by the general population's increasing amount of time spent online, as well as the targeting capabilities offered by online advertising. The following table sets forth information related to various segments of the PRC online advertising market.

	2010	2011	2012E	2013E	2014E	2015E
Display	53.9%	46.3%	44.0%	41.1%	37.5%	34.1%
Search	37.4%	45.2%	47.5%	51.5%	55.2%	59.2%
Others	8.7%	8.5%	8.5%	7.4%	7.3%	6.7%

Source: iResearch

PRC ONLINE SHOPPING MARKET

The PRC online shopping market has experienced significant growth. According to iResearch, the PRC online shopper population was 187 million in 2011 and is projected to reach 314 million by 2014. The total online shopping market in the PRC was US$120.7 billion by GMV in 2011 and is expected to grow to US$316.8 billion by 2014. The following table sets forth information related to the PRC online shopping market size:

	2009	2010	2011	2012E	2013E	2014E
	(in millions/US$ in billions[1])					
PRC Online Shoppers	109	148	187	228	269	314
PRC Online Shopping Market Size	41.4	72.6	120.7	186.4	247.0	316.8

Source: iResearch

Note: 1. The data in the table above were originally stated in RMB. The translation of RMB into U.S. dollars are included solely for the purposes of referential convenience and have been made at the rate of RMB6.3530 to US$1.00 as set forth in the H.10 weekly statistical release of the Federal Reserve Board on June 29, 2012.

As online shoppers become more sophisticated, growth in the B2C market is expected to outpace the C2C market as large-scale B2C websites are able to offer better quality assurance, more efficient fulfillment and payment alternatives and more friendly after-sales services relative to small merchants or individual sellers on the C2C platforms. The PRC B2C market was US$28.4 billion in 2011 by GMV and is projected to reach US$119.7 billion by 2014. The C2C market was US$92.3 billion in 2011 and is expected to reach US$197.0 billion by 2014. The following table sets forth the PRC B2B and C2C market sizes:

	2009	2010	2011	2012E	2013E	2014E
			(US$ in billions)[1]			
PRC B2C Market Size	3.2	9.9	28.4	55.5	83.5	119.7
PRC C2C Market Size	38.2	62.6	92.3	130.8	163.5	197.0

Source: iResearch

Note: 1. The data in the table above were originally stated in RMB. The translation of RMB into U.S. dollars are included solely for the purposes of referential convenience and have been made at the rate of RMB6.3530 to US$1.00 as set forth in the H.10 weekly statistical release of the Federal Reserve Board on June 29, 2012.

B2C leaders in the PRC include 360buy and Tmall. C2C leaders include Taobao and Tencent Paipai. The following table sets forth information related to the market share of online shopping markets in the PRC based on GMV for the second quarter of 2012:

B2C	Q2 2012 Market Share (%)
Tmall	57.1
360buy	20.1
Tencent B2C	4.0
Suning.com	3.8
Amazon China	2.7

Source: iResearch

Note: Market share in terms of GMV on B2C e-Commerce platforms, excluding online bill payments (such as power and water bills) and online traveling booking and flight booking transactions; Tencent B2C includes transactions from Buy.qq.com, QQ Mall and a B2C e-Commerce platform in which it holds a majority interest.

C2C	Q2 2012 Market Share (%)
Taobao	95.0
Tencent Paipai	5.0
Eachnet	0.01

Source: iResearch

Note: Market share in terms of GMV on C2C e-Commerce platforms.

The PRC online shopping market is still at a relatively early stage and new developments, including online sales channel for traditional retail brands, flash sales and group buying, continue to emerge. We believe these developments present opportunities that will further drive the growth of the PRC online shopping market and potentially allow for new segment leaders.

PRC MOBILE INTERNET MARKET

The PRC mobile Internet market has experienced significant growth over the past few years, with the pace expected to increase going forward. The market was estimated by iResearch to be approximately US$6.2 billion in revenue in 2011 and is forecasted to grow to US$44.4 billion by 2014. The PRC mobile users are increasingly using their mobile devices to access the Internet. There were a total of 360 million mobile Internet users in the PRC in 2011, a figure which is expected to reach 600 million users by 2014. The following table sets forth information related to the PRC mobile Internet market size:

	2009	2010	2011	2012E	2013E	2014E
	(US$ in billions[1]/in millions)					
PRC Mobile Internet Market Size	2.4	3.1	6.2	15.4	28.5	44.4
PRC Mobile Internet Users	230	300	360	450	520	600

Source: iResearch

Note: 1. The data in the table above were originally stated in RMB. The translation of RMB into U.S. dollars are included solely for the purposes of referential convenience and have been made at the rate of RMB6.3530 to US$1.00 as set forth in the H.10 weekly statistical release of the Federal Reserve Board on June 29, 2012.

It is expected that the key drivers for mobile Internet market growth in the PRC will be the large mobile subscriber base in the PRC, increasing adoption of smartphones, development of 3G and 4G services, and the proliferation of mobile Internet service offerings.

Largest mobile phone subscriber base in the world. The PRC has the world's largest number of mobile service subscribers. According to MIIT, there were a total of 1,052 million mobile subscribers in the PRC at the end of June 2012.

Development of 3G and 4G services. After the issuance of 3G licenses by the Chinese government in January 2009, the telecommunications operators in the PRC have been making substantial investments to develop their 3G mobile networks. According to MIIT, 3G mobile service subscribers increased from approximately 13 million to approximately 176 million between November 2009 and June 2012. 3G penetration levels remain quite low with only 16.7% of mobile subscribers using the 3G network in June 2012 and are expected to increase going forward. The scheduled rollout of the 4G network is expected to further facilitate increased penetration of mobile Internet usage. China Mobile has mandated TD-LTE technology and plans commercial tests and demo networks in 13 cities by late 2012.

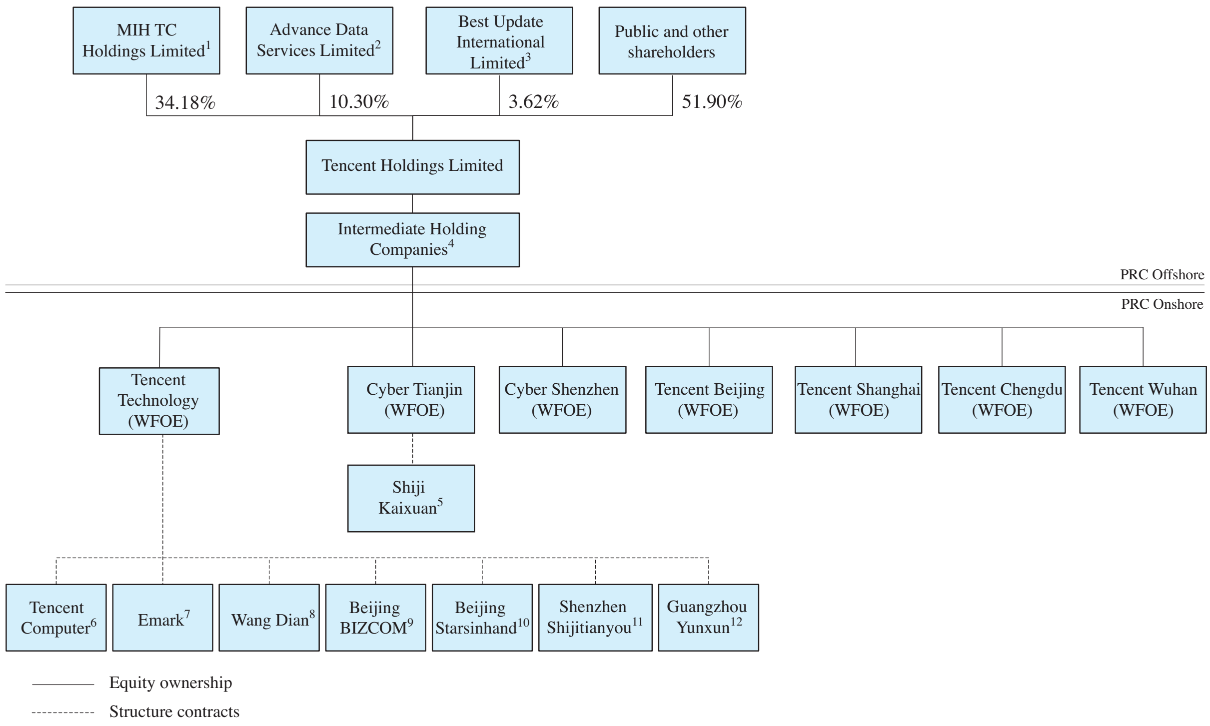
Increasing adoption of mobile devices. Driven by the increasing disposable income of the general population, development of 3G network infrastructure and decrease in the average price of mobile devices, the shipment volume of mobile devices has experienced strong growth and is expected to continue growing. However, the current penetration rate of mobile devices in the PRC is still low compared to regular devices.

Proliferation of mobile Internet service offerings. As mobile Internet develops, additional online service providers, including those who have been successful in traditional desktop Internet markets, are expected to embrace mobile Internet development and begin to tap into this emerging market through the launch of products and services tailored for mobile Internet usage. Such products and services would include mobile games, mobile e-Commerce, location based services, mobile advertising and mobile search. With more service and product choices, it is expected that there will be increased user adoption of mobile Internet going forward.

OUR CORPORATE STRUCTURE

We were incorporated in the BVI on November 23, 1999 as an international business company with limited liability. We redomiciled to the Cayman Islands on February 27, 2004 and continued as an exempted company with limited liability under the Cayman Islands Companies Law.

The following diagram illustrates our principal corporate and share ownership structure as of June 30, 2012.



Notes:

(1) MIH TC Holdings Limited is controlled by Naspers Limited through its wholly owned intermediary companies, MIH (Mauritius) Limited and MIH Holdings Limited

(2) Wholly owned by Mr. Ma Huateng

(3) Wholly owned by Mr. Zhang Zhidong

(4) Intermediate Holding Companies include various Group companies established for the purpose of holding interests in various WFOEs as well as other investments of the Group

(5) The shareholders are Mr. Ma Huateng, Mr. Zhang Zhidong, Mr. Xu Chenye and Mr. Chen Yidan

(6) The shareholders are Mr. Ma Huateng, Mr. Zhang Zhidong, Mr. Xu Chenye and Mr. Chen Yidan

(7) Emark: Beijing Emark Information Technology Company Limited 北京驛碼神通信息技術有限公司

(8) Wang Dian: Nanjing Wang Dian Technology Company Limited 南京網典科技有限公司

(9) Beijing BIZCOM: Beijing BIZCOM Technology Company Limited 北京英克必成科技有限公司

(10) Beijing Starsinhand: Beijing Starsinhand Technology Company Limited 北京市掌中星天下信息技術有限公司

(11) Shenzhen Shijitianyou: Shenzhen Shijitianyou Technology Company Limited 深圳市世紀天游科技有限公司

(12) Guangzhou Yunxun: Guangzhou Yunxun Technology Company Limited 廣州雲訊信息科技有限公司

We primarily conduct our PRC operations through our WFOEs, including Tencent Technology, Cyber Tianjin, Cyber Shenzhen, Tencent Beijing, Tencent Shanghai, Tencent Chengdu and Tencent Wuhan. The Company holds its interests in the WFOEs through certain intermediate holding companies wholly owned by the Company. Our WFOEs employ a substantial portion of our staff, develop the principal software (other than software acquired from third-party providers) for our operations and hold our principal intellectual property rights.

STRUCTURE CONTRACTS

PRC regulations currently restrict foreign ownership of companies that provide value-added telecommunications services. See also "Regulation". As foreign-invested enterprises, our WFOEs do not have licenses to provide Internet content or information services and other value-added telecommunications services. Accordingly, we conduct our value-added telecommunications businesses mainly through Tencent Computer, Shiji Kaixuan and other consolidated affiliated entities, under a series of contractual agreements (collectively, the "**Structure Contracts**") entered into among our constituent members. Tencent Computer and Shiji Kaixuan are licensed to provide Internet information services and other value-added telecommunications services and operate those services. The shareholders of Tencent Computer and Shiji Kaixuan are Mr. Ma Huateng, Mr. Zhang Zhidong, Mr. Xu Chenye and Mr. Chen Yidan.

As a result of the Structure Contracts, the Group is able to effectively control, and recognize and receive substantially all the economic benefit of the business and operations of, our consolidated affiliated entities. In summary, the Structure Contracts provide the Company through the WFOEs with, among other things:

- the right to receive the cash received by the consolidated affiliated entities from their operations which is surplus to their requirements, having regard to their forecast working capital needs, capital expenditure, and other short-term anticipated expenditure through various commercial arrangements;
- the right to ensure that the WFOEs own the valuable assets of the business through the assignment to the WFOEs of the principal present and future intellectual property rights of the consolidated affiliated entities without making any payment; and
- the right to control the management and financial and operating policies of the consolidated affiliated entities.

The Structure Contracts establish a cooperation committee (the "**Cooperation Committee**") for each of the consolidated affiliated entities to oversee its business and operations. The Cooperation Committees advise, supervise and effectively control the businesses of the consolidated affiliated entities. Through the Cooperation Committees, the WFOEs advise, supervise and effectively control the business of the consolidated affiliated entities. Under the Structure Contracts, the Cooperation Committees will adopt an internal governance mechanism for payments, expenditure and expenditure related contracts. Our approval matrix is required to be consistent throughout the Group and can be amended only by the Directors of the Company, and any such amendment applies to all members of the Group.

The Structure Contracts also effectively transfer from the consolidated affiliated entities to the WFOEs all of the cash that is surplus to the requirements of the consolidated affiliated entities, primarily in the form of fees paid for the WFOE's provision of certain technology and information services to the consolidated affiliated entities under the applicable Structure Contracts between the WFOEs and the consolidated affiliated entities. The Cooperation Committee determines and adjusts periodically the fees to be paid by the consolidated affiliated entities to the WFOEs to ensure that all such surplus cash of the consolidated affiliated entities is transferred to the WFOEs.

These arrangements, taken as a whole, permit the results and financial condition of the consolidated affiliated entities to be consolidated with the Company as if they were subsidiaries of the Company and that the economic benefit of their businesses flows to the Company and the WFOEs.

Our PRC legal counsel, Jun He Law Offices, is of the opinion that the contractual arrangements with these consolidated affiliated entities and their respective shareholders and the businesses and operations of these companies with such contractual arrangements as described in the document are in compliance with applicable existing PRC laws and regulations and are enforceable in accordance with their terms and conditions. Nevertheless, there are substantial uncertainties regarding the interpretation and implementation of current PRC laws and regulations. PRC regulatory authorities may in the future take a view that is contrary to the above opinion of our PRC legal counsel and/or enact regulations that prohibit or restrict these corporate structures. We have been advised by our PRC counsel that if the PRC government finds that our structure for operating our PRC value-added telecommunications services does not comply with PRC government restrictions on foreign investments, we could be subject to severe penalties, including being prohibited from continuing operations. See "Risk Factors—Risks Related to our Corporate Structure" and "Regulation".

OVERVIEW

We are a leading integrated Internet services company in the PRC, operating the largest IM community in the country with over 783.6 million monthly active IM user accounts as of June 30, 2012. We are also the largest SNS provider in terms of monthly time spent by users and our QQ.com is the No. 1 portal by user traffic in terms of daily unique visitors in the PRC, both according to iResearch in June 2012. Tencent Microblog has become one of the leading microblogs in the PRC with 468.7 million registered user accounts and 81.6 million daily active user accounts as of June 30, 2012. Leveraging our IM platform and our massive IM user base, we aim to become the hub for fulfilling Internet users' online lifestyle needs, encompassing communication, social networking, entertainment, content, search and e-Commerce. The breadth of our highly popular services extends to: QQ IM, QQ Mail, Qzone, Pengyou, Tencent Microblog, QQ Game Platform, QQ.com, our integrated e-Commerce platform, Buy.qq.com, our wireless portal, 3G.QQ.com and our mobile communication service, WeChat (Weixin). We were founded in November 1998 and we launched our QQ IM service in February 1999. Currently, we have five lines of business:

- ***Internet Value-added Services*** — Our IVAS business mainly consists of online games and community and open platforms services. We offer a diversified game portfolio ranging from web games, MCGs, ACGs to MMOGs. We are a leading provider of community and open platforms services in the PRC, including Qzone, QQ Membership, QQ Show, Pengyou, Tencent Microblog, Q+ and QQ Game Platform. As of June 30, 2012, we had 74.7 million fee-based IVAS registered subscriptions.
- ***Mobile and Telecommunications Value-added Services*** — Our MVAS business includes bundled SMS packages, mobile games, mobile books, mobile music services. Some of these products are an extension of PC-based community and entertainment services, which enable users to interact with each other across PC and mobile platforms. As of June 30, 2012 we had 34.6 million fee-based MVAS registered subscriptions.
- ***Online Advertising*** — Our online advertising primarily comprises brand display advertising, performance display advertising and search advertising. Display advertising mainly comprises branded advertisements displayed on our IM clients, portals and other platforms; as well as performance based advertisements displayed primarily on our SNS platforms. Search advertising is provided through our self-developed search engine.
- ***e-Commerce Transactions*** — Our e-Commerce transactions involving sales of merchandise and services on our B2C open platform, SME2C marketplaces and other open platforms providing lifestyle services and offline-to-online e-Commerce.
- ***Others*** — Our other services include trademark licensing, software development services and software sales.

We aim to build an Internet eco-system that provides benefits to users, content providers, applications developers, our own platforms and the Internet industry as a whole. We believe our users are attracted to our large and active online community as well as our diverse offering of innovative applications. We will continue to leverage our massive user base, proven platforms and well recognized brand to capitalize on the continued growth in Internet and mobile usage in the PRC.

We went public and were listed on the SEHK in June 2004 (Stock Code: 00700). We have been one of the constituent stocks of the Hang Seng Index since June 2008. For the year ended December 31, 2011, our total revenue was RMB28,496.1 million and our profit for the year was RMB10,224.8 million, an increase of 45.0% and 26.0%, respectively, over the year ended December 31, 2010. For the six months ended June 30, 2012, our total revenue was RMB20,175.1 million (US$3,175.7 million) and our profit for the period was RMB6,072.9 million (US$955.9 million), an increase of 54.3% and 16.2%, respectively, over the six months ended June 30, 2011. As of June 30, 2012, our cash and cash equivalents and term deposits with initial term of over three months amounted to RMB27,617.2 million (US$4,347.1 million).

OUR STRENGTHS

We believe that the following strengths contribute to our success and differentiate us from our competitors:

Large and Highly Engaged User Base with Strong Network Effect

We operate the largest IM community in the PRC with over 783.6 million monthly active IM user accounts as of June 30, 2012. For the three months ended June 30, 2012, we recorded 166.6 million IM PCUs up from 136.7 million for the three months ended June 30, 2011. Our large and highly engaged user base creates strong network effect for our IM users to interact with one another through IM and our other applications and value-added services, which in turn enables us to retain our existing users and attract new users. In addition, our large user base provides us with the opportunity to market and deliver our value-added services and products. We believe that our large and active user base creates a high barrier to entry, as it is challenging for our competitors to build a similar critical mass of users for their products and services.

Successful Monetization Through Diversified Products and Services

We continuously develop innovative services to expand and enrich the experience of our users and enhance their loyalty to the "QQ" community. To match our users' online lifestyle needs, we offer a wide range of value-added services, such as social networking, microblog, online games, mobile value-added services and e-Commerce services. Our diverse offering of products and services, combined with our large user base, offer us significant monetization opportunities and enable us to diversify our revenue streams. We generate value-added services revenue from user subscriptions and item-based sales. We have monetized user traffic generated from our IM clients, portals, search engine and other platforms through online advertising. We have also grown our e-Commerce transactions business and are generating revenue from sales of merchandise and services rendered on our e-Commerce platforms by leveraging our large user base, existing online payment platforms and performance display advertising solutions provided on our SNS platforms. By continuing to develop new products and services to meet the rapidly evolving needs of the increasingly sophisticated Internet users in the PRC, we expect that we will be able to generate new revenue streams.

Significant Market Leadership in Multiple Service Areas

We have a strong presence for all of our key products and services, including IM, SNS and social media, online games, Internet portal and MVAS. We believe our leading position is underpinned by our in-depth understanding of the needs of our users and the trends in the market, as well as our strong research and development capability.

- *IM* - We are the leading IM provider in the PRC with QQ having a market share of 72.7% as measured by user preference of IM services in 2010, according to iResearch.
- *SNS and social media* - We provide diversified social networking and social media services including Qzone, Pengyou and Tencent Microblog. We are the largest SNS provider with our Qzone, Pengyou and Tencent Microblog collectively having a market share of 56.2% in the PRC as measured by monthly time spent by users in June 2012, according to iResearch. As of June 30, 2012, we had 597.6 million monthly active user accounts for Qzone, 247.7 million monthly active user accounts for Pengyou and 468.7 million registered user accounts for Tencent Microblog.
- *Online games* - We are the largest online game operator and a leading game developer in the PRC with a market share of 29.1% as measured by revenue in 2010, according to iResearch. We operate 5 of top 10 most popular online game titles in the PRC, according to Baidu online games search ranking as of June 30, 2012. We have several popular online game titles, including Cross Fire, QQ Dancer, Dungeon and Fighter, and QQ Speed, each of which had over 1 million PCU in each of the last four quarters ended June 30, 2012.

- *Internet portal* - QQ.com had 151.8 million daily unique visitors in June 2012, which ranked first among all online portals in the PRC, according to iResearch.
- *Mobile and telecommunications value-added services* - We believe we are the largest provider of MVAS in the PRC by revenue and we offer a variety of mobile Internet applications, including wireless QQ, WeChat (Weixin), mobile browser and mobile search. In addition, our wireless portal, 3G.QQ.com, is the most popular mobile Internet portal as measured by active users in 2011, according to Analysys.

Highly Cash Generative Consumer-oriented Business Model

We have consistently generated healthy cash flows from our operations and maintained a positive operating cash flows since 2001, even during the past economic downturns, including the global economic slowdown that began in the second half of 2008. A significant majority of our revenue is derived from micro-transactions or subscription revenue generated by our massive user base. We price most of our products and services at an affordable level for the average consumer, making our earnings and cash flows more resilient to economic cycles. Consequently, our business is generally less affected by the global economic slowdown and domestic macro-tightening measures. We bill and collect a majority of our revenue through the prepaid channels, including prepaid Q-Coin cards and our e-sales system, which minimizes our working capital needs and achieve a high cash flows conversion ratio. In addition, our Internet-based business model demonstrates significant operational scalability and requires low capital expenditures. As of June 30, 2012, our cash and cash equivalents and term deposits with initial term of over three months reached RMB27.6 billion (US$4.3 billion), up from RMB26.3 billion as of December 31, 2011.

Stable and Proven Management Team

We have a stable and capable senior management team with extensive operating experience in the PRC Internet and telecommunications industries as well as strong capabilities in developing and executing innovative business strategies. Four of the five core founders, Ma Huateng, Zhang Zhidong, Xu Chenye, and Chen Yidan, are still holding key positions at the Company. In addition, we have recruited senior management talents from leading global firms, such as Lau Chi Ping Martin, our President, Xiong Minghua, our Co-chief Technology Officer and James Gordon Mitchell, our Chief Strategy Officer. The collective experience of our management team brings together a mix of local and international experience, industry knowledge and complementary skill sets which have allowed us to smoothly transition to a large scale, professionally managed company since our IPO. We believe our committed and experienced management team will continue to lead us to further success.

OUR STRATEGIES

Our strategic objective is to strengthen our market leading position and become the hub for fulfilling Internet users' online lifestyle needs in the PRC. We will undertake strategic initiatives focused on expanding our market shares, diversifying our services and products and sustaining our growth and profitability. In particular, we will seek to:

Further Expand Our User Base and Increase User Engagement

We believe the size of our user base and depth of user engagement in our online community are our critical competitive advantages. We plan to further expand our user base and increase user engagement by enhancing user experience and broadening our services and products. For example, we plan to further strengthen our Qzone and Pengyou community by continuing to add new features and functionalities as well as offering more third-party applications through the open platform strategy. We will continue to focus on growing the user base of Tencent Microblog and optimizing its user experience. We will further develop our e-Commerce transactions business by continuing to expand our product categories and diversify product and service offerings to deliver premium user experience through our principal business and e-Commerce marketplaces. To better address ever-changing consumer needs, we will continue to study user online behavior and explore local and overseas market trends.

Further Monetize Our User Base and User Traffic

We seek to broaden and enhance our fee-based value-added services, and promote user subscriptions and item sales to increase paying user conversion rate. We are investing to enhance the overall competitiveness of our search engine and online advertising platform, and are exploring the synergies between SNS and our other services. Our e-Commerce transactions business is another opportunity for strategic expansion as we leverage our substantial user base and deep knowledge of our users' preferences and interests. To deliver a better consumer experience, we have integrated our various e-Commerce properties into an integrated e-Commerce platform; and invested in quality B2C verticals as well as stepped up our presence in key merchandise categories like consumer electronics.

Pursue an Open Platform Strategy That Promotes Innovation and Collaboration

We are pursuing an open platform strategy with special focus on SNS, microblog, IM, QQ Game Platform, search and e-Commerce. Qzone, Pengyou, Q+ and Tencent Microblog enable social sharing on third-party websites and support third-party applications with open application programming interfaces. For the six months ended June 30, 2012, our open platforms contributed approximately 25% of our community and open platforms revenue. We seek to increasingly collaborate with third-party developers and industry partners to further enrich the applications offered on our open platforms and thus increase social sharing and interaction among our users. By offering a large number of quality third-party and in-house developed applications, we endeavor to achieve continual innovation of our open platforms and increase user engagement and retention, which will ultimately enhance the value of our open platforms as a whole.

Capture the Emerging Mobile Internet Trend

We are a leading provider of mobile applications in the PRC which cover a range of categories, including communication, social networking, games, music, search and books. As our users demand more mobility and real-time information, we will continue to introduce a growing number of services and applications across a broader range of Internet-enabled mobile devices. We also intend to customize and extend our existing services and products to various mobile devices used by our users.

Pursue Selective Investments and Acquisitions to Enhance Our Business Portfolio, Proprietary Content, Distribution Channels, Technology and International Presence

We have been making strategic investments and acquisitions in the PRC, emerging markets such as Russia, Brazil, India and Southeast Asia, as well as other strategic markets such as the United States, and leveraging our technical and operational know-how to deliver quality Internet and mobile applications and services to users in these markets. We intend to continue pursuing selective investments and acquisitions of businesses, assets, content and technologies that complement our existing capabilities and revenue streams, as well as strategic investments and/or cooperation opportunities with top local players. We seek to capture these opportunities by identifying and analyzing strategic partners and potential investments and acquisition targets that will strengthen our position as the hub for fulfilling Internet users' online lifestyle needs. In addition, we plan to continue investing in and growing our e-Commerce transactions business, such as through potential acquisitions of assets, businesses and emerging e-Commerce companies.

SERVICES AND PRODUCTS

Leveraging our large user base, as well as our strategic relationships with telecommunications operators, device manufacturers, content providers and advertisers, we are continuously expanding our services and products as well as the channels to deliver them to our users. We continuously produce and source new content that seeks to appeal to and engage our target consumers for value-added services.

IM

IM provides a foundation for our online community and serves as a gateway to our value-added services. We are one of the early developers of IM services in the PRC as demonstrated by the launch of our QQ IM service in February 1999. We intend to continue leveraging the popularity of our QQ service to deliver value-added community and entertainment services to our expanding QQ user base.

QQ. QQ is our free IM service that allows users to send and receive instant messages and participate in the QQ community. In addition, via the QQ IM client, our users can have access to a variety of our services such as QQ Mail, Qzone, Pengyou, Tencent Microblog and our e-Commerce platforms.

While the overall IM user growth rate has slowed down due to increased scale and reduced growth of the PRC Internet market, the growth of our mobile IM user base has outperformed that of the overall IM user base. Going forward, we expect that mobile Internet will become an increasingly important driver for the expansion of our IM user base.

QQ.com

Our QQ.com portal provides users with information and community resources via various channels such as news, finance, sports, entertainment and automobile. We have recently revamped the front page and certain major channels of QQ.com to offer personalized communications and information-sharing services for our users and also to improve integration with our media platforms, including online video and microblog.

Business Segments

IVAS

Our IVAS business mainly consists of online games, community and open platforms. Our IVAS revenue mainly comprises of subscription revenue and item sales from our online games, community and open platforms. While most of the basic features of our IVAS are free-of-charge, users can choose to pay for virtual items, special privileges and premium features. Our IVAS revenue was RMB23,042.8 million for the year ended December 31, 2011 and RMB15,168.2 million (US$2,387.6 million) for the six months ended June 30, 2012. IVAS revenue accounted for 80.8% of our total revenue for the year ended December 31, 2011 and 75.2% of our total revenue for the six months ended June 30, 2012.

Online Games

We are the largest online game operator in the PRC with a market share of 29.1% as measured by revenue in 2010, according to iResearch. We operate QQ Game Platform, which is a leading and popular game platform in the PRC in terms of PCU. Some of our most popular self-developed and licensed games include Cross Fire, QQ Dancer, Dungeon and Fighter, League of Legends and QQ Speed.

We currently allow our registered users to play a majority of our games for free. Our online game revenue is derived primarily from sales of virtual items, such as Avatars and accessories that enhance game play experience, and subscription fees for membership services, which provide special privileges, premium game features and discounts on in-game items. These items and services allow players to utilize more functions, improve game character performance and skills and personalize the appearance of a game character. Our online game revenue was RMB15,821.4 million for the year ended December 31, 2011 and RMB10,885.7 million (US$1,713.5 million) for the six months ended June 30, 2012. Online game revenue accounted for 55.5% of our total revenue for the year ended December 31, 2011 and 54.0% of our total revenue for the six months ended June 30, 2012.

Our four main categories of online games are web games, MCGs, ACGs and MMOGs. The games that we operate are self-developed or licensed from third parties. We intend to release a number of self-developed and licensed games each year. We have worked with other major game developers and operators from the PRC, South Korea, the United States, and Germany and customized and localized their games to suit the culture and needs of the PRC market.

QQ Game Platform. We currently offer 42 in-house and third-party web games and more than 110 MCGs, including card games, board games, chess and other evergreen game genres, through QQ Game Platform. For the three months ended June 30, 2012, our QQ Game Platform recorded 4.3 million in combined ACU and 8.8 million in combined PCU.

ACG. We currently offer seven game titles, covering game genres including music, first-person shooting, car racing and multiplayer online battle arena games. For the three months ended June 30, 2012, our ACGs recorded 3.8 million in combined ACU and 12.2 million in combined PCU.

MMOG. We currently offer 12 game titles, with game genres including combat, fantasy, martial arts, adventure and historical events. The interactive and group-oriented nature of these games means that the large size of our user base significantly contributes to retaining our current users and attracting new users. For the three months ended June 30, 2012, our MMOGs recorded 1.7 million in combined ACU and 4.7 million in combined PCU.

Community and Open Platforms

Our community services include social networking websites, premium membership services and other interactive products. The basic features of our community value-added services are generally provided for free. We primarily offer item sales and subscriptions for premium services and products. We intend to improve user activeness and interaction through enhancements in content, functionalities, third-party applications and online and offline member privileges.

We operate multiple open platforms with a large user base across different sectors of the Internet market, including SNS, online games and microblog. We generate item-sales revenue from in-house and third-party applications offered through our open platforms.

Our community and open platforms revenue was RMB7,221.4 million and RMB4,282.6 million (US$674.1 million) for the year ended December 31, 2011 and for the six months ended June 30, 2012, respectively. Community and open platforms revenue accounted for 21.2% of our total revenue for the six months ended June 30, 2012.

Qzone. Qzone is our SNS platform that permits users to write blogs, keep diaries, upload photos, listen to music and engage in other premium services which can be shared among designated peer groups organized and accepted by the users. Users may purchase items or subscriptions that allow access to all services without additional costs. The revenue mix of Qzone is changing with an increasing contribution from item sales through third-party and in-house social applications offered on the platform. We expect to work with a growing number of third-party developers on the Qzone platform which will provide our users with a wide selection of social applications. As of June 30, 2012, Qzone had 597.6 million monthly active user accounts.

Pengyou. In January 2009, we launched a real-name SNS service called Xiaoyou, based on Qzone's platform and targeted at university students. We have rebranded and upgraded our real-name SNS Xiaoyou to Pengyou and promoted the service to a broader user group, including white-collar users and provided enhanced functionality to facilitate users to extend their social graphs through searches by company, industry, education background and other categories. Pengyou caters to a more real-name oriented user base. As of June 30, 2012, Pengyou had 247.7 million monthly active user accounts.

Tencent Microblog. We launched Tencent Microblog in April 2010 and it enables users to broadcast from PC and mobile devices messages with no more than 140 characters for each message. It also allows users to attach photos, music and videos to their messages. In October 2011, we introduced an English version of Tencent Microblog, which is the first English microblog platform in the PRC. We believe that microblog will become an important social media platform in the context of our overall strategy, offering synergistic value to other Internet platforms, such as Qzone, Pengyou, QQ Game Platform and QQ.com. As of June 30, 2012, Tencent Microblog had 468.7 million registered user accounts and 81.6 million daily active user accounts.

QQ Membership. Since its inception in 2000, QQ Membership has developed into a premium membership brand through which we provide our premium customers a range of privileges associated with IM, online games, online and offline lifestyle services and e-Commerce.

QQ Show. The QQ Show platform allows users to create fashionable Avatars, which represent users' online identity throughout their activities in IM, online games, and social networking. Revenue for QQ Show is generated from its monthly subscription service and item sales, such as facial expressions, costumes and character backgrounds.

QQ Mail. We launched our online mailbox service QQ Mail in 2003 and have continued to integrate a number of value-added services to this platform since then, including blog reader, 2GB-sized attachments and audio and video messages.

Other IVAS. We provide a growing list of IVAS services to meet the diversifying needs of our users. These services include our cloud-based application platform Q+ and music service, QQ Music.

MVAS

Since entering the MVAS business in 2000, we have grown our services to extend our PC-based QQ products and services to wireless platforms. Revenue from our MVAS is principally derived from subscriptions fees or item sales. We provide users with mobile chat services, MMS, IVR, content downloads, mobile games and mobile SNS services. We also operate our wireless portal, 3G.QQ.com, a free WAP site that offers users real-time news and information tools such as disk storage, album, weather inquiry, search engine and entertainment. To facilitate the access of mobile Internet users, we also collaborate with mobile device manufacturers to preinstall various QQ products and services directly into the devices.

We have introduced and promoted our MVAS offerings by leveraging our strategic relationships with various industry players, including mobile device vendors, telecommunications operators and content providers and will continue to do so. In addition, we will promote mobile services via both the QQ IM client and the QQ.com portal, where users can directly purchase various content subscription packages and items. We expect our MVAS to grow with the expansion of 3G infrastructure and the growing penetration of smartphones in the PRC. To position ourselves for growth opportunities in the mobile Internet sector, we will continue to extend our PC-based products and services to mobile platforms and develop new services, such as WeChat (Weixin). Although these platforms do not generate significant revenue at the moment, we believe the availability of a large variety of QQ products and services on the mobile platforms will contribute to higher user engagement and loyalty of our users both on PC and mobile devices. Our MVAS revenue was RMB3,270.8 million for the year ended December 31, 2011 and RMB1,842.8 million (US$290.1 million) for the six months ended June 30, 2012. MVAS revenue accounted for 11.5% of our total revenue for the year ended December 31, 2011 and 9.1% for the six months ended June 30, 2012.

Our current MVAS offerings include:

2G

Our services and products for the 2G platform include our bundled SMS packages and voice value-added services. Bundled SMS packages provides subscribers with mobile chat services and privileges related to QQ IM and other services. Users can also send SMS messages for downloading pictures, animation and color ringback tones. These services are charged through subscription packages or on a per item basis. Our voice value-added services include IVR and color ringback tone. Due to the maturity of the voice value-added services and the advancement of mobile Internet technologies, we expect this segment to contribute a smaller portion of our revenue going forward.

2.5G/3G

Our services and products for the 2.5G/3G platforms include our mobile games, mobile SNS, mobile books, mobile music and mobile search. These services operate on both 2.5G and 3G networks and are integrated with QQ IM, Qzone, Tencent Microblog and our other IVAS platforms. In January 2011, we launched WeChat (Weixin), which has become a leading mobile community in the PRC with over 100 million registered users as of March 2012. WeChat (Weixin) provides features including text messaging, hold-to-talk voice messaging, broadcast messaging, photo/video sharing, location-based service (LBS) functionalities and third-party applications through an open application programming interface (API).

Online Advertising

We offer a broad range of advertising formats and solutions, including brand display advertising (such as advertising on IM clients, portals and online video), performance display advertising and search advertising. Our advertising clients include domestic and international companies from a variety of industries, including food and beverages, automobile and online service industries. The PRC advertising market is expected to continue to grow as the PRC GDP grows and the government focuses on increasing domestic consumption. Our online advertising revenue was RMB1,992.2 million for the year ended December 31, 2011 and RMB1,419.8 million (US$223.5 million) for the six months ended June 30, 2012 and accounted for 7.0% of our total revenue for the year ended December 31, 2011 and 7.0% for the six months ended June 30, 2012.

Display

Display advertising consists of two formats — brand display and performance display advertisements. Our brand display advertisements are charged primarily at cost per time or per impression and may be displayed in various formats on our IM clients, portals, online video and other platforms. Performance display advertisements are charged primarily at cost per click and are offered mainly through the bidding system of our targeted advertising platform. Advertisers can place performance display advertisements on our SNS platforms and other platforms based on our user targeting algorithm.

Search

We started to offer search services through our proprietary search engine, Soso, in 2009. Our search advertising model is based primarily on cost per click. Our search advertising business is still in development as we focus on improving the quality of web search results, enhancing mobile search user experience, building our traffic and search advertising platform, as well as increasing our search distribution partnerships. Currently, Soso provides a variety of products and services, including website, image, music, blog, news and video search.

e-Commerce Transactions

Our e-Commerce platforms comprise our B2C open platform, SME2C marketplaces and other open platforms providing lifestyle services and offline-to-online e-Commerce. Our online shopping services are offered free-of-charge for the buyers, while in certain marketplaces, merchants are charged service fees and commissions. For the six months ended June 30, 2012, revenue from e-Commerce transactions was RMB1,610.3 million (US$253.5 million), accounting for 8.0% of our total revenue. Retailers on our B2C open platform sell a wide array of product categories, including consumer electronics, books, jewelry, shoes and cosmetics and beauty products. We also act as a principal to directly offer and sell merchandise in various product categories, such as consumer electronics, on our B2C open platform. Our SME2C marketplaces offer unique items which users can purchase from our small- to medium-sized merchant partners. In addition to products, we offer lifestyle services such as hotel bookings and concert tickets, for our users to purchase online. To enhance customer loyalty and promote shopping activities, we have partnered with certain merchandisers to offer credit points and promotional discounts.

Our payment options include payment upon delivery and payment at the time of order with credit cards and debit cards issued by major banks in the PRC through online payment systems before delivery. A majority of sales from our principal-based transactions are settled through payment upon delivery. Under this option, we deliver products to customers' designated addresses and collect payment on site. The remaining portion of our sales from principal-based transactions and most of the sales from agent-based transactions are settled through online payment service systems before delivery. The online payment service systems used on our e-Commerce platforms include our online payment service and online payment services provided by third parties.

Others

Our others include trademark licensing, software development services and software sales. Our revenue from others was RMB190.3 million for the year ended December 31, 2011 and RMB134.0 million (US$21.0 million) for the six months ended June 30, 2012.

Licensing and Development

We license our trademarks from time to time to increase our brand recognition and further penetrate the consumer market in the PRC. We have licensed the QQ brand to manufacturers of various products, including electronic and consumer goods products. Our trademarks have also appeared along with trademarks of other corporate entities for joint marketing, co-branding and merchandising initiatives.

SALES AND MARKETING

We believe that our large IM user base in itself, is a key driver of our user growth, as many Internet users in the PRC seek to join an established and vibrant online community. We market our value-added services primarily via our platforms and portals. In our online community, "word of mouth" is an important driver for the adoption of value-added services as positive feedback from users can be quickly communicated via various channels, including QQ IM, Tencent Microblog and SNS. We market our advertising services and e-Commerce platforms through a dedicated sales force across the country. Leveraging our user logged-in relationships and user base, we also offer targeted advertising solutions for our e-Commerce merchant partners to reach their target users and increase online purchases. This enables our merchant partners to lower their marketing costs and achieve higher returns using our user targeting technology.

Our sales and marketing efforts are supported by a network of marketing and sales teams throughout the PRC. We conduct a variety of online and offline marketing and promotion activities, including joint marketing activities with telecommunications operators and device manufacturers, in-game promotional events, marketing, and advertisements on our portals. For example, in 2012, we launched nationwide corporate branding and cross-platform promotional campaigns in the PRC for the 2012 Summer Olympic Games to enhance our brand image and media influence. Going forward, we will further enhance our position as a mainstream media platform in the PRC.

DISTRIBUTION AND PAYMENT METHODS

We bill and collect revenue for our value-added services principally through these channels: prepaid Q-Coin cards, e-sales system, telecommunications operators and online banking. A majority of our revenue from value-added services are prepaid through Q-Coin cards, e-sales system and online banking, which allows us to minimize our credit risk.

Q-Coin Cards

We have arrangements with retailers and sub-distributors to sell prepaid Q-Coin cards at approximately 700,000 distribution points in the PRC, including Internet cafes, newsstands, convenience stores, software stores and book stores. We sell prepaid Q-Coin cards in bulk at wholesale rates and do not offer any refund or return mechanisms after the Q-Coin cards are sold to the retailers and sub-distributors. Each prepaid Q-Coin card contains a unique access code and password that enables users to redeem the stored value to increase the balance of their individual online accounts or to purchase our services.

E-sales System

We have arrangements with Internet cafes and other retailers across the PRC to sell Q-Coins and usage credit through an e-sales system. Under the e-sales system, Internet cafes and other retailers purchase Q-Coins and usage credit in bulk at a wholesale rate from us via bank transfers, and then re-sell them to users at the local retail outlet. We do not offer any refunds after the Q-Coins and usage credit are sold to retailers. The e-sales system is an efficient way to sell our services to our customers because they can access our services immediately at the retailer's premises, and no physical distribution of prepaid cards is required.

Telecommunications Operators

Substantially all of the fees for our MVAS and a small portion of the fees for our IVAS are collected through China Mobile, China Unicom and China Telecom. The telecommunications operators collect the fees for our services from their customers and pass such fees to us after withholding their portion of their service fees and imbalance fees. On a periodic basis, we confirm with each telecommunications operator the subscription information and the data transmission volume between our network gateway and the operator's mobile gateway. Each affiliate or branch operator of the PRC telecommunications operators will also provide us with a summary on a monthly basis as to the net fees payable to us by the affiliate or branch operator. We also receive information on customer payment status and coordinate with the telecommunications operators for final billing and collection of revenue.

Online Banking

Users can directly purchase Q-Coins and a majority of our services and products through online payment systems that facilitate online payments from most major commercial banks within the PRC.

STRATEGIC RELATIONSHIPS

We are focused on enriching our value-added services and expanding the networks over which we deliver these services. We maintain strategic relationships with telecommunications operators in the

PRC and major domestic and foreign device vendors and device manufacturers. In addition, while we develop a significant number of our services and products through in-house development teams, we also license and collaborate with an increasing number of third-party content providers, application developers, merchants and manufacturers.

Relationships with Telecommunications Operators

We have strategic relationships with the telecommunications operators in the PRC through which we use their networks to deliver our services and products. Our large user base and innovative applications increase demand for traffic on telecommunications networks. We currently maintain strategic relationships with China Mobile, China Unicom and China Telecom.

Relationships with Device Manufacturers

We currently work with a number of domestic and international major device manufacturers and we believe that our cooperation with them is mutually important and beneficial. Device manufacturers assist in the distribution of our services by making our client software and applications readily available in the devices they manufacture. At the same time, our applications create market demand for more sophisticated devices capable of supporting and interfacing with our applications.

Relationships with Content Providers and Application Developers

Our relationships with content providers and application developers are important to us as we strive to expand our value-added services. The goal of our content and application partnerships is to provide our users with a broad offering of attractive content and applications available. We currently have strategic relationships with a number of content providers including mobile and portal content providers, news and printed media, music content providers, real-time financial quote services providers and game and application providers, and we expect to continue to grow these relationships going forward.

Relationships with Merchant Partners

We continue to develop business and cooperative relationships with merchants and other retailers and manufacturers to expand our product and service offerings on our e-Commerce platforms. We provide these merchants with sellers' business tools and targeted advertising solutions to open and customize their online stores and reach their target users.

COMPETITION

The Internet industry in the PRC is rapidly evolving and competition is expected to further intensify. We face significant competition in almost every aspect of our business, particularly from companies that provide communication, online games, social networking, social media, e-Commerce, search and/or other products and services. In recent years, more foreign investors have begun to explore the opportunities arising from the emerging PRC Internet industry. Many of these Internet start-ups and companies are well funded by private equity or venture capital funds, which has resulted in an increasingly competitive industry landscape. Our competitors for providing IVAS in the PRC are mainly local Internet companies who offer various online games, SNS and other online entertainment and communication services. In the MVAS sector, we face keen competition from a large number of competitors along the entire value chain of the telecommunications industry including mobile device manufacturers, chip manufacturers, telecommunications operators and mobile content/service providers who are leveraging their traditional lines of business to enter and compete in this sector. We compete for online advertising with other websites that sell online advertising services in the PRC through display and search advertising. In addition, we indirectly compete for advertising budgets with traditional advertising media in the PRC, such as terrestrial or satellite broadcasting media like television and radio stations, printed media such as newspapers and magazines, and major out-of-home media. Our current and potential competitors in the e-Commerce sector include other domestic and foreign e-Commerce companies, physical retailers and offline distributors, as well as a number of indirect competitors, including operators of Internet portals and Internet search engines that are involved in e-Commerce, either directly or in collaboration with other retailers.

We believe that as we continue to expand our business scope, we will encounter new competitors and competitive environments that might evolve over time. In addition, we may face increased competition from international competitors that may establish joint venture companies with local companies to provide services based on the foreign investors' technology and experience developed in overseas markets.

We believe the principal competitive factors in our business include size of user base, community cohesiveness and interactivity, brand recognition, understanding of user needs, technology, product development capabilities and pricing. We aim to compete by continuing to develop, acquire and license technologies, services and products that bring quality user experiences to our target users in the PRC.

INTELLECTUAL PROPERTY

We regard our patents, copyrights, trademarks and other intellectual property as critical to our success. We rely primarily on a combination of patent, trademark, copyright, trade secret and other intellectual property-related laws and contractual restrictions to establish and protect our intellectual property rights. We require our employees to enter into agreements requiring them to keep confidential all proprietary and other confidential information relating to our customers, methods, technology, business practices and trade secrets and such obligations shall survive the expiration or earlier termination of their employment with us. Our employees are required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes, whether or not patentable or copyrightable, made by them during their employment are our property. We have independently developed key software used in our business and have registered a number of these software copyrights. We currently have over 1,290 patents that cover our self-developed key technologies and infrastructure.

Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without our authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property rights in the Internet and telecommunications-related industries are uncertain and still evolving. Infringement and misappropriation of our intellectual property could materially harm our business. We have been and may in the future be involved as an applicant or opposing party in several administrative actions involving trademark disputes.

We have registered the domain names, including "www.qq.com" and "www.tencent.com", with Internet Corporation for Assigned Names and Numbers and the domain names "www.tencent.com.cn" and "www.rtx.com.cn" with CNNIC, a domain name registration organization in the PRC. In addition, we have registered approximately 1,500 domain names with various domain name registration services.

Our "QQ (stylized)" mark and the "penguin" device and many associated marks have been registered as trademarks in various classes in the PRC, Hong Kong and other jurisdictions. We have also registered our "QQ (stylized)" mark and the "penguin" device in various classes in jurisdictions including the United States, Japan, Singapore, India, Malaysia, and the European Union. In addition, a series of "QQ" marks and the "penguin" device have also been registered as copyrighted artworks in the PRC.

RESEARCH AND DEVELOPMENT

We believe that our ability to develop IM technology and Internet, mobile and online entertainment applications has been a key factor in the success of our business. To maintain and enhance our leadership position, we will need to continue to invest in research and development in order to enhance our services and products. Currently, our research and development staff constitutes approximately 50% of our full-time employees. Research and development expenses constitute 9.6%, 8.6%, 9.4% and 9.8% of our total revenues for the years ended December 31, 2009, 2010 and 2011 and for the six months ended June 30, 2012, respectively. Our self-developed technologies include IM technology, mobile services, SNS, search engine and other interactive technologies. We also license some services and technologies from third parties such as database technology and audio/video codec technology. We have established an in-house Research Institute and an integrated Customer Research and User Experience Design Center. We will continue to develop our core technologies in-house and when required, license technology from third parties.

NETWORK INFRASTRUCTURE

Our network infrastructure is built to satisfy the requirements of our operations and to support the growth of our business. Our servers and routers are located across the PRC and our systems are designed for scalability and reliability to support growth in our user base. We believe we have developed and are operating one of the largest and most sophisticated cloud computing infrastructures in the PRC.

We believe that our current network facilities and broadband capacity provide us with sufficient capacity to carry out our current operations. We believe that we can expand our network facilities and broadband capacity as needed to accommodate our growth.

CUSTOMER SERVICE AND TECHNOLOGY SUPPORT

We place a high priority on providing our users with a consistently high quality of service and support. We have dedicated customer service teams to handle general product and service inquiries, billing questions, online security and technical support issues 24 hours a day, 7 days a week. Customers can access our customer service teams through various channels such as 24-hour customer service hotline, website and online self-help service center.

SUPPLIERS AND CUSTOMERS

For the year ended December 31, 2011, none of our customers accounted for more than 5.0% of our total revenue. Our customers primarily included retailers and distributors who purchase prepaid Q-Coin cards from the Company, users who purchase our products and services and advertisers who place advertisements on our platforms. For the year ended December 31, 2011, our largest supplier accounted for less than 25% of our total purchases from our suppliers. Our suppliers primarily include telecommunications operators, content providers, server and IT equipment suppliers and merchandise suppliers. As of December 31, 2011, none of the Directors, their associates or any shareholder (which to the knowledge of the Directors owned more than 5% of our issued capital) had an interest in any of the major customers or suppliers noted above.

The telecommunications operators typically settle the amounts due by them within a period of 30 to 120 days. Online advertising customers, which are mainly advertising agencies, are usually granted a credit of 90 days after full execution of the contracted advertisement order.

EMPLOYEES

We have experienced significant growth during recent years; our employee count was 7,515, 10,692, 17,446 and 20,000 as of December 31, 2009, 2010 and 2011 and June 30, 2012, respectively. Most of our employees are based in the PRC.

The remuneration policy and package of our employees are periodically reviewed. Apart from pension funds and in-house training programs, discretionary bonuses, share awards, and share option may be awarded to employees according to the assessment of individual performance. Our total remuneration costs (including capitalized remuneration cost) were RMB2,136.8 million, RMB3,146.1 million, RMB4,879.1 million for the years ended December 31, 2009, 2010 and 2011, respectively, and RMB3,597.9 million (US$566.3 million) for the six months ended June 30, 2012.

All of our management and key executives, and substantially all of our other employees, have entered into employment agreements with us, which contain confidentiality and non-competition provisions.

PROPERTIES AND FACILITIES

Our executive offices and our major operational facilities are located in Shenzhen. We own properties in a number of cities in the PRC, including Shenzhen, Beijing, Chengdu and Shanghai and lease other offices in the PRC and abroad, including the United States, South Korea and Hong Kong. We believe that we will be able to obtain adequate facilities, principally through the leasing of appropriate properties, to accommodate our future expansion plans.

INSURANCE

Insurance companies in the PRC offer limited business insurance products and do not, to our knowledge, offer business liability insurance. While business interruption insurance is available to a limited extent in the PRC, we have determined that the risks of disruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to subscribe for such insurance. As a result, we do not have any business liability, disruption or litigation insurance coverage for our operations in the PRC. Any business disruption or litigation, or any liability or damage to, or caused by, our facilities or our personnel may result in our incurring substantial costs and the diversion of resources. We carry mandatory automobile liability insurance and property insurance. Besides mandatory social insurance, we also maintain commercial health insurance and life insurance coverage for all our employees.

LEGAL PROCEEDINGS

From time to time, we have become and may in the future become a party to various legal or administrative proceedings arising in the ordinary course of our business, including actions with respect to intellectual property claims, breach of contract claims, unfair competitive practice claims, labor and employment claims and other matters. Internet media companies are frequently involved in litigation based on allegations of infringement or other violations of intellectual property rights and other allegations based on the content available on their website or services they provide. See "Risk Factors—Risks Related to our Business—We face uncertainties regarding the legal liability for providing third-party services, content and applications on our platforms", "Risk Factors—Risks Related to our Business—We may be subject to intellectual property claims, which may force us to incur substantial legal expenses and, if determined adversely against us, may materially disrupt our business" and "Risk Factors—Risks Related to our Business — Legal proceedings or allegations of impropriety against us could have a material adverse effect on our reputation, results of operations and financial condition". Other than the matters set forth below, we are not currently a party to any material litigation or legal proceeding.

In early 2011, we sued Beijing Qihoo Technology Co., Ltd. and Qizhi Software (Beijing) Co., Ltd. (together, "**360**") in Beijing for unfair competition, claiming that "Privacy Protector", an online security product offered by 360, made unfair and unsubstantiated allegations regarding our products. The court held for us in September 2011 by ordering 360 to pay damages and to rectify the adverse consequences of its unfair business practices. The verdict was upheld on appeal in October 2011 and is final. In August 2011, we separately brought another unfair competitive practices claim against 360 in the Higher People's Court of Guangdong Province, alleging, among other things, that 360's "Kou Kou Bodyguard" product improperly interfered with the lawful operation of our products, and in connection with this suit we are seeking appropriate remedies including, without limitation, substantial monetary damages. The hearing date is scheduled for September 2012.

In November 2011, Tencent Technology received a copy of a civil complaint which alleges that Tencent Technology infringed the plaintiff's previously registered "QQ" trademark for use on clothing by entering into arrangements with two other named defendants in April 2007 to sell "QQ" branded clothing in the PRC. The plaintiff seeks, among other things, an immediate stop to the use of the "QQ" brand on clothing by all defendants and damages in the amount of RMB125 million (with all three defendants jointly liable for that amount). The trial date has been scheduled for mid-September 2012. We believe these claims are without merit and intend to vigorously defend against such claims. We do not expect this litigation, even if determined adversely to us, to have any material adverse effect on our business, financial condition or results of operations or have any effect on our use of the "QQ" brand for our Internet service business.

In December 2011, we received a notice from the Higher People's Court of Guangdong Province of claims brought by Beijing Qihoo Technology Co., Ltd. against us, alleging unfair competitive practices by us, including hindering the ability of our IM users to use online security products offered by 360 and offering our own online security products as a component of our IM user software. Beijing Qihao Technology Co., Ltd. seeks, among other things, damages in the amount of RMB150 million and cessation of the aforementioned practices. We believed these claims were without merit and defended vigorously against such claims. The initial court hearing was held on April 18, 2012 and the court's judgment is pending as of the date of this document. We do not expect this litigation, even if determined adversely to us, to have any material adverse effect on our business, financial condition or results of operations.

Although such proceedings are inherently uncertain and their results cannot be predicted with certainty, we believe that the resolution of our current pending matters will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows. Regardless of the outcome, however, any litigation can have an adverse impact on us because of legal fees, diversion of management's attention, reputational damages and other factors. In addition, it is possible that an unfavorable resolution of one or more legal or administrative proceedings, whether in the PRC or in another jurisdiction, could materially and adversely affect our financial position, results of operations or cash flows in a particular period or damage our reputation.

DIRECTORS

Our Board currently consists of seven Directors, comprising three Executive Directors, one Non-executive Director and three Independent Non-executive Directors. The following table sets out the name, age and position of our Directors as of the date of this document:

Name	Age	Position
Ma Huateng	40	Chairman of the Board/Chief Executive Officer
Lau Chi Ping Martin	39	Executive Director/President
Zhang Zhidong	40	Executive Director/Chief Technology Officer
Charles St Leger Searle	48	Non-executive Director
Li Dong Sheng	55	Independent Non-executive Director
Iain Ferguson Bruce	71	Independent Non-executive Director
Ian Charles Stone	61	Independent Non-executive Director

Executive Directors

Ma Huateng, age 40, is an Executive Director, Chairman of the Board and Chief Executive Officer of the Company. Mr. Ma has overall responsibilities for strategic planning and positioning and management of the Group. Mr. Ma is one of the core founders and has been employed by the Group since 1999. Prior to his current employment, Mr. Ma was in charge of research and development for Internet paging system development at China Motion Telecom Development Limited, a supplier of telecommunications services and products in China. Mr. Ma is a member of the 5th Shenzhen Municipal People's Congress. Mr. Ma has a Bachelor of Science degree specializing in Computer and its Application obtained in 1993 from Shenzhen University and more than 18 years of experience in the telecommunications and Internet industries. He is also a director of Advance Data Services Limited which holds shares of the Company.

Lau Chi Ping Martin, age 39, is an Executive Director with effect from March 21, 2007. Mr. Lau was appointed as the President of the Company in February 2006 to assist Mr. Ma, Chairman of the Board and Chief Executive Officer, in managing the day-to-day operation of the Company. In February 2005, he joined the Company as the Chief Strategy and Investment Officer of the Company, and was responsible for corporate strategies, investments, merger and acquisitions and investor relations. Prior to joining the Company, Mr. Lau was an executive director at Goldman Sachs (Asia) L.L.C.'s investment banking division and the Chief Operating Officer of its Telecom, Media and Technology Group. Prior to that, he worked at Mckinsey & Company, Inc. as a management consultant. Mr. Lau received a Bachelor of Science Degree in Electrical Engineering from the University of Michigan, a Master of Science Degree in Electrical Engineering from Stanford University and a MBA from Kellogg Graduate School of Management, Northwestern University. On July 28, 2011, Mr. Lau was appointed as a non-executive director of Kingsoft Corporation Limited, an Internet based software developer, distributor and software service provider listed in Hong Kong.

Zhang Zhidong, age 40, is an Executive Director and Chief Technology Officer of the Company. Mr. Zhang has overall responsibilities for the development of our proprietary technologies, including the basic IM platform and massive-scale online application systems. Mr. Zhang is one of the core founders and has been employed by the Group since 1999. Prior to his current employment, Mr. Zhang worked at Liming Network Group focusing on software and network application systems research and development. Mr. Zhang has a Bachelor of Science degree specializing in Computer and its Application obtained in 1993 from Shenzhen University and a Master's degree in Computer Application and System Structure from South China University of Technology obtained in 1996. Mr. Zhang has more than 15 years of experience in the telecommunications and Internet industries. He is also a director of Best Update International Limited which holds shares of the Company.

Non-executive Director

Charles St Leger Searle, age 48, has been a Non-executive Director since June 5, 2001. Mr. Searle is currently the Chief Investment Officer of MIH Internet group companies. Prior to joining the MIH group companies, he held various corporate finance positions at Cable & Wireless plc and Hong Kong Telecom. Prior to joining Cable & Wireless plc, he was a senior corporate finance manager at Deloitte & Touche in London and Sydney. Currently, Mr. Searle serves on the boards of directors of a number of companies that are subsidiaries of or associated companies with MIH. Mr. Searle graduated from the University of Cape Town in 1987 with a Bachelor of Commerce degree and is a member of the Institute of Chartered Accountants in Australia (1992). Mr. Searle has more than 18 years of experience in the telecommunications and Internet industries.

Independent Non-executive Directors

Li Dong Sheng, age 55, has been an Independent Non-executive Director since April 2004. Mr. Li is the Chairman and Chief Executive Officer of TCL Corporation, the Chairman of the Hong Kong listed TCL Multimedia Technology Holdings Limited and the Chairman of the Hong Kong listed TCL Communication Technology Holdings Limited, all of which produce consumer electronic products. Mr. Li graduated from South China University of Technology in 1982 with a Bachelor degree in radio technology and has more than 17 years of experience in the information technology field.

Iain Ferguson Bruce, age 71, has been an Independent Non-executive Director since April 2004. Mr. Bruce joined KPMG in Hong Kong in 1964 and was elected to its partnership in 1971. He was the Senior Partner of KPMG from 1991 until his retirement in 1996 and served as Chairman of KPMG Asia Pacific from 1993 to 1997. Since 1964, Mr. Bruce has been a member of the Institute of Chartered Accountants of Scotland and is a fellow of the Hong Kong Institute of Certified Public Accountants, with over 47 years' experience in the accounting profession. He is also a fellow of The Hong Kong Institute of Directors and a member of The Hong Kong Securities Institute. Mr. Bruce is currently an independent non-executive director of Goodbaby International Holdings Limited, a manufacturer of durable juvenile products, Paul Y. Engineering Group Limited, a construction and engineering services company, Sands China Ltd., an operator of integrated resorts and casinos, Vitasoy International Holdings Limited, a beverage manufacturing company, and Wing On Company International Limited, a department store operating and real property investment company; all of these companies are publicly listed companies in Hong Kong. Mr. Bruce is also a non-executive director of Noble Group Limited, a commodity trading company that is publicly listed in Singapore, of China Medical Technologies, Inc., a China-based medical device company that is listed on NASDAQ, and of Yingli Green Energy Holding Company Limited, a China-based vertically integrated photovoltaic product manufacturer that is listed on the New York Stock Exchange. Mr. Bruce is an independent non-executive director of Citibank (Hong Kong) Limited and is the Chairman of KCS Limited.

Ian Charles Stone, age 61, has been an Independent Non-executive Director since April 2004. Mr. Stone is currently an Advisor on International Projects for PCCW Limited and Chief Executive Officer of SITC (a PCCW joint venture) in Saudi Arabia. Since 2001 in PCCW he has been CEO of UK Broadband in UK and then PCCW Mobile in Hong Kong, followed by being the Managing Director of the International Projects business. Mr. Stone has more than 41 years of experience in the telecom and mobile industries. He was the CEO of SmarTone between 1999 and 2001 prior to which held various senior positions in telecom businesses of the First Pacific Group in Hong Kong and Philippines. Mr. Stone has also held senior positions at Cable & Wireless plc and Hong Kong Telecom, including as Managing Director of CSL and Commercial Director of Hong Kong Telecom. Mr. Stone is a fellow member of the Hong Kong Institute of Directors.

SENIOR MANAGEMENT (NON-DIRECTORS)

Xu Chenye, age 41, Chief Information Officer, oversees the strategic planning and development for the website properties and communities, customer relations and public relations of the Company. Mr. Xu is one of the core founders and has been employed by the Group since 1999. Prior to that, Mr. Xu had experiences in software system design, network administration as well as marketing and sales management in his previous position at Shenzhen Data Telecommunications Bureau. Mr. Xu received a Bachelor of Science Degree in Computer Science from Shenzhen University in 1993 and a Master of Science Degree in Computer Science from Nanjing University in 1996.

Chen Yidan, age 41, Chief Administration Officer, oversees administration, legal affairs, human resources and charity fund of the Company. Mr. Chen is also responsible for the Group's management system, intellectual property rights and government relations. Mr. Chen is one of the core founders and has been employed by the Group since 1999. Prior to that, Mr. Chen worked in the Shenzhen Entry-Exit Inspection and Quarantine Bureau for several years. Mr. Chen received a Bachelor of Science Degree in Applied Chemistry from Shenzhen University in 1993 and a Master of Law Degree in Economic Law from Nanjing University in 1996.

Ren Yuxin, age 36, Chief Operating Officer and President of Interactive Entertainment Group, joined the Company in 2000 and had served as General Manager for the value-added services development division and General Manager for Interactive Entertainment business division. Since September 2005, Mr. Ren has been responsible for the R&D, operations, marketing and sales of gaming products for the Interactive Entertainment Business. Since May 2012, Mr. Ren has been appointed as COO and in charge of the Social Network Group and Interactive Entertainment Group. Prior to joining the Company, Mr. Ren has worked in Huawei Technologies Co., Ltd.. Mr. Ren received a Bachelor of Science Degree in Computer Science and Engineering from the University of Electronic Science and Technology of China in 1998 and an EMBA from China Europe International Business School (CEIBS) in 2008.

Xiong Minghua, age 47, Co-Chief Technology Officer, joined the Company in 2005. He is responsible for product strategy planning of the overall platform, new product innovation, research and development of core technologies, and management for engineering excellence of the Group. Mr. Xiong has been responsible for research and investment in Internet technology innovation and forefront of the industry development trend since May 2012. Prior to joining the Company, Mr. Xiong worked at Microsoft for 9 years and was responsible for the product management of Internet Explorer, Windows and MSN. He also established the MSN China Development Center. Prior to that, he worked at IBM Internet Division. Mr. Xiong received a Bachelor of Engineering Degree in Information System Engineering from National University of Defense Technology in 1987 and a Master of Science Degree in Information Retrieval from Chinese Defense Science and Technology Information Center (CDSTIC) in Beijing in 1990.

James Gordon Mitchell, age 38, Chief Strategy Officer and Senior Executive Vice President, joined the Company in August 2011. He has responsibility for areas such as the Company's strategic planning, strategic implementation, and investor relationships since 2012. Prior to joining the Company, Mr. Mitchell had worked in investment banking for 16 years. Most recently, Mr. Mitchell was a managing director at Goldman Sachs in New York, leading the bank's Communications, Media and Entertainment research team, which analyzed Internet, entertainment and media companies globally. Mr. Mitchell received a Bachelor Degree from Oxford University and holds a Chartered Financial Analyst Certification.

Liu Chengmin, age 40, Senior Executive Vice President and President of Mobile Internet Group, joined the Company in 2003 as General Manager for telecommunication business division and mobile communication business division. Since October 2005, Mr. Liu has been responsible for the development and operation of the Company's wireless business and the management of its regional markets in China. Since May 2012, Mr. Liu has been in charge of the operation management and development of the mobile Internet business and commercialization of search. Prior to joining the Company, Mr. Liu worked for Huawei Technologies Co., Ltd. in its domestic marketing and sales department. Mr. Liu received a Master of Science Degree in Mechanics from Harbin Industrial University.

Lau Seng Yee, age 46, Senior Executive Vice President and President of Online Media Group, joined the Company in 2006 and is responsible for overseeing the Company's online media business, and the development of the Company's online advertising business model, as well as the branding strategies for the Company. Mr. Lau is a seasoned professional in the media and marketing industry with more than 20 years of solid experience working, with a rare 17 years of on-ground China market experience. In 2007, Mr. Lau sat in the advisory board for ad:tech, the globally renowned organization for Online Marketing. Mr. Lau held the post of Vice Chairman of China Advertising Association since 2007, as well as the Visiting Professor of both Shanghai Normal University and Xiamen University. Prior to joining the Company, Mr. Lau was the Managing Partner of Publicis China and the CEO for BBDO China. Before that, he also held senior management positions at Dentsu Young & Rubicam in Shanghai, and McCann-Erickson in Beijing and Hong Kong. Mr. Lau received an EMBA from Rutgers State University of New Jersey, USA. He completed the AMP (Advanced Marketing Management) courses of Harvard Business School in 2007 and the Advanced Management Program of Harvard Business School in 2010. In 2011, Mr. Lau was honored by New York based AdAge publication as one of "The World's 21 Most Influential People in Marketing and Media Industry".

Tong Tao Sang, age 39, Senior Executive Vice President and President of Social Network Group, joined the Company in 2005 and has been responsible for social network platforms as well as the related value-added businesses since October 2008. Since May 2012, Mr. Tong has been responsible for the development of social networking platform and open-platform. Prior to joining the Company, Mr. Tong worked for Sendmail, Inc. on managing the development of operator-scale messaging systems; and later on was involved in new product planning and management. Mr. Tong also worked for Oracle on the development and testing of Oracle Server and Oracle Applications. Mr. Tong received a Bachelor of Science Degree in Computer Science from University of Michigan, Ann Arbor in 1991 and a Master of Science Degree in Electrical Engineering from Stanford University in 1997.

Lu Shan, age 37, Senior Executive Vice President and President of Technology and Engineering Group, joined the Company in 2000 and had served as General Manager for IM Product Division, Vice President for Platform Research and Development of the Company and Senior Vice President for Operations Platform System. Since March 2008, Mr. Lu has been responsible for overseeing the Operations Platform System of the Company. Since May 2012, Mr. Lu has been in charge of management of the technical and operational platform, search related products, technology development and operations. Prior to joining the Company, he worked for Liming Network Systems. Mr. Lu received a Bachelor of Science Degree in Computer Science and Technology from University of Science and Technology of China (USTC) in 1998.

Wu Xiaoguang, age 36, Senior Executive Vice President and CEO of Tencent E-Commerce Holdings Limited, joined the Company in 1999, he led the development and product planning for the Group's core product, the QQ IM client software and has served as Project Manager for the research and development team of QQ, General Manager for IM product, General Manager for Internet business division and Senior Vice President of Internet Services Division. Since May 2012, Mr. Wu has been appointed as CEO of Tencent E-Commerce Holdings Limited, responsible for the development and management of e-Commerce business. Mr. Wu has extensive experience in product R&D, product planning, product operation and marketing of Internet business. He received a Bachelor of Science Degree in Weather Dynamics from Nanjing University in 1996 and an EMBA from China Europe International Business School (CEIBS) in 2008.

David A M Wallerstein, age 38, Senior Executive Vice President, joined the Company in 2001. He oversees the Company's international business initiatives through identifying cooperation with multinational partners and is responsible for the Group's operations outside the PRC. Prior to joining the Company, Mr. Wallerstein was the Vice President, Business Development of MIH in China, and was involved in Internet strategy and mergers and acquisitions activities in China. Prior to that, Mr. Wallerstein worked as a management consultant in China's telecommunications and IT industries. Mr. Wallerstein received a Master's Degree in Political Economy from UC Berkeley and a Bachelor's Degree from the Jackson School at the University of Washington.

Li Haixiang, age 39, Senior Executive Vice President, joined the Company in 1999 and has been responsible for planning, construction and managing the technical platform supporting our various operations, including technical architecture, information security, settlements, business intelligence, channel connection, fundamental IT, applications maintenance and customer services since December 2005. Since 2010, Mr. Li has been in charge of the Company's search businesses. Mr. Li has been responsible for research and investment in Internet technology innovation and forefront of the industry development trend since May 2012. Mr. Li was awarded as "China Outstanding Chief Information Officer" by "IT Manager" magazine in 2008. Prior to joining the Company, Mr. Li served in a system integration company for the research and development of financial and network application software. Mr. Li received a Bachelor of Science Degree in Computer Software from South China University of Technology and an EMBA from China Europe International Business School (CEIBS) in 2007.

Lo Shek Hon John, age 44, Senior Vice President and Chief Financial Officer, joined the Company in 2004 and served as our Financial Controller from 2004 to 2008. Mr. Lo was appointed as the Company's Vice President and Deputy CFO in 2008 and was appointed Chief Financial Officer in May 2012. Prior to joining the Company, Mr. Lo worked in PricewaterhouseCoopers as Senior Manager (audit services). He is a Fellow of the CPA Australia, a Fellow of the Hong Kong Institute of Certified Public Accountants and a Fellow of the Chartered Institute of Management Accountants. Mr. Lo received a Bachelor of Business in Accounting from Curtin University of Technology and an EMBA from Kellogg Graduate School of Management, Northwestern University and HKUST.

Guo Kaitian, age 40, Senior Vice President, joined the Company in 2002 and has been responsible for overseeing the Company's functional divisions of administration, legal affairs, government relations, public relations, charity fund, procurement, board of directors office as well as the functional management of the branches in Beijing, Shanghai and Chengdu. Mr. Guo received a Bachelor of Law Degree from Zhongnan University of Economics and Law in 1996.

Xi Dan, age 36, Senior Vice President, joined the Company in 2002 and has been responsible for overseeing the Company's talent development and functional management since May 2008. Prior to joining the Company, Mr. Xi was responsible for HR management in ZTE Corporation and has more than 16 years of experience in IT and Internet industries. Mr. Xi received a Bachelor of Science Degree in Computer Science from Shenzhen University in 1996 and a MBA Degree from Tsinghua University in 2005.

BOARD COMMITTEES

Audit Committee

The Audit Committee currently comprises two Independent Non-executive Directors and one Non-executive Director, with Mr. Iain Ferguson Bruce as the Chairman. To retain independence and objectivity, the Audit Committee is chaired by an Independent Non-executive Director (with appropriate professional qualifications or accounting or related financial management expertise). None of the members of the Audit Committee is a former partner of our existing external auditor. The primary duties of the Audit Committee are to review and supervise our financial reporting process and internal control system and nominate and monitor external auditor.

Corporate Governance Committee

The Corporate Governance Committee was set up in March 2012 and currently comprises two Independent Non-executive Directors and one Non-executive Director, with Mr. Charles St Leger Searle as the Chairman. The primary duties of the Corporate Governance Committee are to develop and review our policies and practices on corporate governance and make recommendations to the Board of Directors.

Nomination Committee

The Nomination Committee was set up in March 2012 and currently comprises three Independent Non-executive Directors, one Non-executive Director and one Executive Director, with Mr. Ma Huateng as the Chairman. The primary duties of the Nomination Committee are to review and monitor the structure, size and composition (including the skills, knowledge and experience) of the Board of Directors regularly and make recommendations on any proposed changes to the Board of Directors to complement our corporate strategy.

Remuneration Committee

The Remuneration Committee currently comprises two Independent Non-executive Directors, with Mr. Ian Charles Stone as the Chairman. The primary duties of the Remuneration Committee are to evaluate the performance and make recommendations on the remuneration packages for our Directors, management and general staff and evaluate and make recommendations on employee benefit arrangements.

The Board has also established an Investment Committee and may establish other committees as necessary.

COMPENSATION OF DIRECTORS AND SENIOR MANAGEMENT

The aggregate amount of compensation (including fees, salaries, bonuses, allowances and benefits in kind, share-based compensation expenses and contributions to pension plans) paid or payable to our Directors for each of the years ended December 31, 2009, 2010 and 2011 were RMB54.5 million, RMB63.9 million and RMB67.3 million (US$10.6 million), respectively.

For the year ended December 31, 2011, 35,000 awarded shares were granted to Independent Non-executive Directors of the Company and no options/awarded shares were granted to our other Executive, Non-executive or Independent Non-executive Directors. For the year ended December 31, 2010, 1,000,000 share options were granted to Mr. Lau Chi Ping Martin and no options/awarded shares were granted to our other Executive, Non-executive or Independent Non-executive Directors. For the year ended December 31, 2009, no options/awarded shares were granted to any Executive, Non-executive or Independent Non-executive Directors.

During the years ended December 31, 2009, 2010 and 2011 and other than as set out below:

- No remuneration was paid by us to or receivable by our Directors as an inducement to join or upon joining us.
- No compensation was paid by us to or receivable by our Directors or past Directors for the loss of office as a Director or for loss of any other office in connection with the management of our affairs.
- None of our Directors waived any compensation.

The remuneration of members of our senior management team is determined by the Remuneration Committee and is reviewed on an annual basis taking into consideration performance criteria such as the Company's operating results, individual performance and comparable market statistics.

The five highest paid individuals of the Company include three Directors for the year ended December 31, 2009 and two Directors for the years ended December 31, 2010 and 2011, whose aggregate compensation has been included in the aggregate compensation of our Directors above. Including the compensation of such Directors, the aggregate emoluments (including fees, salaries, bonuses, allowances and benefits in kind, share-based compensation expenses and contributions to pension plans) paid/payable to the five highest paid employees during the years ended December 31, 2009, 2010 and 2011 were RMB77.6 million, RMB99.9 million and RMB104.5 million (US$16.4 million). No compensation was paid/payable by us to such employees for the years ended December 31, 2009, 2010 and 2011 for loss of office in connection with the management of our affairs.

Except as disclosed above, no other payments have been paid or payable by us or any of our subsidiaries to our Directors, with respect to the years ended December 31, 2009, 2010 and 2011.

The following discussion summarizes certain aspects of PRC law and regulations, which are relevant to our operations and business. For a description of the legal risks relating to government regulation of our business, see “Risk Factors”.

CORPORATE LAWS AND INDUSTRY CATALOGUE RELATING TO FOREIGN INVESTMENT

The establishment, operation and management of corporate entities in the PRC are governed by the Company Law of the PRC (“**Company Law**”) (公司法), effective in 1994, as amended. The Company Law is applicable to our PRC subsidiaries and consolidated affiliated entities unless the PRC laws on foreign investment have stipulated otherwise.

The establishment, approval, registered capital requirement and day-to-day operational matters of wholly foreign-owned enterprises are regulated by the Wholly Foreign-owned Enterprise Law of the PRC (外資企業法) effective in 1986, as amended in 2000, and the Implementation Rules of the Wholly Foreign-owned Enterprise Law of the PRC (外資企業法實施細則) effective in 1990, as amended in 2001.

Investment activities in the PRC by foreign investors are principally governed by the Guidance Catalogue of Industries for Foreign Investment (“**Catalogue**”) (外商投資產業指導目錄), which was promulgated and has been amended from time to time by the MOFCOM and the National Development and Reform Commission (“**NDRC**”). The Catalogue divides industries into three categories: encouraged, restricted and prohibited. Industries not listed in the Catalogue are generally permitted to receive foreign investment unless specifically restricted by other PRC regulations.

Establishment of wholly foreign-owned enterprises is generally permitted in encouraged industries. Some restricted industries are limited to equity or contractual joint ventures, while in some cases Chinese partners are required to hold the majority interests in such joint ventures. In addition, restricted category projects may also be subject to higher-level government approvals. Foreign investors are not allowed to invest in industries in the prohibited category.

REGULATORY AUTHORITIES

Certain areas related to the Internet, such as telecommunications, Internet information services, international connections to computer information networks, information security and censorship are regulated heavily in the PRC and are covered extensively by a number of existing laws and regulations issued by various PRC governmental authorities, including but not limited to:

- GAPP;
- MOFCOM;
- MOC;
- MIIT;
- MPS;
- SAFE;
- SAIC;
- the State Administration for Radio, Film and Television (“**SARFT**”);
- the State Council Information Office (“**SCIO**”); and
- the State Internet Information Office (“**SIIO**”).

GENERAL REGULATIONS ON INTERNET AND TELECOMMUNICATIONS INDUSTRIES

Regulations on Value-added Telecommunications Services

On September 25, 2000, the State Council promulgated the Telecommunications Regulations ("**Telecom Regulations**") (電信條例) which draws a distinction between "basic telecommunication services" and "value-added telecommunication services". Pursuant to the currently effective Catalogue of Telecommunications Business (電信業務分類目錄), "value-added telecommunication services" cover (i) online data processing and transaction processing, (ii) domestic multi-party communication service, (iii) domestic Internet protocol-virtual private network (IP-VPN), (iv) Internet data center, (v) storage-transfer service, (vi) call center service, (vii) Internet access service, and (viii) information service. Under the Telecom Regulations, commercial operators of value-added telecommunications services must first obtain an operating license from MIIT or its local branch.

On September 25, 2000, the State Council promulgated the Administrative Measures on Internet Information Services ("**Internet Measures**") (互聯網信息服務管理辦法). According to the Internet Measures, Internet content provision services ("**ICP**") is a subcategory of value-added telecommunications services and ICP operators must obtain an ICP License ("**ICP License**") from MIIT or its local branch before engaging in any commercial ICP operations within the PRC. When the Internet information service involves certain particular areas, such as news, publication, education, medicine, health, pharmaceuticals, and medical equipment, prior approval from the respective regulatory authorities must be obtained prior to applying for the ICP License.

On March 1, 2009, MIIT promulgated the Administrative Measures on Telecommunications Business Operating License ("**Telecom License Measures**") (電信業務經營許可管理辦法), effective on April 10, 2009, which replaced the previously issued Measures on Administration of Telecommunications Business Operating License (電信業務經營許可證管理辦法). The Telecom License Measures set forth the qualifications and procedures for obtaining the ICP License, the supervision obligation of telecommunications service operators and the annual review system. An ICP operator conducting value-added telecommunications services within a single province must obtain the ICP License from MIIT's local branch, while an ICP operator providing value-added telecommunication services across different provinces must obtain a trans-regional ICP License directly from MIIT. According to the Telecom Licensing Measures, ICP operators are also required to lodge certain documents with the competent authorities in first quarter of each year and go through the annual inspection process with respect to their operations during the previous year.

Regulations on Foreign Investment in the Value-added Telecommunications Services

Foreign investment in the telecommunications sector is governed by the Regulations on Administration of Foreign Invested Telecommunications Enterprises ("**FITE Regulations**") (外商投資電信企業管理規定), which were promulgated by the State Council on December 11, 2001 and amended on September 10, 2008. Pursuant to the FITE Regulations, a foreign investor must establish a foreign invested telecommunications enterprise ("**FITE**") with a PRC joint venture partner, to engage in basic telecommunications and value-added telecommunications businesses. The foreign investor 's ultimate equity ownership in a value-added telecommunications business must not exceed 50%. Moreover, for a foreign investor to establish a new FITE or acquire any equity interest in an existing value-added telecommunications business in the PRC, it must demonstrate a good track record and experience in operating value-added telecommunications services. Foreign investors that meet these requirements must obtain approvals from MIIT and MOFCOM or their local branches.

On July 13, 2006, MIIT issued the MIIT Circular, which emphasizes that a foreign investor planning to invest in the value-added telecommunications sector in the PRC must set up a FITE and apply for the applicable telecommunications business operation license. A domestic value-added telecommunications services provider shall not lease, transfer or sell any telecommunications business operation license in any way to a foreign investor, or provide resources, sites, facilities or other conditions for a foreign investor to illegally operate a telecommunications business in the PRC.

According to the MIIT Circular, if a foreign investor cooperates with a domestic value-added telecommunications services provider, the following requirements apply: (1) the domain names and registered trademarks used by the value-added telecommunications services provider must be legally owned by itself or its shareholder; (2) the value-added telecommunications services provider must have a premise, servers and other necessary facilities for its approved business operations and maintain such facilities in the regions covered by its license; and (3) the value-added telecommunications services provider must safeguard its network and Internet security in accordance with standards set forth in relevant PRC regulations.

On September 28, 2009, GAPP, the National Copyright Administration, and the National Office of Combating Pornography and Illegal Publications jointly issued the Notice on Further Strengthening of the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games ("**Circular 13**") (進一步加強網絡遊戲前置審批和進口網絡遊戲審批管理的通知). Circular 13 states that foreign investors are not permitted to invest in online game operating businesses in the PRC via wholly owned, PRC-foreign equity joint ventures or cooperative joint ventures or to exercise control over or participate in the operation of domestic online game businesses through indirect means, such as other joint venture companies or contractual or technical arrangements. Regarding the risks with respect to the MIIT Circular and Circular 13, please see "Risk Factors—Risks Related to our Corporate Structure—If the PRC government finds that the agreements that establish the structure for operating our services in the PRC do not comply with PRC governmental restrictions on foreign investment in value-added telecommunications businesses or other related businesses, or if these regulations or the interpretation of existing regulations change in the future, we could be subject to severe penalties or be forced to relinquish our interests in those operations."

Regulations on the Order of the Internet Information Service Market

On December 29, 2011, the MIIT promulgated Certain Rules on Regulating the Order of the Internet Information Service Market ("**Internet Market Order Rules**") (規範互聯網信息服務市場秩序若干規定), effective from March 15, 2012. The Internet Market Order Rules aim to regulate the order of the Internet information service market, protect the legitimate rights and interests of Internet information service providers and users, and promote the healthy development of the Internet industry. Pursuant to the Internet Market Order Rules, an internet information service provider shall offer services under the principles of equality, voluntariness, fairness and integrity, and shall not commit acts infringing the legitimate rights and interests of other service providers such as maliciously interfering in services offered by other Internet information service providers at user terminals, or maliciously interfering in the downloading, installation, operation and upgrading of software and other products related to Internet information services, or refusing, postponing or ceasing to provide users with Internet information services or products without any proper reason. An Internet information service provider may be subject to administrative penalties, including warnings and fines and other legal liabilities, for violation of the Internet Market Order Rules.

Regulations on Internet Content Services

National security considerations are an important factor in the regulation of Internet content in the PRC. Under the Internet Measures, violators may be subject to penalties, including criminal sanctions, for the production, duplication, posting or dissemination of any Internet content that:

- opposes the fundamental principles stated in the PRC Constitution;
- compromises national security, divulges state secrets, subverts state power or damages national unity;
- harms the dignity or interests of the state;
- incites ethnic hatred or racial discrimination or damages inter-ethnic unity;
- undermines PRC religious policy or propagates heretical teachings or feudal superstitions;
- disseminates rumors, disturbs social order or disrupts social stability;
- disseminates obscenity, pornography, gambling, violence, murder, terror or induces crimes;

- humiliates or defames any other person, or infringes the legal interests of any other person; or
- is otherwise prohibited by the laws or administrative regulations.

ICP operators are required to monitor their websites. They shall not post or disseminate any content that falls within these prohibited categories and must remove any such content from their websites. MIIT or its local branches may shut down the websites of ICP operators that violate any of the above-mentioned content restrictions, order them to suspend their operations, or revoke their ICP Licenses.

On December 28, 2000, the Standing Committee of National People's Congress, the PRC national legislative body, adopted the Decisions on Maintenance of Internet Security ("**Internet Security Decisions**") (關於維護互聯網安全的決定), which provide that individuals or entities may be subject to criminal charges for certain misconduct which threaten or harm (i) the Internet operation safety, (ii) national security and social stability, (iii) economic system and social management and (iv) legal rights and interests of individuals, legal persons and other organizations.

Regulations on Internet Cultural Activities

On May 10, 2003, MOC promulgated the Provisional Regulations for the Administration of Internet Culture ("**Internet Culture Regulations**") (互聯網文化管理暫行規定), which were revised in July 2004 and February 2011 and the revised Internet Culture Regulations became effective on April 1, 2011. The Internet Culture Regulations apply to entities that engage in activities related to "Internet cultural products", which are classified as cultural products produced, disseminated and circulated via the Internet, including Internet cultural products: (i) specifically produced for the Internet, such as online music entertainment, online games, network games, network performance programs, online performing arts, online artworks and online animation features and cartoons and so forth; and (ii) converted from music entertainment, games, performance programs, performing arts, artworks and animation features and cartoons and disseminated via the Internet.

Pursuant to the Provisional Regulations for the Administration of Internet Culture (互聯網文化管理暫行規定) promulgated by MOC on February 17, 2011 and effective on April 1, 2011, an entity is required to obtain a Network Culture Operating Permit from the relevant local branch of MOC, in addition to the ICP License if it intends to commercially engage in any of the following types of activities:

(i) production, duplication, import, distribution or broadcasting of Internet cultural products;

(ii) publication of Internet cultural products on the Internet or transmission of Internet cultural products via an information network, such as the Internet and mobile networks, to a computer, fixed-line or mobile phones, television sets or gaming consoles for the purpose of browsing, reviewing, using or downloading such products by online users; or

(iii) exhibitions or contests related to Internet cultural products.

REGULATIONS ON ONLINE GAMING

Regulations on Electronic and Internet Publications

On February 21, 2008, GAPP issued the Regulations on Administration of Publishing of Electronic Publications ("**Electronic Publications Regulations**") (電子出版物出版管理規定), which became effective from April 15, 2008 and repealed the prior Regulations on Administration of Electronic Publications issued on December 30, 1997. Pursuant to the Electronic Publications Regulations, the PRC implements a licensing system for publishing of electronic publications, which include mobile games and online games. A company wishing to publish electronic publications must meet the specified requirements with respect to registered capital, equipment, premise, organizational structure and obtain an approval from GAPP. With such approval, the company must then register with the local branch of GAPP and obtain an Electronic Publications Publishing License. A company engaged in publishing of electronic publications is also required to go through a regular inspection process every two years, during which the company's registration, qualification, business operation, compliance and internal management will be reviewed by the local branch of GAPP.

On June 27, 2002, GAPP and MIIT jointly issued the Interim Regulations on Administration of Internet Publication ("**Internet Publication Regulations**") (互聯網出版管理暫行規定), which became effective from August 1, 2002. These regulations require business operations involving Internet publishing to be approved by GAPP. Internet publishing is defined as any act by an Internet information service provider to select, edit and process works created by itself or others and to make such works publicly available on the Internet.

Under Circular 13, provision of online games via Internet is regarded as an Internet publishing activity and online game operators must be examined and approved by GAPP. With such approval, the online game operator will receive an Internet Publishing License specifically allowing for online game operation business. The notice prohibits any direct foreign investment in online game operation business. Furthermore, it prohibits foreign control or participation in domestic companies' online game operation business in an indirect way such as entering into technical support agreements or in any other disguised manner.

Regulations on Online Game Operations

Online game operations are covered extensively by a number of existing laws and regulations issued by various PRC governmental authorities, including MIIT, GAPP and MOC. Under the Electronic Publication Regulations and other regulations issued by GAPP, online games are classified as a kind of electronic production and publishing of online games is required to be done by licensed electronic publishing entities with standard publication codes. The Internet Publication Regulations require online game operators, to obtain an Internet Publication License from GAPP prior to directly making its online games publicly available in the PRC. Under the revised Internet Culture Regulations, which became effective on April 1, 2011, online game operators are required to apply to the local branch of MOC for a Network Culture Operating Permit as online games fall within the scope of Internet cultural products.

On March 5, 2009, MIIT issued the Measures on Administration of Software Products ("**Software Measures**") (軟件產品管理辦法), which became effective on April 10, 2009 and replaced the previous measures governing software products issued on October 27, 2000. The Software Measures regulate development, production, sales, import and export of software products in the PRC with the view to promote the development of the PRC software industry. The Software Measures provide a registration and filing system with respect to software products made in or imported into the PRC. These software products may be registered with the competent local software registration authority authorized by the local branch of MIIT. Registered software products may enjoy preferential treatment pursuant to the relevant software industry regulations. Software products can be registered for five years, and registration can be renewed upon expiration. In order to further implement the Computer Software Protection Regulations (計算機軟件保護條例) promulgated by the State Council on December 20, 2001, the National Copyright Administration of the PRC issued the Computer Software Copyright Registration Procedures (計算機軟件著作權登記辦法) on February 20, 2002, which apply to software copyright registration, license contract registration and transfer contract registration.

According to the Circular on Purifying Online Games (關於淨化網絡遊戲工作的通知) jointly issued by MOC, MIIT, SAIC and other relevant government authorities on June 9, 2005, if an online game is not registered and filed under the Software Measures, it may not be released in the PRC.

Regulations on Online Game Censorship and Imported Games

On May 14, 2004, MOC issued the Notice Regarding the Strengthening of Online Game Censorship ("**Censorship Notice**") (文化部關於加強網絡遊戲產品內容審查工作的通知), which mandates the establishment of a new committee under MOC that will screen the content of imported online games. In addition, all imported and domestic online games are required to be examined and filed with MOC.

On July 12, 2005, MOC and MIIT promulgated the Opinions on the Development and Administration of Online Games (關於網絡遊戲發展和管理的若干意見), reflecting the government's intent to both foster and control the development of the online game industry in the PRC. In addition, MOC will censor online games that "threaten state security", "disturb the social order", or contain "obscenity" or "violence."

Pursuant to Circular 13, online game operators must provide each online game to GAPP for examination and approval prior to its online release. Circular 13 further provides that GAPP is responsible for the examination and approval of any imported online games. Any online game operator that intends to operate imported online games shall first apply for approval on copyright registration certificate from the relevant local branch of the Copyright Administration and then pre-approval from GAPP.

On November 13, 2009, MOC issued its Notice Regarding Improving and Strengthening the Administration of Online Game Content ("**Online Game Content Notice**") (文化部關於改進和加強網絡遊戲內容管理工作的通知), calling for online game operators to improve and innovate their game models. Emphasis is placed specifically on the following: (i) mitigating the pre-eminence of the "upgrade by monster fighting" model, (ii) imposing more severe restraints on the "player kill" model, (iii) restricting in-game marriages among game players; and (iv) improving the enforcement of the legal requirements for the registration of minors and gaming time-limits.

The Online Game Content Notice also requires online game operators to set up a committee to carry out game content self-censorship. The person responsible for such self-censorship must receive training from MOC or its local branch. MOC also intends to introduce a training and evaluation system for the persons in charge of research and development and operations at online game companies. In addition, MOC intends to formulate technical standards and norms for game development in order to provide technological support for original domestic games. The development and operation of "thoughtful and educational" online games is also to be encouraged.

On June 3, 2010, MOC issued the Interim Measures for the Administration of Online Games, which became effective on August 1, 2010 ("**Online Game Measures**") (網絡遊戲管理暫行辦法). The Online Games Measures govern the activities with respect to online game development and operations, issuance of virtual currency, and provision of virtual currency exchange service. The Online Game Measures require that domestic online games must be filed with MOC within 30 days of their initial online release and in case of any substantial change. The Online Game Measures also require that all imported online games be subject to content review by MOC prior to their online release.

On July 29, 2010, MOC issued the Notice of the Ministry of Culture on the Implementation of the Interim Measures for the Administration of Online Games (文化部關於貫徹實施《網絡遊戲管理暫行辦法》的通知), which took effect on date of its issuance. This notice provides details as to the requirements relating to applications for Network Culture Operating Permits and the MOC's content review of online games. In addition, the notice emphasizes the protection of minors playing online games and requires online game operators to promote real-name registration users of their games.

Regulations on Web-based Games

Generally speaking, Circular 13 and Online Game Measures include web-based games within the definition of online games. Prior to the promulgation of Circular 13 and the Online Game Measures, both GAPP and MOC attempted to regulate the operation and operators of MMORPGs, although there was no specific regulation or policy that included web-based games as online games. However, due to the growing popularity of social and web-based games, these games are coming under increasing scrutiny with efforts being made to limit the role and impact of foreign companies in this sector. GAPP and MOC have both indicated that social and web-based games should be regulated similarly to other online games.

Regulations on Virtual Currency

On February 15, 2007, MOC, PBOC and other relevant government authorities jointly issued the Notice on the Reinforcement of the Administration of Cybercafe and Online Games ("**Cybercafe Notice**") (關於進一步加強網吧及網絡遊戲管理工作的通知). Under the Cybercafe Notice, PBOC is directed to strengthen the administration of virtual currency in online games to avoid any adverse impact on the real economic and financial systems. The Cybercafe 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 e-Commerce transactions. This notice also provides that (i) virtual currency should only be used to purchase virtual items provided in the online games by the online game operator; (ii) if the customers would like to redeem the virtual currency for legal currency, the amount so redeemed shall not exceed the original purchase amount; and (iii) the activity of buying and reselling virtual currency for a profit is strictly prohibited.

On June 4, 2009, MOC and MOFCOM jointly issued the Notice on the Strengthening of Administration on Online Game Virtual Currency ("**Virtual Currency Notice**") (關於加強網絡遊戲虛擬貨幣管理工作的通知). Virtual currency is broadly defined in the Virtual Currency Notice as a type of virtual exchange instrument issued by Internet game operation enterprises, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the Internet game operation enterprises in electronic record format and represented by specific numeric units. Virtual currency is used to exchange Internet game services provided by the issuing enterprise for a designated extent and time, and is represented by several forms, such as prepaid game cards, prepaid amounts or Internet game points. Game props, which are virtual items or equipment obtained from playing online games, are excluded from the definition of virtual currency. The Virtual Currency Notice specifically states that game props should not be confused with virtual currency and that MOC, jointly with other authorities, will issue separate rules to govern them.

The Virtual Currency Notice divides the virtual currency business into (i) enterprise engaging in virtual currency issuing service, which is an online game operating enterprise engaged in the issuance and provide of virtual currency use service and (ii) enterprise engaging in virtual currency trading service, which is an enterprise providing a trading platform between the users in respect of the virtual currency.

On July 20, 2009, MOC promulgated the Filing Guidelines on Online Game Virtual Currency Issuing Enterprises and Online Game Virtual Currency Trading Enterprises ("網絡遊戲虛擬貨幣發行企業"、"網絡遊戲虛擬貨幣交易企業" 申報指南), which specifically defines "issuing enterprise" and "trading enterprise" and stipulates that a single enterprise may not operate both types of business. MOC also established that the activities of issuing virtual currency fall within the scope of "online game operations" and those enterprises must apply for a Network Culture Operating Permit.

In addition, when applying for an online game virtual currency issuing service business, an issuing enterprise must file detailed information about its virtual currency, including form, extent of circulation, unit purchase price, and how the virtual currency will be refunded upon termination of services. Issuing enterprises are prohibited from altering the unit purchase price of the virtual currency after filing, and must complete filing procedures with MOC or its local branch before issuing new types of virtual currency.

Pursuant to Virtual Currency Notice, virtual currency may not be used to pay for any services outside of the online game realm. The Virtual Currency Notice prohibits online game operators from awarding game props or virtual currency through lucky draws or lotteries that require users to first contribute cash or virtual currency.

Regulations on Anti-fatigue System and Real-Name Registration System

On April 15, 2007, MIIT, GAPP, the Ministry of Education and five other government authorities jointly issued the Notice on the Implementation of Online Game Anti-fatigue System to Protect the Physical and Psychological Health of Minors ("**Anti-fatigue Notice**") (關於保護未成年人身心健康實施網絡遊戲防沉迷系統的通知). Pursuant to the Anti-fatigue Notice, online game operators are required to install an "anti-fatigue system" that discourages game players under 18 years of age from playing games for more than five hours per day. Under such anti-fatigue system, three hours or less of continuous play by minors is considered to be "healthy," three to five hours to be "fatiguing," and five hours or more to be "unhealthy." Game operators are required to reduce the value of in-game benefits to a game player by half if the player has reached the "fatiguing" level, and to zero for the "unhealthy" level. To identify whether a game player is a minor and thus subject to the anti-fatigue system, online game operators must also use a real-name registration system.

On July 1, 2011, the GAPP, the Ministry of Education, MPS, MIIT and four other governmental authorities issued the Notice regarding Launch of Real-Name Verification for Online Game Anti-fatigue System ("**Real-Name Verification Notice**") (關於啓動網絡遊戲防沉迷實名驗證工作的通知). Pursuant to the Real-Name Verification Notice, starting from October 1, 2011, real-name verification for online game (excluding mobile online games) anti-fatigue systems shall be launched nationwide and the National Center for Citizen's Identification Card Number Search Service ("**ID Card Search Center**"), an affiliate of MPS, is responsible for the real-name verification for online game anti-fatigue systems. The ID Card Search Center shall verify the identification information reported by online game operators in a timely manner and effectively in accordance with the Procedures for Real-Name Verification for Online Game Anti-fatigue Systems (網絡遊戲防沉迷實名驗證流程). Online game operators shall be responsible for the recognition of real-name registration information of users, report any user identification information that needs to be verified and include users who have been determined to have provided fake identification information to the online game anti-fatigue system by real-name verification.

REGULATIONS ON INTERNET VALUE-ADDED SERVICES

Regulations on Instant Messaging and Short Messaging Services

There are no specific provisions under PRC regulations that regulate IM services. Instead, IM services are allowed to be provided by an ICP operator holding an ICP License without the need for separate and additional approvals from MIIT or any other government authorities. Therefore, the IM service will not be described as a particular service item appearing on the ICP License.

On April 15, 2004, MIIT issued the Notice on Certain Issues Regarding Standardizing Short Messaging Service ("**SMS Notice**") (關於規範短信息服務有關問題的通知). Pursuant to the SMS Notice, only duly approved ICP operators are permitted to provide SMS. The SMS Notice provides that an ICP operator engaging in SMS services must prominently advise users of the charge standards, collection methods and subscription cancellation procedures. In addition, the ICP operator shall provide SMS services strictly in accordance with users' requirements. Further, the ICP operators must examine the content of SMS to ensure compliance with PRC law. The service systems of the telecommunications operator and ICP operator must automatically record and keep for a period of five months information including the time of transmission and receipt, telephone numbers and codes of the sending and receiving terminal devices.

Regulations on Internet Bulletin Board Services and Microblog Services

Microblog or other SNS activities provided by an ICP operator are usually regarded as a type of BBS service and therefore an ICP License specifying the BBS service is required. Where the BBS service provided by the ICP operator involves any Internet cultural activities, such as online contests, online games or music, a Network Culture Operating Permit is also required.

On March 7, 2001, MIIT issued a Notice on Further Strengthening Administrative Regulation on Internet Information Bulletin Board Services ("**BBS Notice**") (關於進一步做好互聯網信息服務電子公告服務審批管理工作的通知). The BBS Notice regulates BBS services from six aspects: (i) the category and content of the forum shall be clearly specified; (ii) the editor of this BBS forum shall regulate the forum and if there are any improper content that violate applicable regulations, the website and the editor in charge of such forum shall be liable; (iii) user registration prior to using the BBS services; (iv) the rules governing the BBS services and the ICP operator shall be published in a conspicuous position on the webpage of the BBS forum; (v) the information posted by the BBS user shall be automatically monitored and manually filtered before release on the Internet; and (vi) if the website engages in the Internet information service business and provides information relating to topics such as, news, education and medicine, prior approval from the relevant authorities shall be obtained before applying for the ICP License to the local branch of MIIT.

On December 16, 2011, the Information Office of Beijing Municipal Government, Beijing Municipal Public Security Bureau, Beijing Communications Administration and the Internet Information Office of Beijing Municipality jointly promulgated the Several Provisions of the Beijing Municipality on the Administration and Development of Microblog in Beijing ("**Beijing Microblog Provision**") (北京市微博客發展管理若干規定). Beijing Microblog Provision applies to websites within the jurisdiction of the Beijing Municipality that provide microblog services and their microblog users. Pursuant to the Beijing Microblog Provision, websites that provide microblog services shall establish and improve their information content examination system to monitor the creation, copying, publishing and dissemination of microblog information content. Entities or individuals who register microblog accounts to create, copy, publish and disseminate information content shall use true identity information and shall not register with fake or fraudulent resident identity information, enterprise registration information or organization code information. Websites that provide microblog services shall guarantee the authenticity of the registration information of users.

Regulations on Internet News Publication and Dissemination

On November 7, 2000, SCIO and MIIT jointly promulgated the Provisional Measures for Administration of Internet Websites Carrying on the News Publication Business ("**Internet News Measures**") (關於互聯網站從事登載新聞業務管理暫行規定). These measures require an ICP operator, other than a government authorized news unit/organization, to obtain the approval from SCIO to publish news on its website or disseminate news through the Internet. Furthermore, any disseminated news is required to be obtained from government-approved sources based on contracts between the ICP operator and these sources or produced by the ICP operators themselves. The copies of such contracts must be filed with the news office of the provincial-level government.

On September 25, 2005, SCIO and MIIT jointly issued the Provisions on the Administration of Internet News Information Services (互聯網新聞信息服務管理規定), which requires Internet news information service organizations to obtain the Internet News Information Service License from SCIO before they can provide the approved service and file an annual business report to SCIO or its local branch.

Regulations on Internet Medicine Information Services and Internet Medical Care Information Services

On July 8, 2004, State Food and Drug Administration ("**SFDA**") promulgated the Administration Measures on Internet Medicine Information Service ("**Medicine Information Measures**") (互聯網藥品信息服務管理辦法). The Medicine Information Measures set forth the classification, application, approval, content, qualifications and requirements for Internet medicine information services. Under the Medicine Information Measures, an ICP operator that provides medicine information service shall obtain an Internet Medicine Information Service Qualification Certificate, which is valid for 5 years, from the SFDA local branch before it applies for the ICP License. The ICP operator must clearly display its Internet Medicine Information Service Qualification Certificate number on its website.

On September 20, 2005, the SFDA promulgated the Interim Provisions on the Approval of Internet Drug Transaction Services ("**Drug Transaction Provisions**") (互聯網藥品交易服務審批暫行規定), effective on December 1, 2005. The SFDA issued two notices concerning the implementation of the Drug Transaction Provisions on October 25, 2005 and March 3, 2006, respectively. According to the Drug Transaction Provisions and these implementation notices, enterprises engaging in the Internet drug transaction services shall obtain Internet drug transaction services organization qualification certificates. Internet drug transaction services include services provided for Internet drug transactions among pharmaceutical production enterprises, pharmaceutical marketing enterprises and medical institutions, services provided for Internet drug transactions conducted by pharmaceutical production enterprises and pharmaceutical wholesale enterprises through their own websites with enterprises other than the members of their enterprise groups, as well as services provided for Internet pharmaceutical transactions by individual consumers.

On May 1, 2009, Ministry of Health ("**MOH**") promulgated the Administration Measures on Internet Medical Care Information Service ("**Medical Information Measures**") (互聯網醫療保健信息服務管理辦法), which became effective on July 1, 2009. Under the Medical Information Measures, an ICP operator that provides medical care information service shall obtain a consent letter for Internet Medical Care Information Service, which is valid for two years, from the MOH local branch before it applies for the ICP License. Online medical advertisements must also comply with the Measures for the Administration of Medical Advertisements (醫療廣告管理辦法) jointly promulgated by MOH and SAIC on September 27, 1993 and amended on November 10, 2006.

Regulations on Online Music

On November 20, 2006, MOC issued Several Suggestions of the Ministry of Culture on the Development and Administration of Internet Music ("**Suggestions**") (關於網絡音樂發展和管理的若干意見), which became effective on that date. The Suggestions, among other things, reiterate the requirement for an ICP operator to obtain the Network Culture Operating Permit to carry out any business relating to Internet music products. In addition, foreign investors are prohibited from operating Internet culture businesses. The Suggestions further provide that, any online music that will be circulated within the PRC is required to (i) for foreign music, be approved for importation by MOC and (ii) for domestic music, be registered with MOC. Imported online music is required to be filed for content review by MOC before being circulated online.

On August 18, 2009, MOC promulgated the Notice on Strengthening and Improving the Content Review of Online Music ("**Online Music Notice**") (關於加強和改進網絡音樂內容審查工作的通知). According to the Online Music Notice, only "Internet culture operating entities" approved by MOC may engage in the production, release, dissemination, including providing direct links to music products, and importation of online music products. The content of online music shall be reviewed by or filed with MOC. Furthermore, Internet culture operating entities are required to establish a strict self-monitoring system of online music content and set up a special department in charge of such monitoring.

Since 2010, MOC has taken great efforts to crack down music websites which carry out an online music operation without approval. It is expected that MOC will release more regulations and tighten its regulatory enforcement on online music operations in the future.

Regulations on Online Audio/Video Broadcasting

On July 6, 2004, SARFT promulgated the Rules for the Administration of Broadcasting of Audio and Video Programs through the Internet and Other Information Networks ("**Audio and Video Broadcasting Rules**") (互聯網等信息網絡傳播視聽節目管理辦法), which became effective on October 11, 2004. The Audio and Video Broadcasting Rules apply to the launch, broadcasting, aggregation, transmission or download of audio or video programs via the Internet and other information networks. Anyone who wishes to engage in Internet broadcasting activities must first obtain an Information Network Audio and Video Program Dissemination License, with a term of two years, issued by SARFT and operate pursuant to the scope as provided in such license.

On April 13, 2005, the State Council announced Several Decisions on Investment by Non-state-owned Companies in Culture-related Business in China (國務院關於非公有資本進入文化產業的若干決定). These decisions encourage and support non-state-owned companies to enter certain culture-related business in the PRC, subject to restrictions and prohibitions for investment in audio or video broadcasting, website news and certain other businesses by non-state-owned companies. These decisions authorize SARFT, MOC and GAPP to adopt detailed implementation rules according to these decisions.

On December 20, 2007, SARFT and MIIT jointly issued the Rules for the Administration of Internet Audio and Video Program Services ("**Circular 56**") (互聯網視聽節目服務管理規定). Circular 56 reiterates the requirement set forth in the Audio and Video Broadcasting Rules that Internet (including mobile network) audio and video service providers must obtain the Information Network Audio and Video Program Dissemination License from SARFT. Furthermore, Circular 56 requires all Internet audio or video service providers to be either wholly state-owned or state-controlled. According to relevant official answers to press questions published on SARFT's website dated February 3, 2008, officials from SARFT and MIIT clarified that Internet audio or video service providers (foreign-invested websites not included) that have been operating lawfully prior to the issuance of Circular 56 may re-register and continue to operate without becoming state-owned or controlled, provided that such providers have not engaged in any unlawful activities. This exemption will not be granted to Internet audio or video service providers established after Circular 56 was issued. Such policies have been reflected in the application procedures for Audio and Video Program Dissemination License.

On December 28, 2007, SARFT issued the Notice on Strengthening the Administration of TV Dramas and Films Transmitted via the Internet ("**Notice on Dramas and Films**") (關於加強互聯網傳播影視劇管理的通知). According to the Notice on Dramas and Films, before an ICP operator makes film and drama programs available online, it must obtain the Permit for Issuance of TV Dramas, the Permit for Public Projection of Films, the Permit for Issuance of Cartoons and/or the Permit for Public Projection of Academic Literature Movies and TV Plays accordingly. In addition, the ICP operator must obtain authorization from the copyright owners of the film and drama programs regarding the online dissemination.

On March 31, 2009, SARFT issued the Notice on Strengthening the Administration on Content of Internet Audio-Visual Programs (關於加強互聯網視聽節目內容管理的通知), which requires that Internet audio and video service providers must edit or delete programs that contain illegal content and improve their program content administration systems. Internet audio and video service providers should obtain relevant permits such as film screening license, television drama distribution license or television animation distribution license etc. for the TV dramas and films they provide.

On September 15, 2009, SARFT issued the Notice on Issues Concerning the Administration of Internet Audio-Video Program Service Permits (關於互聯網視聽節目服務許可證管理有關問題的通知). According to this notice, any website or individual that has not obtained an Information Network Audio and Video Program Dissemination License may not provide audio-video program services via the Internet. The administrative departments in charge of radio, film and television at all levels shall order the websites and individuals that provide Internet-based audio-video program services without having obtained the Information Network Audio and Video Program Dissemination Licenses to immediately cease such unauthorized services.

On March 17, 2010, SARFT issued the Internet Audio and Video Program Services Categories (Provisional) ("**Categories**") (互聯網視聽節目服務業務分類目錄(試行)), which classify Internet audio and video programs into four categories. Category I includes Internet audio and video programs that take the form of broadcast station and television station and is only open to state-owned broadcast media companies. The other three categories are open to privately-held entities and include non-political Internet audio/video programs, programs uploaded by Internet users and Internet relay programs.

On April 6, 2011, the GAPP and General Administration of Customs jointly issued the "Administrative Measures for Importing Audio and Video Products" (音像製品進口管理辦法) and repealed the old Administrative Measures for Importing Audio and Video Products which had been effective since June 1, 2002. According to these Measures, the government implements a licensing system to the import of Audio and video products, and the importer of audio and video products shall report to the GAPP for content examination before import and may import audio and video products only after obtaining a license upon approval.

Regulations on Production and Operation of Radio and TV Programs

On July 19, 2004, SARFT promulgated the Administrative Measures on the Production and Operation of Radio and Television Programs ("**Radio and TV Programs Measures**") (廣播電視節目製作經營管理規定), which became effective on August 20, 2004. These measures provide that anyone who wishes to produce or operate radio or television programs must first obtain the Permit for Production and Operation of Radio and TV Programs from SARFT or its local branches. Applicants for this permit must meet several criteria, including having a minimum registered capital of RMB3 million. Entities with the Permit for Production and Operation of Radio and TV Programs must conduct their business operations in strict compliance with the approved scope of production and operation provided under the permit. Furthermore, entities other than radio and TV stations are strictly prohibited from producing radio and TV programs covering contemporary political news or similar subjects and topics.

On July 9, 2012, SARFT and SIIO jointly issued the Notice on Further Strengthening the Administration of Internet Dramas, Micro-Films, and Other Internet Audio/Video Programs (關於進一步加強網絡劇、微電影等網絡視聽節目管理的通知). Pursuant to this notice, Internet companies offering audio/video programming services must review the contents of Internet dramas, micro-films and other Internet audio/video programs before broadcasting in accordance with the principle of "you provide Internet services, you take responsibility for it." The notice also requires Internet audio/video programming industry associations to perform industry self-regulation functions and government departments shall regulate market access and withdraw Internet audio/video programming service providers in accordance with the relevant laws and regulations.

Regulations on Online Trading

Currently, unless otherwise mentioned herein, there is no PRC law or regulation at the national level that requires a special license, qualification or permit be obtained in order to provide an online trading platform service.

On March 6, 2007, MOFCOM promulgated the Guiding Opinions of the Ministry of Commerce on Online Trading (Interim) ("**Online Trading Opinions**") (商務部關於網上交易的指導意見(暫行)). Under the Online Trading Opinions, an online trading platform operator, as one type of the online trading service operator, shall (i) be qualified as a legal entity; (ii) standardize its service and set up a user registration system, trading rules, information disclosure and examination system and other necessary systems; (iii) provide proper information disclosure to the users; (iv) maintain transaction in order; (v) protect users' interest and costumers' benefit; (vi) store trading information and ensure data security; (vii) monitor the information on its online trading platform; and (viii) maintain online platform system security.

On May 31, 2010, SAIC promulgated the Interim Measures for the Trading of Commodities and Services through the Internet ("**Internet Trading Measures**") (網絡商品交易及有關服務行為管理暫行辦法), which became effective on July 1, 2010. Under the Internet Trading Measures, an online trading platform operator is obligated to, without limitation, (i) examine the identification of merchandisers using the platform; (ii) enter into agreements with merchandisers using the platform; (iii) set up platform rules and regulations; (iv) inspect and supervise the trading information and activities on the platform; (v) take measures to protect the trademark, enterprise name use right and other proprietary rights, (vi) protect and maintain confidentiality of trade secrets and private data, and (vii) comply with other requirements and cooperate with SAIC or its local branch for monitoring illegal online trading activities and protecting consumers' rights.

On April 2, 2009, MOFCOM promulgated the Norms for e-Commerce Model ("**e-Commerce Norms**") (電子商務模式規範), which became effective on December 1, 2009. Under the e-Commerce Norms, e-Commerce operators shall guarantee that their commodities or services meet the requirements for the safety of person or property. e-Commerce operators shall not offer defective commodities or services or conduct false promotion and shall not default or conduct any infringing acts. Where a dispute arises between a consumer, buyer or individual and an e-Commerce operator, the operator shall bear the burden of proof for the legitimacy of its operation, while the consumer, buyer or individual shall prove the existence of any alleged damage.

On April 2, 2009, MOFCOM promulgated the Norms for Online Transaction Services ("Online Transaction Norms") (網絡交易服務規範), which became effective on December 1, 2009. Under the Online Transaction Standards, products or services that require qualification and have not been examined or approved by competent authorities cannot be provided and traded in online transactions. The Online Transaction Norms require that online transaction platform providers and online payment platform providers shall provide an online dispute handling mechanism and complaint channel; online transaction platform providers and online payment platform providers shall positively assist the investigation and dispute resolution when there is a dispute.

On August 19, 2010, MOFCOM promulgated the Notice of Relevant Issues concerning the Examination, Approval and Administration of Projects of Foreign Investment in Internet and Vending Machine Sales ("**Internet Trading Notice**") (商務部辦公廳關於外商投資互聯網、自動售貨機方式銷售項目審批管理有關問題的通知). Under the Internet Trading Notice, a foreign-invested enterprise, which provides online trading services using its own online platform, shall apply to MIIT for a value-added telecommunications business operation license; and a foreign-invested enterprise, which directly engages in commodity sales through its own online platform, shall register with the telecommunications administration authority.

On January 5, 2011, MOFCOM issued the "Notice of the Ministry of Commerce on Regulating Sales Promotion Acts of Online Shopping" (商務部關於規範網絡購物促銷行為的通知). The Notice requires online shopping companies: (i) to conduct sales promotion according to law; (ii) to ensure the quality of promotional commodities; (iii) to protect the legitimate rights and interests of consumers and government authorities (iv) to severely investigate and punish false promotion publicity; (v) to strengthen intellectual property rights protection; and (vi) to advocate scientific and rational consumption.

On April 12, 2011, MOFCOM promulgated the Service Norms for Third-Party Electronic Commerce Trading Platform ("**Service Norms**") (第三方電子商務交易平台服務規範). The Service Norms recommend that platform operators supervise online merchandisers in the following aspects: member registration, contract standardization, information management, order maintenance, error trading handling, intellectual property protection and prohibited acts. The Service Norms propose that the platform requires online merchandisers to establish and carry out the reputation system with respect to various commercial commodities by contracts or other methods. It should be noted that all technical contents of the Service Norms are recommended approaches.

Regulations on Online Payment Services

On June 14, 2010, PBOC promulgated the Administration Measures on Non-financial Institutions Payment Services ("**Payment Measures**") (非金融機構支付服務管理辦法), which became effective on September 1, 2010. On December 1, 2010, PBOC promulgated the Implementing Rules for the Administration Measures on Non-financial Institutions Payment Services (非金融機構支付服務管理辦法實施細則). Pursuant to the Payment Measures and their implementing rules, non-financial institutions which intend to engage in online payment services, shall satisfy various requirements in connection with registered capital, number of qualified professionals, anti-money laundering measures, corporate structure, internal control and risk management, and shall maintain full compliance records for the last three years. The Payment Measures require all non-financial institutions engaged in online payment services to obtain a Payment Service License from PBOC within a one-year grace period commencing from September 1, 2010. Failure to obtain the Payment Service License will lead to the termination of the right to provide online payment services.

On June 16, 2011, the PBOC promulgated the Provisions on the Administration of Testing and Certification of the Payment Service Business Systems of Non-financial Institutions (非金融機構支付服務業務系統檢測認證管理規定), which require that non-financial institutions shall have their business systems tested and certified within six months before applying for the payment service permits. Non-financial institutions must have their business systems tested and certified in a comprehensive manner at least once every three years according to their needs for payment business development and safety management.

Regulations on Online Search Services

Pursuant to the currently effective Catalogue of Telecommunications Business, "value-added telecommunication services" cover, among other things, "the information service", which is defined as "to provide, by means of information collection, development, processing and building of the information platform, online information and data search services through the public communication network (such as fixed network, mobile network and Internet) to the general public." Therefore, online search service falls within the scope of value-added telecommunication services. An enterprise that intends to carry out the business of online search service is required to hold a valid ICP License, setting out that the ICP operator is permitted by the MIIT to provide Internet information services.

An online search service provides links to other websites in response to search queries. The operators of such linked websites shall be responsible for maintaining appropriate approvals, licenses, permits and registrations in connection with the contents on the linked websites.

Regulations on Email Services

On February 20, 2006, the MIIT promulgated the Administrative Measures on Electronic Mail Services on the Internet ("**Email Service Measures**") (互聯網電子郵件服務管理辦法), which became effective on March 30, 2006. Pursuant to the Email Service Measures, an Internet email service provider shall obtain a license for the operation of value-added telecommunications services or go through the formalities for record-filing for non-profit Internet information services. An Internet email service provider shall, 20 days prior to the commencement of use of the email servers, register the IP address of the Internet email server with the MIIT or its local branches.

Regulations on Online Sales of Lottery Tickets

On September 26, 2010, the Ministry of Finance issued the Interim Measures for the Administration of Sales of Lottery Tickets via the Internet ("**Lottery Tickets Measures**") (互聯網銷售彩票管理暫行辦法), pursuant to which a lottery issuing organization may collaborate with an entity or authorize a lottery sales organization to carry out the business of selling lottery tickets via the Internet or authorize an entity to carry out the business of lottery sales agency via the Internet. Cooperating entities and Internet sales agents shall meet several qualifications and shall sign a cooperation agreement or sales agency contract with the lottery issuing organization.

REGULATIONS ON MVAS

Regulations on Short Messaging Services and Other Mobile-based Wireless Services

Pursuant to the currently effective Catalogue of Telecommunications Business, messaging service, search engine, mobile-based music or games and download of mobile software fall under the scope of information service, and therefore an Operating Permit (Mobile Network) Value-added Telecommunications Business ("**SP License**") is required for engaging in such business operations.

On April 15, 2004, MIIT issued the SMS Notice, specifying that only those information service providers holding the SP License can provide short messaging services in the PRC. The SMS Notice provides that service providers are required to expressly advise users of the charge standards, collection methods and subscription and cancellation procedures. In addition, operators shall provide SMS strictly in accordance with users' requirements. The SMS Notice also specifies that operators shall examine the contents of short messages and automatically record and store for five months the time of sending and receiving the short messages, the mobile numbers or codes of the sending and receiving terminals.

Regulations on Telecommunications Networks Code Number Resources

A value-added telecommunications service provider must apply to MIIT authorities to obtain a telecommunications network code number. On January 29, 2003, MIIT issued the Administrative Measures on Telecommunications Networks Code Number Resources ("**Code Number Measures**") (電信網碼號資源管理辦法) to regulate network code numbers, including those of mobile communications networks. According to the Code Number Measures, service providers who provide services across provinces shall apply to MIIT, and entities which apply for network code numbers to be used within a provincial-level administrative region shall apply to the relevant provincial branch of MIIT. The Code Number Measures also specify the qualification requirements, application materials and application procedures to obtain network code numbers.

In June 2006, MIIT issued the Administrative Measures on Application, Distribution, Usage and Withdrawal of SMS Services Access Codes ("**SMS Code Measures**") (短消息類服務接入代碼申請、分配、使用和收回管理辦法). According to the SMS Code Measures, the administration and usage of services relating to SMS codes shall comply with the Code Number Measures. The SMS Code Measures also specify that operators who provide services relating to SMS codes across provinces shall apply with the relevant provincial branch of MIIT. The SMS code for a commercial SMS provider is valid for the term specified in the SP License, while the SMS code for the noncommercial SMS provider is valid for five years.

REGULATIONS ON ONLINE ADVERTISEMENTS

The principal regulations governing advertising businesses in the PRC include: (i) the Advertising Law of the PRC (廣告法) promulgated by the Standing Committee of the National People's Congress on October 27, 1994 and effective on February 1, 1995, (ii) the Advertising Administrative Regulations (廣告管理條例), promulgated by the State Council on October 26, 1987 and effective on December 1, 1987, and (iii) the Implementing Rules for the Advertising Administrative Regulations (廣告管理條例施行細則) promulgated by SAIC on November 30, 2004 and effective on January 1, 2005.

The PRC government regulates advertising, including online advertising, principally through SAIC. Prior to November 30, 2004, in order to conduct any advertisement business, an enterprise was required to hold an advertising operation license in addition to a relevant business license. On November 30, 2004, SAIC issued the Administrative Rules for Advertising Operation Licenses (廣告經營許可證管理辦法), which became effective on January 1, 2005 and granted a general exemption to this requirement for most enterprises, other than radio stations, television stations, newspapers and magazines, non-corporate entities and entities specified in other regulations. Nonetheless, an enterprise that engages in advertising activities must obtain a business license, which specifically includes operating an advertising business within its business scope from SAIC or its local branch.

There is no PRC law or regulation at the national level that specifically regulates online advertising business. However, certain local regulations have imposed license requirements on the online advertising business. SAIC has also expressed its intent to further tighten its supervision over the online advertising business.

PRC advertising laws and regulations set forth certain content requirements for advertisements in the PRC, which include prohibitions of, among other things, misleading content, superlative wording, socially destabilizing content or content involving obscenities, superstition, violence, discrimination or infringement of the public interest. Advertisements for anesthetic, psychotropic, toxic or radioactive drugs are prohibited. The dissemination of advertisements of some other products, such as tobacco, patented products, pharmaceuticals, medical instruments, agrochemicals, foodstuff, alcohol and cosmetics are also subject to specific restrictions and requirements.

Advertisers, advertising operators and advertising distributors are required by PRC advertising laws and regulations to ensure that the contents of the advertisements they produce or distribute are true and in full compliance with applicable laws and regulations. In addition, where a special government review is required for certain categories of advertisements before publishing, the advertisers, advertising operators and advertising distributors must ensure that such review has been duly performed and that the relevant approval has been obtained. Violation of these regulations may result in penalties, including fines, confiscation of advertising income, orders to cease dissemination of the advertisements and orders to publish an advertisement correcting the misleading information. In circumstances involving serious violations, SAIC or its local branches may order the violator to terminate its advertising operation or even revoke its business license. Furthermore, advertisers, advertising operators or advertising distributors may be subject to criminal liability if their conduct breaches the criminal law or subject to civil liability if their conduct infringes on the legal rights and interests of third parties.

On August 22, 2008, SAIC and MOFCOM issued the Regulations on the Administration of Foreign-Invested Advertising Enterprises ("**Foreign-Invested Advertising Regulations**") (外商投資廣告企業管理規定) which became effective on October 1, 2008. According to the Foreign-Invested Advertising Regulations, foreign investor(s) should obtain an approval opinion from SAIC or its provincial-level branches before the provincial branches of MOFCOM can approve the establishment of the foreign-invested advertising enterprises. The Foreign-Invested Advertising Regulations also provide for certain requirements for qualifications of the foreign investors.

REGULATIONS RELATING TO INTELLECTUAL PROPERTY

Copyright

The Copyright Law of the PRC (著作權法), adopted in 1991 and revised in 2001 and 2010, together with its implementing rules (著作權法實施條例), promulgated in 2002, protect copyright and explicitly cover computer software copyrights. On December 20, 2001, the State Council promulgated the new Regulations on Computer Software Protection (計算機軟件保護條例), which became effective from January 1, 2002, are intended to protect the rights and interests of computer software copyright holders and encourage the development of the software industry and information economy. The Provisional Measures on Voluntary Registration of Works (作品自願登記試行辦法), promulgated by National Copyright Administration of the PRC on December 31, 1994 and effective on January 1, 1995, further provides for a voluntary registration system to be administered by the National Copyright Administration and its local branches. In the PRC, software developed by PRC citizens, legal person or other organizations is automatically protected by copyright immediately after its development without an application or approval. The Copyright Protection Center of China may provide a certificate of registration to registrants which may serve as preliminary evidence of the ownership of the copyright and other registered matters. On February 20, 2002, the National Copyright Administration of the PRC introduced the Measures on Computer Software Copyright Registration (計算機軟件著作權登記辦法), which outlines the application procedures for software copyright registration, license contract registration and transfer contract registration.

On May 18, 2006, the State Council promulgated the Regulations on Protection of the Right of Dissemination through Information Networks ("**Protection Regulations**") (信息網絡傳播權保護條例), which became effective on July 1, 2006. The Protection Regulations require that any organization or individual who disseminates a third-party's work, performance, audio or visual recording products to the public through information networks shall obtain permission from and pay compensation to, the legitimate copyright owner of such products, unless otherwise provided under relevant laws and regulations. The legitimate copyright owner may take technical measures to protect his or her right to disseminate through information networks and any organization or individual shall not intentionally avoid, destroy or otherwise assist others in avoiding such protective measures unless permissible under law.

In order to address copyright issues relating to the Internet, the PRC Supreme People's Court adopted and revised the Interpretations on Some Issues Concerning Applicable Laws for Trial of Disputes over Internet Copyright in 2000, 2003 and 2006 (together, "**Internet Copyright Interpretations**"). The Internet Copyright Interpretations establish joint liability for Internet service providers if they participate in, assist in or abet infringing activities committed by any other person through the Internet, are aware of infringing activities committed by their users through the Internet and fail to remove infringing content or take other action to eliminate infringing consequences after receiving an infringement notice from the legitimate copyright holder. In addition, Internet service providers will be held liable for copyright infringement if they knowingly upload, transmit or provide any methods, equipment or materials which are intended to bypass or disrupt technologies designed to protect copyright holders. Upon request, the Internet service providers shall provide the copyright holder with the registration information of the alleged infringer for legal claims, provided that such copyright holder has produced relevant evidence of identification, copyright ownership and infringement.

Patent

The National People's Congress adopted the Patent Law (專利法) in 1984, and amended it in 1992, 2000 and 2008. The purpose of the Patent Law is to protect the lawful interests of patent holders, encourage invention, foster applications of invention, enhance innovative capabilities and promote the development of science and technology. To be patentable, invention or utility models must meet three conditions: novelty, inventiveness and practical applicability. Patents cannot be granted for scientific discoveries, rules and methods for intellectual activities, methods used to diagnose or treat diseases, animal and plant breeds, substances obtained by means of nuclear transformation or a design which identifies the patterns or colors or a combination of both patterns and colors of graphic print products. The Patent Office, under the State Intellectual Property Office, is responsible for receiving, examining and approving patent applications. A patent is valid for a term of twenty years in the case of an invention and a term of ten years in the case of utility models and designs. A third-party user must obtain consent or a proper license from the patent owner to use the patent. Otherwise, the use constitutes an infringement of patent rights.

Trademark

The Trademark Law of the PRC (商標法), adopted in 1983 and revised in 1993 and 2001, protects registered trademarks. The Trademark Office under SAIC is responsible for trademark registrations. Upon the registration of a trademark, the applicant will have the right to exclusive use of the trademark for ten years. Registered trademark license agreements must be recorded with the Trademark Office.

Domain Name

Internet domain name registration and related matters are primarily regulated by the Implementing Rules on Registration of Domain Names(域名註冊實施細則) issued by CNNIC, which became effective on June 5, 2009, as amended on May 28, 2012, the Measures on Administration of Domain Names for the Chinese Internet (中國互聯網絡域名管理辦法), issued by MIIT on November 5, 2004 and effective on December 20, 2004, and the Measures on Domain Name Disputes Resolution (域名爭議解決辦法) issued by CNNIC on February 14, 2006 and effective on March 17, 2006 as amended on May 28, 2012. These regulations provide that domain name registrations will be handled through domain name service agencies and that applicants become domain name holders upon successful domain name registration.

OTHER REGULATIONS

Regulations on Information Security

The National People's Congress has enacted legislation that prohibits use of the Internet that breaches public security, disseminates socially destabilizing content or leaks state secrets. A breach of public security is defined as a breach of national security or disclosure of state secrets; infringement on state, social or collective interests or the legal rights and interests of citizens; or illegal or criminal activities. Socially destabilizing content includes any content that incites defiance or violation of PRC laws or regulations or subversion of the PRC government or its political system, spreads socially disruptive rumors or involves cult activities, superstition, obscenities, pornography, gambling or violence. State secrets are defined broadly to include information concerning PRC national defense, state affairs and other matters as determined by the PRC authorities.

According to other relevant regulations, ICP operators must complete mandatory security filing procedures, regularly update information security and censorship systems for their websites with local public security authorities and report any public dissemination of prohibited content.

On December 13, 2005, the Ministry of Public Security promulgated Provisions on Technological Measures for Internet Security Protection ("**Internet Protection Measures**") (互聯網安全保護技術措施規定), which became effective on March 1, 2006. The Internet Protection Measures requires all ICP operators to keep user information records, including user registration information, log-in and log-out time, IP address, content and time of posts by users, for at least 60 days and submit the above information as required by laws and regulations. The ICP operators must regularly update information security and censorship systems for their websites with local public security authorities, and must also report any public dissemination of prohibited content. If an ICP operator violates these measures, the PRC government may revoke its ICP License and shut down its websites.

On December 16, 1997, MPS promulgated the Measures for Security Protection Administration of the International Networking of Computer Information Networks (計算機信息網絡國際聯網安全保護管理辦法), which requires that the ICP operators must regularly update information security and censorship systems for their websites with local public security authorities, and must also report any public dissemination of prohibited content. If an ICP operator violates these measures, the PRC government may revoke its ICP License and shut down its websites. In addition, the State Secrecy Bureau has issued provisions authorizing the blocking of access to any website it deems to be leaking state secrets or failing to comply with the relevant legislation regarding the protection of state secrets.

The newly amended Law on Preservation of State Secrets (保守國家秘密法), which became effective on October 1, 2010, provides that whenever an ICP operator detects any leakage of state secrets in the distribution of online information, it should stop the distribution of such information and report such violation to the state security and public security authorities. Upon the request of state security, public security or state secrecy authorities, the ICP operator must delete any contents on its website that may lead to disclosure of state secrets. Failure to do so on a timely and adequate manner may subject the ICP operator to liability and certain penalties enforced by the State Security Bureau, MPS and MIIT or their respective local branches.

Regulations on Internet Privacy

The PRC Constitution states that PRC law protects the freedom and privacy of communications of citizens and prohibits infringement of such rights. In recent years, PRC government authorities have enacted legislation on Internet use to protect personal information from any unauthorized disclosure. The Internet Measures prohibit an ICP operator from insulting or slandering a third party or infringing the lawful rights and interests of a third party. Pursuant to the BBS Measures, ICP operators that provide electronic messaging services must maintain the confidentiality of users' personal information and must not disclose such personal information to any third party without the user consent or unless required by law. The regulations further authorize the relevant government authorities to order ICP operators to rectify unauthorized disclosure. ICP operators are subject to legal liability if the unauthorized disclosure results in damages or losses to the users. The PRC government, however, has the power and authority to order ICP operators to turn over personal information if an Internet user posts any prohibited content or engages in illegal activities on the Internet.

Regulations on Internet Infringement

The Tort Law of the PRC ("**PRC Tort Law**") (侵權責任法) was promulgated by the Standing Committee of National People's Congress on December 26, 2009 and became effective on July 1, 2010. According to the PRC Tort Law, both Internet users and Internet service provider may be liable for the wrongful acts of users who infringe the legal rights and interests of other parties. Where an Internet user infringes upon the legal rights or interests of another through the use of Internet services, the party whose rights are infringed may request the Internet service provider whose Internet services are facilitating the infringement to take necessary measures including the deletion, blocking or disconnection of an Internet link. If, after being notified, the Internet service provider fails to take necessary measures in a timely manner to end the infringement, it will be jointly and severally liable for any further damages suffered by the rights holder. Further, if an Internet service provider is aware that an Internet user is utilizing its Internet services to infringe upon the civil rights or interests of others and fails to take necessary measures, it shall be jointly and severally liable with the Internet user for damages resulting from the infringement.

Regulations on Technology and Software Imports

On December 10, 2001, the State Council promulgated the Regulations on Administration of Import and Export of Technologies ("**Import and Export Technologies Regulations**") (技術進出口管理條例), which became effective on January 1, 2002. These regulations and related legislations set out the regime regulating the import and export of technologies. The import and export of technologies is broadly defined as including transfer or license of patents, software and know-how, and provision of services related to the technologies. Under the regime, technologies are classified as prohibited, restricted or freely-tradable. The technologies in the freely-tradable category may be traded freely without a special approval or license. The contracts for the export of freely-tradable technologies are required to be filed with the relevant government authority for their records but the filing procedure is not a pre-condition for effectiveness of the contracts.

To implement this requirement, the Administrative Measures for Registration of Technology Import and Export Contracts (技術進出口合同登記管理辦法), the Administrative Measures on Prohibited and Restricted Technology Exports (禁止出口限制出口技術管理辦法), the Administrative Measures on Prohibited and Restricted Technology Imports (禁止進口限制進口技術管理辦法) have been promulgated by MOFCOM or by MOFCOM jointly with other governmental authorities since February 2009.

MOFCOM is the principal approval authority for restricted technologies, as well as the registration authority for permitted technologies, but the Import and Export Technologies Regulations also provide that MOFCOM may delegate its approval and registration authority to its local branches. The operation and sales (distribution) of imported software in the PRC are also governed by the Software Measures.

Regulations Relating To Foreign Exchange and Dividend Distribution

The principal regulations governing foreign currency exchange in the PRC are the Regulations on Administration of Foreign Exchange ("**Foreign Exchange Regulations**") (外匯管理條例), promulgated by the State Council in 1996 and amended in 1997 and 2008. Under the Foreign Exchange Regulations, RMB is freely convertible for current account items, such as dividends distributions, interest payments, and trade and service-related foreign exchange transactions, on a basis of true and lawful transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside the PRC, unless the prior approval of SAFE is obtained and registration with SAFE is completed.

Pursuant to the Rules on Administration of Settlement, Sale and Payment of Foreign Exchange Provisions (結匯、售匯及付匯管理規定) issued by PBOC on June 20, 1996 and effective on July 1, 1996, foreign-invested enterprises in the PRC may purchase foreign currency, subject to a cap approved by SAFE, to settle current account transactions without the approval from SAFE. Foreign exchange transactions involving capital account items are still subject to limitations and will require approval from or registration with SAFE.

On August 29, 2008, SAFE issued the Circular 142 and on July 18, 2011, SAFE issued the Supplementary Notice on Issues Relating to the Improvement of Business Operations with Respect to the Administration over Payment and Settlement of Foreign Exchange Capital of Foreign-Invested Enterprises ("**Circular 88**") (關於完善外商投資企業外匯資本金支付結匯管理有關業務操作問題的補充通知). Circular 142 and Circular 88 require that the registered capital of a foreign-invested enterprise converted into RMB from foreign currencies be utilized only for purposes within its business scope approved by the applicable governmental authority and may not be used for equity investments in the PRC unless specifically permitted in its business scope or under applicable law. In addition, SAFE strengthened its oversight of the flow and use of RMB funds converted from the foreign currency-denominated capital of a foreign-invested company. The purpose for the use of such RMB funds may not be changed without approval from SAFE. In addition, the converted RMB funds may not be used to repay RMB loans if the proceeds of such loans have not yet been used for purposes within the company's approved business scope. Violations of Circular 142 and Circular 88 may result in severe penalties, including substantial fines imposed by the Foreign Exchange Regulations.

On November 19, 2010, SAFE promulgated the Notice of the State Administration of Foreign Exchange on Relevant Issues concerning Strengthening the Administration of the Foreign Exchange Business ("**Circular 59**") (關於加强外匯業務管理有關問題的通知), which requires that the governmental authority closely examine the authenticity of settlement of proceeds from offshore offerings. In particular, it specifically requires that proceeds from offshore offerings which will be converted into RMB shall be used in the manner as described in the offering documents.

The principal regulations governing distribution of dividends by wholly foreign-owned enterprises include the Company Law, the Law on Wholly Foreign-owned Enterprises of the PRC (外資企業法), adopted in 1986 and amended in 2000, the Implementing Rules of the Wholly Foreign-owned Enterprise Law (外資企業法實施細則), issued in 1990 and amended in 2001, and the PRC Enterprise Income Tax Law adopted in 2007 and its implementation rules in 2007. Under these laws and regulations, wholly foreign invested enterprises in the PRC may pay dividends only out of their accumulated profits, if any, determined in accordance with the PRC accounting standards and regulations. Wholly foreign-owned enterprises in the PRC are required to set aside at least 10% of their accumulated after-tax profits each year, if any, to fund certain statutory reserve funds, until the aggregate amount of the relevant fund reaches 50% of its registered capital.

Regulations on Offshore Investment by PRC Residents

Pursuant to Circular 75 issued by SAFE on October 21, 2005: (i) a PRC citizen residing in the PRC or non-PRC citizen primarily residing in the PRC due to his or her economic ties to the PRC, who is referred to as a PRC resident in Circular 75, shall register with the local branch of SAFE before it establishes or controls an overseas special purpose company, for the purpose of overseas equity financing; (ii) when a PRC resident contributes the assets of or its equity interests in a domestic enterprise into an overseas special purpose company, or engages in overseas financing after contributing assets or equity interests into a special purpose company, such PRC resident shall register his or her interest in the special purpose company and the change thereof with the local branch of SAFE; and (iii) when the special purpose company undergoes a material event outside of the PRC not involving inbound investments, such as change in share capital, creation of any security interests on its assets or merger or division, the PRC resident shall, within 30 days from the occurrence of such event, register such change with the local branch of SAFE. PRC residents who are shareholders of special purpose companies established before November 1, 2005 were required to register with the local branch of SAFE before March 31, 2006.

Under Circular 75, failure to comply with the registration procedures above may result in penalties, including imposition of restrictions on a PRC subsidiary's foreign exchange activities and its ability to distribute dividends to the overseas special purpose company.

To further clarify the implementation of the Circular 75, SAFE issued Circular 106 ("**Circular 106**") on May 29, 2007. Under Circular 106, PRC subsidiaries of an offshore special purpose company are required to coordinate and supervise the filing of foreign exchange registrations by the offshore holding company's shareholders who are PRC residents in a timely manner. If these shareholders fail to comply, the PRC subsidiaries are required to report to the local branch of SAFE. If the PRC subsidiaries of the offshore parent company do not report to the local branch of SAFE, they may be prohibited from distributing their profits and proceeds from any reduction in capital, share transfer or liquidation to their offshore parent company and the offshore parent company may be restricted in its ability to contribute additional capital into its PRC subsidiaries. Moreover, failure to comply with the above foreign exchange registration requirements could result in liabilities for such PRC subsidiaries under PRC laws for evasion of foreign exchange restrictions, including (i) requirements by SAFE to return the foreign exchange remitted overseas within a period specified by SAFE, with a fine of up to 30% of the total amount of foreign exchange remitted overseas and deemed evasive and (ii) in circumstances involving serious violations, a fine of no less than 30% of and up to the total amount of remitted foreign exchange deemed evasive. Furthermore, the persons-in-charge and other persons at such PRC subsidiaries who are held directly liable for the violations may be subject to administrative sanctions or, possibly, criminal liabilities.

On May 20, 2011, SAFE issued Operating Instructions on Foreign Exchange Administration for Domestic Residents Engaging in Financing and Round-trip Investment via Overseas Special Purpose Vehicles ("**Circular 19**") (境內居民通過境外特殊目的公司融資及返程投資外匯管理操作規程), which further clarifies the administration principles of Circular 75 and relevant issues in its application and simplifies operating procedures of Circular 75.

As these SAFE regulations are still relatively new and their interpretation and implementation has been constantly evolving, it is unclear how these regulations, and any future regulation concerning offshore or cross-border transactions, will be interpreted, amended or implemented by the relevant government authorities. We cannot predict how these regulations will affect our business operations or future strategy. See "Risk Factors—Risks Relating to the PRC—PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident beneficial owners or our PRC subsidiaries to liability or penalties, limit our ability to inject capital into our PRC subsidiaries, limit our PRC subsidiaries' ability to increase their registered capital or distribute profits to us, or may otherwise adversely affect us."

Regulations on Employee Stock Options Plans

On December 25, 2006, the PBOC promulgated the Administrative Measures for Individual Foreign Exchange (個人外匯管理辦法) , which set forth the respective requirements for foreign exchange transactions by individuals (both PRC or non-PRC citizens) under either the current account or the capital account. On January 5, 2007, SAFE issued the Implementation Rules of the Administrative Measures for Individual Foreign Exchange(個人外匯管理辦法實施細則), which, among other things, specifies approval requirements for a PRC citizen's participation in the employee stock ownership plans or stock option plans of an overseas publicly listed company.

On February 15, 2012, SAFE promulgated the Notice on Issues concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas-Listed Company (國家外匯管理局關於境內個人參與境外上市公司股權激勵計劃外匯管理有關問題的通知), which supersedes a previous notice issued by SAFE in March 2007 and requires domestic employees who participate in stock incentive plan including employee stock holding plan, share option plan or similar plans in an overseas-listed company to register with the relevant local SAFE branch through a PRC agent and complete certain other procedures. A PRC agent shall be a domestic company participating in the stock incentive plan or a domestic institution that is qualified to engage in assets custodian business and has been duly designated by such domestic company.

Regulations on Foreign Investor's Merger and Acquisition of PRC Enterprises

In August 2006, six PRC regulatory agencies jointly adopted M&A Rules which became effective on September 8, 2006 and were amended by MOFCOM on June 22, 2009. The M&A Rules provided for the filing and approval procedure on the merger and acquisition of domestic enterprises by foreign investors.

According to the Anti-Monopoly Law (反壟斷法) which took effect as of August 1, 2008, where the concentration of business operators reaches the filing thresholds stipulated by the State Council, the business operators shall file a declaration with the anti-monopoly enforcement agency under the State Council, and no concentration shall be implemented until the anti-monopoly enforcement agency clears the anti-monopoly filing.

The Provisions of the State Council on Standards for Prior Declaration of Concentrations of Business Operators (國務院關於經營者集中申報標准的規定), which became effective as of August 3, 2008, stipulated declaration thresholds provided in the Anti-Monoply Law.

In November 2009, MOFCOM promulgated the Measures for Prior Declaration of Concentration of Business Operators (經營者集中申報辦法) and the Measures for Examination and Approval of Concentration of Business Operators (經營者集中審查辦法), which provide for detailed provisions regarding the filing of prior declaration and examination and approval process by the MOFCOM with respect to anti-monopoly review.

On February 3, 2011, the General Office of the State Council promulgated the Notice on Establishment of the Security Review System for the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("**Security Review Notice**") (國務院辦公廳關於建立外國投資者併購境內企業安全審查制度的通知), which became effective on March 3, 2011. The Security Review Notice officially established the security review system for mergers and acquisitions of domestic enterprises by foreign investors, which is to be implemented by an inter-ministerial panel under the leadership of the State Council.

On August 25, 2011, MOFCOM issued the Provisions of the Ministry of Commerce on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("**Security Review Provisions**") (商務部實施外國投資者併購境內企業安全審查制度的規定), which became effective on September 1, 2011. Pursuant to the Security Review Provisions, if a foreign investor's merger or acquisition of a domestic enterprise falls within the scope of security review specified in the Security Review Notice, the foreign investor shall file an application with MOFCOM for security review. Whether a foreign investor 's merger or acquisition of a domestic enterprise falls within the scope of security review or not shall be determined based on the substance and actual influence of the merger or acquisition transaction. No foreign investor is allowed to substantially avoid the security review in any way, including but not limited to, holding shares on behalf of others, trust arrangements, multi-level reinvestment, leasing, loans, contractual control, or overseas transactions.

Substantial Shareholders' Interests

As of June 30, 2012, the following persons, other than the Directors or chief executive of the Company, had an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company under section 336 of the SFO, or who was, directly or indirectly, interested in 5% or more of the issued share capital of the Company:

Name of shareholder	Long/short position	Nature of interest	Number of shares held	Percentage of issued share capital
MIH TC Holdings Limited	Long	Corporate[1]	630,240,380	34.18%
Advance Data Services Limited	Long	Corporate[2]	189,892,880	10.30%
JPMorgan Chase & Co.	Long	Beneficial owner	13,276,638	
		Investment manager	20,153,213	
		Custodian corporation / Approved lending agent	58,797,939	
		Total[3][i]	92,227,790	5.00%
	Short	Beneficial owner [3][ii]	7,100,066	0.39%

Notes:

(1) As MIH TC Holdings Limited is controlled by Naspers Limited through its wholly owned intermediary companies, MIH (Mauritius) Limited and MIH Holdings Limited. Naspers Limited, MIH (Mauritius) Limited and MIH Holdings Limited are deemed to be interested in the same block of 630,240,380 shares under Part XV of the SFO.

(2) As Advance Data Services Limited is wholly owned by Ma Huateng, Mr. Ma has interest in these shares as disclosed under the section of "Directors' Interests".

(3) (i) Such long position includes derivative interests in 4,998,986 underlying shares of the Company of which (a) 1,402,400 underlying shares are derived from listed and physically settled derivatives; (b) 1,634,000 underlying shares are derived from listed and cash settled derivatives; (c) 1,317,800 underlying shares are derived from unlisted and physically settled derivatives; and (d) 644,786 underlying shares are derived from unlisted and cash settled derivatives. It also includes 58,797,939 shares in lending pool.

(ii) Such short position includes derivative interests in 3,385,066 underlying shares of the Company of which (a) 507,700 underlying shares are derived from listed and physically settled derivatives; (b) 721,500 underlying shares are derived from listed and cash settled derivatives; (c) 1,870,250 underlying shares are derived from unlisted and physically settled derivatives; and (d) 285,616 underlying shares are derived from unlisted and cash settled derivatives.

Directors' Interests

As of June 30, 2012, the interests and short positions of the Directors in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the SEHK pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, Appendix 10 to the Listing Rules, were as follows:

(A) Long positions in the shares and underlying shares of the Company

Name of Director	Long/short position	Nature of interest	Number of shares/ underlying shares held	Percentage of issued share capital
Ma Huateng	Long	Corporate(1)	189,892,880	10.30%
Zhang Zhidong	Long	Corporate(2)	66,750,000	3.62%
Lau Chi Ping Martin	Long	Personal	9,903,600(3)	0.54%
Li Dong Sheng	Long	Personal	40,000(4)	0.002%
Iain Ferguson Bruce	Long	Personal	105,000(5)	0.006%
Ian Charles Stone	Long	Personal	75,000(6)	0.004%

Notes:

(1) These shares are held by Advance Data Services Limited, a BVI company wholly owned by Ma Huateng.

(2) These shares are held by Best Update International Limited, a BVI company wholly owned by Zhang Zhidong.

(3) The interest comprises 4,103,600 shares and 5,800,000 underlying shares in respect of the share options granted pursuant to the Post-IPO Option Scheme II and the Post-IPO Option Scheme III.

(4) The interest represents the underlying shares in respect of the share options granted pursuant to the Post-IPO Option Scheme I.

(5) The interest comprises 49,000 shares and 56,000 underlying shares in respect of 40,000 share options granted pursuant to the Post-IPO Option Scheme I and 16,000 awarded shares granted pursuant to the Share Scheme (as defined below).

(6) The interest comprises 3,000 shares and 72,000 underlying shares in respect of 60,000 share options granted pursuant to the Post-IPO Option Scheme I and 12,000 awarded shares granted pursuant to the Share Scheme.

(B) Long positions in the shares of associated corporations of the Company

Name of Director	Name of associated corporation	Nature of interest	Number of shares and class of shares held	Percentage of issued share capital
Ma Huateng	Tencent Computer	Personal	RMB16,285,710 (registered capital)	54.29%
	Shiji Kaixuan	Personal	RMB5,971,427 (registered capital)	54.29%
Zhang Zhidong	Tencent Computer	Personal	RMB6,857,130 (registered capital)	22.86%
	Shiji Kaixuan	Personal	RMB2,514,281 (registered capital)	22.86%

As disclosed above, as of June 30, 2012, the register maintained by the Company pursuant to Section 352 of the SFO or as otherwise notified to the Company and the SEHK pursuant to the Model Code for Securities Transactions by Directors of Listed Companies recorded no other interests or short positions of the Directors in any shares, underlying shares or debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO).

RELATED PARTY TRANSACTIONS

The following discussion describes certain material related party transactions between our consolidated subsidiaries and our Directors, executive officers and substantial shareholders and, in each case, the companies with whom they are affiliated.

The Company and its subsidiaries from time to time engage in transactions with affiliates of the Company in the ordinary course of their business. It is the Company's policy to conduct these transactions on normal commercial terms and on an arm's-length basis.

License and Option Agreement with MIH India Global Internet Limited and MIH India Holdings Limited

On June 17, 2008, the Company entered into a license agreement with MIH India Global Internet Limited ("**MIH India Global Internet**") and an option agreement with MIH India Holdings Limited ("**MIH India Holdings**") and MIH India Global Internet. MIH India Holdings and MIH India Global Internet are wholly owned subsidiaries of Naspers Limited, the holding company of MIH TC Holdings Limited ("**MIH TC**"), which is a substantial shareholder of the Company.

Pursuant to the license agreement, the Company agreed to grant to MIH India Global Internet an irrevocable, perpetual and royalty-free license to use and to authorize end users to use the licensed materials in the territory of the Republic of India. Pursuant to the option agreement, MIH India Global Internet agreed to grant an irrevocable option (the "**Option**") to the Company to subscribe up to a specified total number of shares at an agreed exercise price. If the Company exercised the Option in full, it would subscribe up to 50% of the shareholding of MIH India Global Internet minus one share. Simultaneously with the closing of each tranche of the Option, the Company would (a) purchase the pro rata loans from the other shareholders of MIH India Global Internet on a pro rata basis, based on the relative amounts of shareholder loans extended to MIH India Global Internet by each such other shareholder as at the relevant closing date of the relevant tranche of the Option; and (b) be assigned the proportional existing loan at no cost. Upon closing of the first tranche of the Option, the Company and the other two companies would enter into a shareholders' agreement which would set out the rights and obligations of shareholders of MIH India Global Internet relating to transfer of shares and shareholder loans and the management and operations of MIH India Global Internet and its subsidiaries. No cost was paid by the Company to acquire the Option.

The above agreements are deemed as linked transactions, and the Option granted to the Company, which should be treated as a derivative financial instrument, is deemed to be the consideration for the License Agreement. The Company has partially exercised the option in MIH India Global Internet as of June 30, 2012.

Acquisition of 40% Equity Interests in Shenzhen Domain

Shenzhen Domain, a non-wholly owned subsidiary of Shiji Kaixuan, underwent a shareholding restructuring in August 2008, in which certain existing minority interest shareholders sold their equity interests in Shenzhen Domain to Zhang Yan, a founder, CEO, director and substantial individual shareholder of Shenzhen Domain. In connection with Zhang Yan's acquisition of such equity interests in Shenzhen Domain, Shiji Kaixuan provided Zhang Yan with a loan of RMB73.1 million and a long-term put option plan to Zhang Yan pursuant to a loan agreement and a put-option agreement on August 5, 2008. Zhang Yan transferred all his equity interests in Shenzhen Domain, together with the above loan and put-option, to Shijiaqi pursuant to a supplemental agreement on April 21, 2009.

On April 19, 2010, Tencent Computer entered into a share acquisition agreement to purchase 29% of the equity interest in Shenzhen Domain from Shijiaqi for a consideration of approximately RMB141.8 million. As part of the share acquisition agreement, the employee restricted stock unit of Shenzhen Domain, representing 11% of the share capital, was also transferred to us. Upon completion of the acquisition, Shenzhen Domain became our wholly owned subsidiary. The loan agreement, put option agreement and supplemental agreement referenced above were terminated upon repayment of the loan and interest outstanding under the loan agreement in June 2010.

Subscription for Shares in DST

On April 12, 2010, TCH Amur Limited, a company incorporated under the laws of the British Virgin Islands and a wholly owned subsidiary of the Company, entered into a subscription agreement with DST to subscribe for 8,114 ordinary shares of DST for an aggregate consideration of up to approximately US$300.0 million. We held approximately 10.3% economic interest in DST upon completion of the subscription of all 8,114 ordinary shares. DST subsequently changed its name to Mail.ru and, in November 2010, completed an initial public offering of its shares. After this initial public offering, we held 16,228,000 ordinary shares in Mail.ru as at June 30, 2012.

Investment in a Jointly Controlled Entity

On August 26, 2010, we acquired 49.92% equity interest of Sanook, an Internet service company in Thailand, for a total consideration of US$10.5 million. The vendor is a wholly owned subsidiary of Naspers Limited.

Acquisition of 49% of the issued share capital in Level Up! International Holdings Pte Ltd. and Option Letter Agreement with MIH LatAm Holdings B.V.

On January 19, 2012, Aceville Pte. Ltd., a wholly owned subsidiary of the Company, entered into a sale and purchase agreement and option letter agreement with MIH LatAm Holdings B.V. ("**MIH LatAm Holdings**"). MIH LatAm Holdings is a wholly-owned subsidiary of Myriad International Holdings B.V., which is a wholly-owned subsidiary of Naspers Limited.

Pursuant to the sale and purchase agreement, Aceville Pte. Ltd. purchased 320,722 shares of Level Up representing 49% of its issued share capital on the date of the sale and purchase agreement for a cash consideration of US$26.95 million. Pursuant to the option letter agreement, MIH LatAm Holdings granted Aceville Pte. Ltd. an option to acquire such number of shares that, together with the shares acquired pursuant to the sale and purchase agreement, will represent 67% of the issued share capital of Level Up at the date of the exercise of the option. Aceville Pte. Ltd. may exercise the option any time during a two-year period after the closing of the sale and purchase agreement by giving a written notice to MIH LatAm Holdings. The purchase price shall be an amount equal to the sum of (i) US$9.9 million and (ii) an amount equal to the interest that would accrue on US$9.9 million over the period from the closing date of the sale and purchase agreement to the date of the exercise of the option at a simple interest rate per annum equal to the three-month LIBOR applicable on the closing date of the sale and purchase agreement plus 1%, on the basis of a 365-day year and the actual number of days elapsed. The acquisition of 320,722 shares of Level Up was completed in July 2012.

Share Option Schemes and Share Award Scheme

Share Option Schemes

The Company has adopted share option schemes for the purpose of providing incentives and rewards to its Directors, executives or officers, employees, consultants and other eligible persons.

On May 16, 2007, the Company adopted the Post-IPO Option Scheme II. Pursuant to the Post-IPO Option Scheme II, the Board may, at its discretion, grant options to any eligible person to subscribe for shares in the Company. The Post-IPO Option Scheme II shall be valid and effective for a period of ten years commencing on its date of adoption. The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme II shall not exceed 88,903,654 shares, 5% of the issued shares as of the date of shareholders' approval of the Post-IPO Option Scheme II. Options granted under the Post-IPO Option Scheme II will expire no later than the last day of the seven-year period after the date of grant of options (subject to early termination as set out in the terms of the Post-IPO Option Scheme II).

On May 13, 2009, the Company adopted the Post-IPO Option Scheme III. Pursuant to the Post-IPO Option Scheme III, the Board may, at its discretion, grant options to any eligible person (any senior executive or senior officer, director of any member of the Group or any invested entity and any consultant, advisor or agent of any member of the Board) to subscribe for shares in the Company. The Post-IPO Option Scheme III shall be valid and effective for a period of ten years commencing on its date of adoption. The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme III shall not exceed 36,018,666 shares, 2% of the issued shares as of the date of shareholders' approval of this scheme. Options granted under the Post-IPO Option Scheme III will expire after the last day of the ten-year period after the date of grant of options (subject to early termination as set out in the terms of the Post-IPO Option Scheme III).

The maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Post-IPO Option Scheme II, the Post-IPO Option Scheme III and any other share option schemes of the Company must not in aggregate exceed 30% of issued shares from time to time.

The maximum number of shares (issued and to be issued) in respect of which options may be granted under the Post-IPO Option Scheme II, the Post-IPO Option Scheme III and any other share option schemes of the Company (whether exercised, cancelled or outstanding) to any eligible person in any 12-month period shall not exceed 1% of the issued shares from time to time unless such grant has been duly approved by an ordinary resolution of the shareholders in a general meeting at which the relevant eligible person and his associates are abstained from voting. In calculating the aforesaid limit of 1%, options that have lapsed shall not be counted. 16,249,906 shares, 15,801,201 shares and 7,624,113 shares were issued in 2009, 2010, 2011, respectively, pursuant to the share option schemes mentioned above.

Share Award Scheme

On December 13, 2007, the Company adopted a share award scheme (the "**Share Scheme**"), which was subsequently amended on January 31, 2008 and May 13, 2009, respectively. The Board may, at its absolute discretion, select any eligible persons (the "**Awarded Persons**") to participate in the Share Scheme. Pursuant to the Share Scheme, ordinary shares of the Company are acquired by an independent trustee at the cost of the Company or shares are allotted to the trustee under general mandates granted or to be granted by shareholders of the Company at general meetings from time to time. These shares are/will be held in trust for the Awarded Persons by the trustee until the end of each vesting period. Vested shares are/will be transferred at no cost to the Awarded Persons. The Awarded Persons are not entitled to the dividends on the awarded shares not yet transferred to them.

Unless it is terminated by the Board, the Share Scheme shall be valid and effective for a term of fifteen years commencing on the adoption date according to the amendment on May 13, 2009.

The number of shares to be awarded under the Share Scheme throughout its duration shall not exceed 2% of the issued share capital of the Company as of the adoption date. The maximum number of shares which may be awarded to an Awarded Person under the Share Scheme shall not exceed 1% of the issued share capital of the Company as of the adoption date.

Share Options Granted to Directors

For the six months ended June 30, 2012 and the year ended December 31, 2011, no share options were granted to any Executive, Non-executive or Independent Non-executive Directors. For the year ended December 31, 2010, 1,000,000 share options were granted to Mr. Lau Chi Ping Martin. For the year ended December 31, 2009, no share options were granted to any Executive, Non-executive or Independent Non-executive Directors.

Compensation of Directors

Our Directors receive compensation including fees, salaries, bonuses, allowances and benefits in kind, share-based compensation expenses and contribution to pension plans for their services to the Company. See "Management—Compensation of Directors and Senior Management".

DESCRIPTION OF OTHER MATERIAL INDEBTEDNESS

The following summary of the principal terms of the instruments governing our material indebtedness does not purport to be a complete description of all of the terms of these instruments. You should read the consolidated financial statements contained elsewhere is this document for additional information about our indebtedness.

As of June 30, 2012, our short-term borrowings, long-term borrowings and long-term notes payable were RMB3,609.3 million (US$568.1 million), RMB948.7 million (US$149.3 million) and RMB3,751.8 million (US$590.6 million), respectively. Our total short-term borrowings comprise onshore borrowings that are accounted for as RMB borrowings, as well as offshore U.S. dollar borrowings. Long-term borrowings are accounted for as offshore U.S. dollar borrowings and long-term notes payable is accounted for the 4.625% Senior Notes.

RMB Borrowings

Our total RMB borrowings as of June 30, 2012 were US$50.0 million and the interest rates were fixed at 3.54% per annum. These borrowings were denominated in U.S. dollars according to the relevant loan agreements and will be repaid in full in U.S. dollars. The term for each of these borrowings is one year. Concurrently with these borrowings, foreign exchange forward contracts were arranged with the same banks as of the respective initial borrowing dates in order to enable us to purchase the required amount of U.S. dollars with RMB for settling the principal amounts of the borrowings plus related interests upon the loan due dates. The bank borrowings and the foreign exchange forward contracts are deemed as linked transactions and as a result, the bank borrowings have been accounted for as borrowings denominated in RMB.

These bank borrowings and the forward contracts were transacted on the belief that, despite the associated interest expenses to be incurred, we would benefit from the interest income from the restricted cash and the cash increased as a result of the unsecured bank borrowings, as well as the fixed exchange gains arising from the bank borrowings (which are calculated as the difference between the forward rates stated in the contracts and the respective spot rates at the borrowing dates).

These bank borrowings were entered into by one of our PRC subsidiaries, under which it has agreed to certain customary covenants relating to, among other things, the disposal of assets, use of proceeds and significant events that would have a material impact on the borrower's ability to repay the loan. These bank borrowings contain certain customary events of default, including breaches of terms of the facilities agreement, any events or circumstances that result in a materially adverse change in the business or financial condition of the borrower, borrower's dissolution and insolvency, misleading statements or material omissions, cessation of all or a material part of the borrower's business, and cross defaults under other loans. The banks are entitled to terminate their respective agreements and/or demand immediate repayment of all or part of the loans and any accrued interest upon the occurrence of an event of default.

These bank borrowings are generally secured by restricted bank balances. Our secured bank borrowings of RMB320.4 million as of June 30, 2012 were secured by a pledge of bank deposits of RMB324.3 million with the banks.

U.S. Dollar Borrowings

The aggregate principal amount of our short-term and long-term U.S. dollar bank borrowings was US$670.0 million as of June 30, 2012 and the interest rates were fixed ranging from LIBOR plus 0.85% to 2.44% per annum. All such borrowings were unsecured. In addition, we entered into foreign exchange forward contracts to purchase the required amount of U.S. dollars with RMB for settling some of the bank borrowings with an aggregate principal amount of US$45.0 million upon the due dates for the respective loans. However, as we arranged the bank loans and the forward contracts with different banks and did not adopt hedge accounting, these bank borrowings and the relevant foreign forward contracts were accounted for separately. The bank borrowings were accounted for as U.S. dollar bank borrowings stated at amortized cost, while the forward contracts were accounted for as derivative financial instruments stated at fair value with their gains or losses recorded in "Other (losses)/gains, net" in the consolidated income statement.

These bank borrowings were entered into by one of our offshore subsidiaries, under which it has agreed to certain customary covenants relating to, among other things, securities over its assets, disposals of its assets, and mergers and acquisitions. These bank borrowings contain certain customary events of default, including breaches of terms of the facilities agreement, any events or circumstances that result in a materially adverse change in the business or financial condition of the borrower, borrower's dissolution and insolvency, misleading statements or material omissions, cessation of all or a material part of the borrower's business, change in ownership of the borrower and cross defaults under other loans. The banks are entitled to terminate their respective agreements and/or demand immediate repayment of all or part of the loans and any accrued interest upon the occurrence of an event of default.

These bank borrowings are generally guaranteed by the Company up to the relevant maximum guaranteed amount.

4.625% Senior Notes due 2016

We issued the 4.625% Senior Notes in an aggregate principal amount of US$600.0 million for general corporate purposes pursuant to the terms of an indenture dated December 12, 2011, between the Company and Deutsche Bank Trust Company Americas as trustee. The 4.625% Senior Notes were issued at 99.74% of the aggregate principal amount. Interest on the 4.625% Senior Notes will be payable semi-annually in arrears on June 12 and December 12 of each year. The 4.625% Senior Notes will mature on December 12, 2016.

The indenture includes customary covenants that, among other things, limit our ability to incur liens and consolidate, merge or sell all or substantially all of our assets. These covenants are subject to certain exceptions and qualifications as described in the indenture. The indenture contains customary events of default, including failure to make required payments, failure to comply with certain agreements or covenants, failure to pay or acceleration of certain other indebtedness, certain events of bankruptcy and insolvency and failure to pay certain judgments. Generally, an event of default under the indenture will allow either the trustee or the holders of at least 25% in aggregate principal amount of the then-outstanding 4.625% Senior Notes to accelerate the amounts due under the 4.625% Senior Notes.

INDEPENDENT AUDITOR

The consolidated financial statements as of and for the years ended December 31, 2010 and 2011 included in this document have been audited by PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, as stated in their reports appearing herein. With respect to the unaudited condensed consolidated interim financial information as of and for the six months ended June 30, 2012, included in this document, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, reported that they have applied limited procedures in accordance with the International Standard on Review Engagements 2410 "Review of interim financial information" for a review of such information. However, their separate report dated August 15, 2012 appearing herein states that they did not audit and they do not express an audit opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied.

PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, has agreed to the inclusion in this document of its audit report on our consolidated financial statements as of and for the years ended December 31, 2010 and 2011, and its review report on the review of our unaudited condensed consolidated interim financial information as of and for the six months ended June 30, 2012 in the form and context in which they are included in this document, respectively.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Independent Auditor's Report

羅兵咸永道

TO THE SHAREHOLDERS OF TENCENT HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Tencent Holdings Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 72 to 188, which comprise the consolidated and company statements of financial position as at 31 December 2011, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2011, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

OTHER MATTERS

This report, including the opinion, has been prepared for and only for you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 14 March 2012

Consolidated Statement of Financial Position

As at 31 December 2011

	Note	As at 31 December 2011 RMB'000	2010 RMB'000
ASSETS			
Non-current assets			
Fixed assets	6	**5,884,952**	3,292,828
Construction in progress	7	**158,656**	386,943
Investment properties	8	**21,871**	37,229
Land use rights	9	**230,915**	229,890
Intangible assets	10	**3,779,976**	572,981
Investment in associates	12	**4,338,075**	1,070,633
Investment in jointly controlled entities	13	**61,903**	74,542
Deferred income tax assets	30	**198,058**	219,019
Available-for-sale financial assets	15	**4,343,602**	4,126,878
Prepayments, deposits and other assets	17	**2,282,869**	445,430
		21,300,877	10,456,373
Current assets			
Accounts receivable	16	**2,020,796**	1,715,412
Prepayments, deposits and other assets	17	**2,211,917**	487,872
Term deposits with initial term of over three months	18	**13,716,040**	11,725,743
Restricted cash	24, 27	**4,942,595**	1,036,457
Cash and cash equivalents	19	**12,612,140**	10,408,257
		35,503,488	25,373,741
Total assets		**56,804,365**	35,830,114

Consolidated Statement of Financial Position

As at 31 December 2011

	Note	As at 31 December 2011 RMB'000	2010 RMB'000
EQUITY			
Equity attributable to the Company's equity holders			
Share capital	20	**198**	198
Share premium	20	**123,021**	1,100,302
Shares held for share award scheme	20	**(606,874)**	(258,137)
Share-based compensation reserve	20	**1,935,030**	1,199,663
Other reserves	21	**302,091**	1,919,695
Retained earnings		**26,710,368**	17,795,225
		28,463,834	21,756,946
Non-controlling interests		**624,510**	83,912
Total equity		**29,088,344**	21,840,858
LIABILITIES			
Non-current liabilities			
Long-term notes payable	28	**3,733,331**	–
Deferred income tax liabilities	30	**939,534**	967,211
Long-term payables	26	**1,859,808**	–
		6,532,673	967,211

Consolidated Statement of Financial Position

As at 31 December 2011

	Note	As at 31 December 2011 RMB'000	2010 RMB'000
Current liabilities			
Accounts payable	23	**2,244,114**	1,380,464
Other payables and accruals	24	**5,014,281**	2,997,808
Derivative financial instruments	25	**20,993**	17,964
Short-term borrowings	27	**7,999,440**	5,298,947
Current income tax liabilities		**708,725**	341,103
Other tax liabilities	39(b)	**179,499**	225,188
Deferred revenue	29	**5,016,296**	2,760,571
		21,183,348	13,022,045
Total liabilities		**27,716,021**	13,989,256
Total equity and liabilities		**56,804,365**	35,830,114
Net current assets		**14,320,140**	12,351,696
Total assets less current liabilities		**35,621,017**	22,808,069

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 72 to 188 were approved by the Board of Directors on 14 March 2012 and were signed on its behalf.

Ma Huateng
Director

Zhang Zhidong
Director

Statement of Financial Position - The Company

As at 31 December 2011

	Note	As at 31 December 2011 RMB'000	2010 RMB'000
ASSETS			
Non-current assets			
Fixed assets		**243**	342
Intangible assets		**4,958**	4,809
Investments in subsidiaries	11(a)	**5,782,381**	2,834,852
Contribution to Share Scheme Trust	11(c)	**896**	287
		5,788,478	2,840,290
Current assets			
Amounts due from subsidiaries		**1,260,180**	708,074
Prepayments, deposits and other receivables		**3,706**	4,584
Term deposits with initial term of over three months		**–**	635
Cash and cash equivalents	19	**187,791**	237,525
		1,451,677	950,818
Total assets		**7,240,155**	3,791,108
EQUITY			
Equity attributable to the Company's equity holders			
Share capital	20	**198**	198
Share premium	20	**123,021**	1,100,302
Shares held for share award scheme	20	**(606,874)**	(258,137)
Share-based compensation reserve		**1,827,855**	1,199,663
Retained earnings/(accumulated deficit)		**246,667**	(140,999)
Total equity		**1,590,867**	1,901,027

Statement of Financial Position - The Company

As at 31 December 2011

		As at 31 December	
		2011	2010
	Note	**RMB'000**	RMB'000
LIABILITIES			
Non-current liabilities			
Long-term notes payable	28	**3,733,331**	–
Current liabilities			
Amounts due to subsidiaries	11(b)	**1,829,429**	1,833,802
Other payables and accruals		**86,528**	56,279
		1,915,957	1,890,081
Total liabilities		**5,649,288**	1,890,081
Total equity and liabilities		**7,240,155**	3,791,108
Net current liabilities		**(464,280)**	(939,263)
Total assets less current liabilities		**5,324,198**	1,901,027

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 72 to 188 were approved by the Board of Directors on 14 March 2012 and were signed on its behalf.

Ma Huateng
Director

Zhang Zhidong
Director

Consolidated Income Statement

For the year ended 31 December 2011

	Note	Year ended 31 December 2011 RMB'000	2010 RMB'000
Revenues			
Internet value-added services		**23,042,758**	15,482,301
Mobile and telecommunications value-added services		**3,270,841**	2,715,931
Online advertising		**1,992,216**	1,372,522
Others		**190,257**	75,277
	5	**28,496,072**	19,646,031
Cost of revenues	31, 34	**(9,928,308)**	(6,320,200)
Gross profit		**18,567,764**	13,325,831
Interest income	32	**468,990**	255,922
Other gains, net	33	**420,803**	38,056
Selling and marketing expenses	34	**(1,920,853)**	(945,370)
General and administrative expenses	34	**(5,283,154)**	(2,836,226)
Operating profit		**12,253,550**	9,838,213
Finance income/(costs), net	38	**35,505**	(838)
Share of (losses)/profit of associates		**(24,255)**	72,359
Share of (losses)/profit of jointly controlled entities		**(165,731)**	3,399
Profit before income tax		**12,099,069**	9,913,133
Income tax expense	39(a)	**(1,874,238)**	(1,797,924)
Profit for the year		**10,224,831**	8,115,209
Attributable to:			
Equity holders of the Company		**10,203,083**	8,053,625
Non-controlling interests		**21,748**	61,584
		10,224,831	8,115,209

Consolidated Income Statement

For the year ended 31 December 2011

		Year ended 31 December	
		2011	2010
	Note	**RMB'000**	RMB'000
Earnings per share for profit attributable to equity holders of the Company (expressed in RMB per share)			
– basic	41(a)	**5.609**	4.432
– diluted	41(b)	**5.490**	4.328
Dividend per share			
Final dividend proposed	42	**HKD0.75**	HKD0.55

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2011

	Year ended 31 December	
	2011	2010
	RMB'000	RMB'000
Profit for the year	**10,224,831**	8,115,209
Other comprehensive income, net of tax:		
Net (losses)/gains from changes in fair value of available-for-sale financial assets	**(1,233,873)**	1,821,129
Currency translation differences	**(34,256)**	–
	(1,268,129)	1,821,129
Total comprehensive income for the year	**8,956,702**	9,936,338
Attributable to:		
Equity holders of the Company	**8,937,627**	9,874,754
Non-controlling interests	**19,075**	61,584
	8,956,702	9,936,338

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2011

	Attributable to equity holders of the Company								
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2011	198	1,100,302	(258,137)	1,199,663	1,919,695	17,795,225	21,756,946	83,912	21,840,858
Comprehensive income									
Profit for the year	–	–	–	–	–	10,203,083	10,203,083	21,748	10,224,831
Other comprehensive income:									
– net losses from changes in fair value of available-for-sale financial assets	–	–	–	–	(1,233,873)	–	(1,233,873)	–	(1,233,873)
– currency translation differences	–	–	–	–	(31,583)	–	(31,583)	(2,673)	(34,256)
Total comprehensive income for the year	–	–	–	–	(1,265,456)	10,203,083	8,937,627	19,075	8,956,702
Total contributions by and distributions to owners of the Company recognised directly in equity									
Capital injection	–	–	–	–	–	–	–	9,800	9,800
Employee share option schemes:									
– value of employee services	–	–	–	159,233	–	–	159,233	–	159,233
– proceeds from shares issued	–	159,729	–	–	–	–	159,729	–	159,729
Employee share award scheme:									
– value of employee services	–	–	–	576,134	–	–	576,134	–	576,134
– shares purchased for share award scheme	–	–	(438,714)	–	–	–	(438,714)	–	(438,714)
– vesting of awarded shares	–	(89,977)	89,977	–	–	–	–	–	–

Consolidated Statement of Changes in Equity

For the year ended 31 December 2011

	Attributable to equity holders of the Company								
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Profit appropriations to statutory reserves	–	–	–	–	439,650	(439,650)	–	–	–
Repurchase and cancellation of shares	–	(1,047,033)	–	–	–	–	(1,047,033)	–	(1,047,033)
Dividend (Note 42)	–	–	–	–	–	(838,290)	(838,290)	(56,531)	(894,821)
Transfer	–	–	–	–	10,000	(10,000)	–	–	–
Total contributions by and distributions to owners of the Company for the year	–	(977,281)	(348,737)	735,367	449,650	(1,287,940)	(1,428,941)	(46,731)	(1,475,672)
Non-controlling interests and deemed consideration arising from business combinations (Note 43(a) and (b))	–	–	–	–	(154,732)	–	(154,732)	581,725	426,993
Changes in equity interests in a subsidiary without change of control	–	–	–	–	23,919	–	23,919	(13,471)	10,448
Recognition of financial liabilities in respect of the put options granted to non-controlling interests (Note 43(a))	–	–	–	–	(670,985)	–	(670,985)	–	(670,985)
Total transactions with owners for the year	–	(977,281)	(348,737)	735,367	(352,148)	(1,287,940)	(2,230,739)	521,523	(1,709,216)
Balance at 31 December 2011	198	123,021	(606,874)	1,935,030	302,091	26,710,368	28,463,834	624,510	29,088,344

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2011

	Attributable to equity holders of the Company								
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2010	197	1,244,425	(123,767)	703,563	(166,364)	10,520,453	12,178,507	120,146	12,298,653
Comprehensive income									
Profit for the year	–	–	–	–	–	8,053,625	8,053,625	61,584	8,115,209
Other comprehensive income:									
– net gains from changes in fair value of available-for-sale financial assets	–	–	–	–	1,821,129	–	1,821,129	–	1,821,129
Total comprehensive income for the year	–	–	–	–	1,821,129	8,053,625	9,874,754	61,584	9,936,338
Total contributions by and distributions to owners of the Company recognised directly in equity									
Employee share option schemes:									
– value of employee services	–	–	–	139,621	–	–	139,621	–	139,621
– proceeds from shares issued	1	199,248	–	–	–	–	199,249	–	199,249
Employee share award scheme:								–	
– value of employee services	–	–	–	356,479	–	–	356,479	–	356,479
– shares purchased for share award scheme	–	–	(167,519)	–	–	–	(167,519)	–	(167,519)
– vesting of awarded shares	–	(33,149)	33,149	–	–	–	–	–	–

Consolidated Statement of Changes in Equity

For the year ended 31 December 2011

	Attributable to equity holders of the Company								
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Profit appropriations to statutory reserves	–	–	–	–	8,237	(8,237)	–	–	–
Dividend	–	–	–	–	–	(639,264)	(639,264)	(66,723)	(705,987)
Repurchase and cancellation of shares	–	(310,222)	–	–	–	–	(310,222)	–	(310,222)
Total contributions by and distributions to owners of the Company for the year	1	(144,123)	(134,370)	496,100	8,237	(647,501)	(421,656)	(66,723)	(488,379)
Reversal of the liabilities in respect of put options granted to non-controlling interests owners	–	–	–	–	94,246	–	94,246	–	94,246
Acquisition of additional interests in a subsidiary	–	–	–	–	154,198	(123,103)	31,095	(31,095)	–
Transfer	–	–	–	–	8,249	(8,249)	–	–	–
Total transactions with owners for the year	1	(144,123)	(134,370)	496,100	264,930	(778,853)	(296,315)	(97,818)	(394,133)
Balance at 31 December 2010	198	1,100,302	(258,137)	1,199,663	1,919,695	17,795,225	21,756,946	83,912	21,840,858

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2011

	Note	Year ended 31 December **2011** RMB'000	2010 RMB'000
Cash flows from operating activities			
Cash generated from operations	44(a)	**15,194,370**	13,191,728
Income tax paid		**(1,836,263)**	(872,435)
Net cash flows generated from operating activities		**13,358,107**	12,319,293
Cash flows from investing activities			
Payments for business combinations, net of cash acquired		**(1,444,442)**	(268,852)
Purchase of fixed assets, construction in progress and investment properties		**(4,046,246)**	(1,488,220)
Proceeds from disposals of fixed assets	44(a)	**599**	1,574
Payments for investment in associates		**(3,427,363)**	(511,967)
Payments for investment in jointly controlled entities		**(194,915)**	(71,143)
Purchase/Prepayment of intangible assets		**(788,375)**	(301,831)
Payments for land use rights		**(5,950)**	(456,555)
Purchase of available-for-sale financial assets		**(1,706,752)**	(2,179,096)
Payment for acquisition of non-controlling interests in non-wholly owned subsidiaries		**(23,919)**	(118,260)
Proceeds from disposal of equity interests in a subsidiary without change of control		**10,448**	–
Proceeds from the redemption of held-to-maturity investments		**–**	341,410
Receipt from the repayments of term deposits with initial term of over three months		**5,989,298**	114,662
Payments for term deposits with initial term of over three months		**(7,979,595)**	(6,530,237)
Payment for restricted cash		**(2,055,486)**	(836,457)
(Loan advanced)/Repayment of loan to associates and jointly controlled entities		**(117,115)**	54,700
Interest received		**415,055**	219,937
Dividend received		**20,000**	15,338
Net cash flows used in investing activities		**(15,354,758)**	(12,014,997)

Consolidated Statement of Cash Flows

For the year ended 31 December 2011

	Year ended 31 December	
	2011	2010
	RMB'000	RMB'000
Cash flows from financing activities		
Proceeds from short-term borrowings	**6,682,837**	5,298,947
Repayment of short-term borrowings	**(3,765,941)**	(202,322)
Payment for derivative financial instruments in relation to short-term borrowings	**(93,761)**	–
Net proceeds from issuance of long-term notes	**3,760,928**	–
Proceeds from issuance of ordinary shares	**159,729**	199,249
Payments for repurchase of shares	**(1,047,033)**	(310,222)
Payment for purchase of shares for share award scheme	**(438,714)**	(167,519)
Proceeds from capital injection from non-controlling interests	**9,800**	–
Dividends paid to the Company's shareholders	**(838,290)**	(639,264)
Dividends paid to non-controlling interests	**(56,531)**	(66,723)
Net cash flows generated from financing activities	**4,373,024**	4,112,146
Net increase in cash and cash equivalents	**2,376,373**	4,416,442
Cash and cash equivalents at beginning of the year	**10,408,257**	6,043,696
Exchange losses on cash and cash equivalents	**(172,490)**	(51,881)
Cash and cash equivalents at end of the year	**12,612,140**	10,408,257

The notes on pages 86 to 188 are an integral part of these consolidated financial statements.

1 GENERAL INFORMATION

Tencent Holdings Limited (the "Company") was incorporated in the Cayman Islands. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY 1-1111, Cayman Islands. The shares of the Company have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 16 June 2004.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the "Group") are principally engaged in the provision of Internet value-added services ("IVAS"), mobile and telecommunications value-added services ("MVAS") and online advertising services to users in the People's Republic of China (the "PRC").

The operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited ("Tencent Computer"), a limited liability company established in the PRC by certain shareholders of the Company on 11 November 1998. Tencent Computer is legally owned by the core founders of the Company who are PRC citizens (the "Registered Shareholders").

The PRC regulations restrict foreign ownership of companies that provide value-added telecommunications services, which include activities and services operated by Tencent Computer. In order to enable certain foreign companies to make investments into the business of the Group, the Company established a subsidiary, Tencent Technology (Shenzhen) Company Limited ("Tencent Technology"), which is a wholly foreign owned enterprise incorporated in the PRC, on 24 February 2000. The foreign investors of the Company then subscribed to additional equity interest in the Company.

Under a series of contractual arrangements (collectively, "Structure Contracts") entered into among the Company, Tencent Technology, Tencent Computer and the Registered Shareholders, the Company is able to effectively control, and recognise and receive substantially all the economic benefit of the business and operations of Tencent Computer. In summary, the Structure Contracts provide the Company through Tencent Technology with, among other things, the rights to:

- receive the cash received by Tencent Computer from its operations which is surplus to its requirements, having regard to its forecast working capital needs, capital expenditure, and other short-term anticipated expenditure through various commercial arrangements;
- ensure that Tencent Technology own the valuable assets of the business through the assignment to Tencent Technology of the principal present and future intellectual property rights of Tencent Computer without making any payment; and
- control the management and financial and operating policies of Tencent Computer.

As a result, Tencent Computer is accounted for as a subsidiary and the formation of the Group in 2000 was accounted for as a business combination between entities under common control under a method similar to the uniting of interests method for recording all assets and liabilities at predecessor carrying amounts. This approach was adopted because in management's belief it best reflected the substance of the formation.

1 GENERAL INFORMATION (Cont'd)

Similar Structure Contracts were also executed for other PRC operating companies similar to Tencent Computer subsequent to 2000. All these PRC operating companies were treated as subsidiaries of the Company and their financial statements have also been consolidated by the Company.

The consolidated financial statements of the Group have been approved for issue by the board of directors of the Company (the "Board") on 14 March 2012.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and derivative financial instruments.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

The following revised standards, amendments and interpretation to existing standards, have been published and are mandatory for the financial year beginning 1 January 2011, but are not currently relevant to the Group.

- IAS 32 (Amendment) — Classification of Rights Issue
- Amendment to IFRIC 14 — Prepayments of A Minimum Funding Requirement
- IFRIC 19 — Extinguishing Financial Liabilities with Equity Instruments
- IAS 24 (Revised) — Related Party Disclosures

The third improvements to International Financial Reporting Standards (2010) were issued in May 2010 by the International Accounting Standards Board ("IASB"), certain of which were effective in 2011. Management has considered that these amendments have no material impact on the Group's financial statements for the year ended 31 December 2011.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation (Cont'd)

The following new standards have been issued but are not effective for the financial year beginning 1 January 2011, and have not been early adopted by the Group.

- IFRS 9, 'Financial Instruments' addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, IFRS 9 retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Group is yet to assess the full impact of IFRS 9 and intends to adopt this standard no later than the accounting period beginning on or after 1 January 2015.

- IFRS 10 'Consolidated Financial Statements' builds on the existing principles by identifying the concept of control as the determining factor for whether an entity should be included in the consolidated financial statements of the parent company. The standard provides additional guidance for the determination of control where it is difficult to assess. The Group is yet to assess the full impact of IFRS 10 and intends to adopt this standard no later than the accounting period beginning on or after 1 January 2013.

- IFRS 11 'Joint Arrangements' is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Group is yet to assess the full impact of IFRS 11 and intends to adopt this standard no later than the accounting period beginning on or after 1 January 2013.

- IFRS 12 'Disclosures of Interests in Other Entities' includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Group is yet to assess the full impact of IFRS 12 and intends to adopt this standard no later than the accounting period beginning on or after 1 January 2013.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation (Cont'd)

- IFRS 13 'Fair Value Measurement' aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRS. The Group is yet to assess the full impact of IFRS 13 and intends to adopt this standard no later than the accounting period beginning on or after 1 January 2013.

There are no other IFRS or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31 December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than 50% of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the group controls another entity. The group also assesses existence of control where it does not have more than 50% of the voting rights but is able to govern the financial and operating policies by virtue of de-facto control. De-facto control may arise from circumstances such as enhanced minority rights or contractual terms between shareholders.

Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains or losses on transactions between group companies are eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(b) Associates

Associates are all entities over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of loss in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount within "Other gains, net" in the income statement.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(c) Jointly controlled entities

The Group's interests in jointly controlled entities are accounted for using the equity method, which is similar to that for associates in note (b) above. The Group's share of its jointly controlled entities' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of loss in a jointly controlled entity equals or exceeds its interest in the jointly controlled entity, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity.

The Group determines at each reporting date whether there is any objective evidence that the investment in jointly controlled entities is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the jointly controlled entities and its carrying value and recognises the amount within "Other gains, net" in the income statement.

(d) Business combinations

The Group uses the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interests in the acquiree either at fair value or at the non-controlling interests' proportionate share of the acquiree's net assets.

The excess of the consideration transferred, the amount of any non-controlling interests in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the consolidated income statement (Note 2.8).

Acquisition-related costs are expensed as incurred.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(d) Business combinations (Cont'd)

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

For a business combination achieved in stages, the Group applies acquisition method at the acquisition date. The previously held interest is remeasured to fair value at the acquisition date and a gain or loss is recognised in the income statement. Goodwill is calculated by deducting the fair value of identifiable net assets from the fair value of the previously held interest, the consideration and non-controlling interests.

(e) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchase from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposal to non-controlling interests are also recorded in equity.

(f) Investment in an associate/a jointly controlled entity achieved in stages

The cost of an associate/a jointly controlled entity acquired in stages is measured as the sum of the fair value of the interest previously held plus the fair value of any additional consideration transferred as of the date when the associate/jointly controlled entity became an associate/a jointly controlled entity. A gain or loss on remeasurement of the previously held interest is taken to the income statement. Any other comprehensive income recognised in prior periods in relation to the previously held interest is also taken to the income statement. Any acquisition-related costs are expensed in the period in which the costs are incurred.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(g) Partial disposals

When the group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, a jointly controlled entity or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the income statement.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to the income statement where appropriate.

(h) Separate financial statements

In the Company's statement of financial position, the investments in subsidiaries are accounted for at cost less impairment. Cost includes direct attributable costs of investment. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable. In addition, the contribution to the Company's Share Scheme Trust (as defined in Note 11(c)), a controlled special purpose entity, is stated at cost in "Contribution to Share Scheme Trust" first, and then will be transferred to the "Shares held for share award scheme" under equity when the contribution is used for the acquisition for the shares of the Company.

Impairment testing of the investments in subsidiaries is required upon receiving dividends from these investments if the dividend exceeds the total comprehensive income of the subsidiary in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee's net assets including goodwill.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.3 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-makers, who are responsible for allocating resources and assessing performance of the operating segments and making strategic decisions. The chief operating decision-makers mainly include the executive directors.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in RMB, which is both the functional currency of the Company and presentation currency of the Group.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale financial assets are analysed between translation differences resulting from changes in the amortised cost of the securities, and other changes in the carrying amount of the securities. Translation differences related to changes in the amortised cost and interest income are recognised in the income statement, and other changes in carrying amount are recognised in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in the income statement as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale financial assets, are included in other comprehensive income.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.4 Foreign currency translation (Cont'd)

(c) Group companies

The results and financial position of all group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency of RMB are translated into the presentation currency as follows:

(i) assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.5 Fixed assets

All fixed assets are stated at historical costs less accumulated depreciation and accumulated impairment charge. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.5 Fixed assets (Cont'd)

Depreciation is calculated on the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	20 - 50 years
Computer equipment	3 - 5 years
Furniture and office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	the shorter of their useful lives and the lease terms

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Construction in progress represents buildings under construction, which is stated at actual construction cost less any impairment loss. Construction in progress is transferred to fixed assets when completed and ready for use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.10).

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised within "Other gains, net" in the income statement.

2.6 Investment properties

Investment properties are held for long-term rental yields and are not occupied by the Group. Investment properties are carried at historical costs less accumulated depreciation and accumulated impairment charges. Historical costs include expenditures that are directly attributable to the acquisition of the items.

Depreciation is calculated on the straight-line method to allocate their costs to their residual values over their estimated useful lives of 50 years.

Investment properties' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Investment properties' carrying amounts are written down immediately to their recoverable amount if its carrying amounts are greater than their estimated recoverable amounts.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.7 Land use rights

Land use rights are up-front payments to acquire long-term interest in land. These payments are stated at cost and charged to the income statement on a straight-line basis over the remaining period of the lease or capitalised in construction in progress upon completion of construction.

2.8 Intangible assets

(a) Goodwill

Goodwill arises on the acquisition of subsidiaries, associates and jointly controlled entities, and represents the excess of the consideration transferred over the Group's interest in net fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree and the fair value of the non-controlling interests in the acquiree.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units ("CGUs"), or groups of CGUs, that is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes. Goodwill is monitored at the operating segment level.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs to sell. Any impairment is recognised immediately as an expense and is not subsequently reversed.

(b) Other intangible assets

Other intangible assets mainly include licence, computer software and technology and non-compete agreements. They are initially recognised and measured at cost or estimated fair value of intangible assets acquired through business combinations.

Other intangible assets are being amortised over their estimated useful lives (generally three to seven years).

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.9 Shares held for share award scheme

The consideration paid by the Share Scheme Trust (as defined in Note 11(c)) for purchasing the Company's shares from the market, including any directly attributable incremental cost, is presented as "Shares held for share award scheme" and deducted from total equity.

When the Share Scheme Trust transfers the Company's shares to the awardees upon vesting, the related costs of the awarded shares vested are credited to "Shares held for share award scheme", with a corresponding adjustment to share premium.

2.10 Impairment of non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.11 Financial assets

(a) Classification

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired, management's intentions and whether the assets are quoted in an active market. Management determines the classification of its financial assets at initial recognition.

(i) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.11 Financial assets (Cont'd)

(a) Classification (Cont'd)

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the end of the reporting period which are classified as non-current assets. Loans and receivables are classified as "Accounts receivable", "Deposits and other receivables", "Term deposits with initial term of over three months", "Restricted cash" and "Cash and cash equivalents" in the statement of financial position.

(iii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale financial assets. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the end of the reporting period which are classified as current assets.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other category. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the end of the reporting period.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.11 Financial assets (Cont'd)

(b) Recognition and measurement

Regular purchases and sales of investments are recognised on trade-date - the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the "Financial assets at fair value through profit or loss" category are presented in the income statement within "Other gains, net" in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement as part of "Other gains, net" when the Group's right to receive payments is established.

Changes in the fair value of monetary and non-monetary securities classified as available-for-sale financial assets are recognised in other comprehensive income.

When securities classified as available-for-sale financial assets are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the income statement as gains and losses from investment securities.

Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

2.12 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liabilities simultaneously.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.13 Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation, and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the consolidated income statement.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.13 Impairment of financial assets (Cont'd)

(b) Assets classified as available-for-sale financial assets

The Group assesses at the end of the reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale financial assets, a significant or prolonged decline in the fair value of the securities below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement - is removed from other comprehensive income and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

2.14 Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

During the year ended 31 December 2011, the Group did not hold any derivative instruments designated as a hedging instrument but held certain derivative instruments which did not qualify for hedge accounting. The derivative instruments, which do not qualify for hedge accounting, are accounted for at fair value through profit or loss. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement within "Other gains, net".

2.15 Accounts receivable

Accounts receivable is amounts due from customers or agents for merchandise sold or services performed in the ordinary course of business. If collection of accounts receivable and other receivables is expected in one year or less, they are classified as current assets. Otherwise, they are presented as non-current assets.

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.16 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with initial maturities of three months or less.

2.17 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or share options are shown in equity as a deduction from the proceeds.

Where any group company purchases the Company's equity share capital (treasury share), the considerations paid, including any directly attributable incremental costs, is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received (net of any directly attributable incremental transaction costs) is included in equity attributable to the Company's equity holders.

2.18 Accounts payable

Accounts payable is obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable is classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Accounts payable is recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.19 Put option liabilities

Put option is the financial instrument granted by the Group that the counterparty may have the right to request the Group to purchase its own equity instruments for cash or other financial assets when certain conditions are met. If the Group does not have the unconditional right to avoid delivering cash or another financial assets under the put option, it has to recognise a financial liability at the present value of the estimated future cash outflows under the put option. The financial liability is initially debited to equity at fair value. Subsequently, if the Group revises its estimates of payments, the Group will adjust the carrying amount of the financial liability to reflect actual and revised estimated cash outflows. The Group will recalculate the carrying amount by computing the present value of revised estimated future cash outflows at the financial instrument's original effective interest rate and the adjustments will be recognised as income or expenses in the income statement. If the put option expires without delivery, the carrying amount of the liability is reclassified as equity.

The put option liabilities are current liabilities unless the put option can only be exercised 12 months after the end of the reporting period.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.20 Borrowings

Borrowings (including short-term borrowings and long-term notes issued by the Group) are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

Borrowing costs are recognised in profit or loss in the period in which they are incurred.

2.21 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of goodwill or the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction neither accounting nor taxable profit or loss is affected. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.21 Current and deferred income tax (Cont'd)

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2.22 Employee benefits

(a) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the end of the reporting period. Employee entitlements to sick and maternity leave are not recognised until the time of leave.

(b) Pension obligations

The Group contributes on a monthly basis to various defined contribution benefit plans organised by the relevant governmental authorities. The Group's liability in respect of these plans is limited to the contributions payable in each period. Contributions to these plans are expensed as incurred. Assets of the plans are held and managed by government authorities and are separate from those of the Group.

(c) Share-based compensation benefits

The Group operates a number of share-based compensation plans (including share option scheme and share award scheme), under which the Group receives services from employees as consideration for equity instruments (including share options and awarded shares) of the Group. The fair value of the employee services received in exchange for the grant of equity instruments of the Group is recognised as an expense over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied, and credited to share-based compensation reserve under equity.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.22 Employee benefits (Cont'd)

(c) Share-based compensation benefits (Cont'd)

For grant of share options, the total amount to be expensed is determined by reference to the fair value of the options granted by using an option-pricing model - Black-Scholes valuation model (the "BS Model"), which includes the impact of market performance conditions (such as the Company's share price) but excludes the impact of service condition and non-market performance conditions. For grant of award shares, the total amount to be expensed is determined by reference to the market price of the Company's shares at the grant date. The Group also adopts valuation technique to assess the fair value of other equity instruments of the Group granted under the share-based compensation plans as appropriate.

Non-market performance and services conditions are included in assumptions about the number of options that are expected to become vested.

From the perspective of the Company, the Company grants its equity instruments to employees of its subsidiaries to exchange for their services related to the subsidiaries. Accordingly, the share-based compensation expenses, which are recognised in the consolidated financial statement, are treated as part of the "Investment in subsidiaries" in the Company's statement of financial position.

At each reporting period end, the Group and the Company revise its estimates of the number of options and awarded shares that are expected to ultimately vest. It recognises the impact of the revision of original estimates, if any, in the income statement of the Group and in the "Investment in subsidiaries" of the Company, with a corresponding adjustment made to equity over the remaining vesting period.

When the options are exercised, the proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.23 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for further operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.24 Revenue recognition

The Group principally derives revenues from provision of IVAS, MVAS and online advertising services in the PRC.

(a) IVAS and MVAS

Revenues from IVAS are derived principally from the provision of online games and community value-added services across various Internet platforms.

MVAS revenues are derived principally from providing users with bundled SMS packages, mobile games, and other mobile value-added services such as mobile music and mobile books.

IVAS and MVAS are either billed on a subscription basis or on a per transaction/message basis. Certain of these services are delivered to the Group's customers through the platforms of various subsidiaries of telecommunication operators in the PRC, namely China Mobile Communications Corporation ("China Mobile"), China United Network Communications Corporation Limited ("China Unicom") and China Telecommunications Corporation ("China Telecom"), and these operators also collect certain service fees (the "Internet and Mobile Service Fees") on behalf of the Group.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.24 Revenue recognition (Cont'd)

(a) IVAS and MVAS (Cont'd)

In collecting the Internet and Mobile Service Fees on behalf of the Group, these telecommunication operators are entitled to a fixed commission, which is calculated based on agreed percentages of the Internet and Mobile Service Fees received/receivable by them, plus, in certain cases, a fixed per-message adjustment for the excess of messages sent over messages received between the platforms of the Group and these operators (collectively defined as "Mobile and Telecom Charges"). The Mobile and Telecom Charges are withheld and deducted from the gross Internet and Mobile Service Fees collected by the operators from the users, with the net amounts remitted to the Group.

The Internet and Mobile Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by these operators to the Group on a monthly basis. The Group recognises the Internet and Mobile Service Fees as revenue on a gross basis and treats the Mobile and Telecom Charges as cost of revenues.

For the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on the historical data. The historical data used in estimating revenues includes the most recent three-month history of the Internet and Mobile Service Fees actually derived from the operators, the number of subscriptions and the volume of data transmitted between the network gateways of the Group and the mobile operators. Adjustments are made in subsequent periods in the event that the actual revenue amounts are different from the original estimates.

In addition, the IVAS can also be paid by way of prepaid cards and tokens (represented a specific amount of payment unit) sold by the Group through non-mobile channels such as sales agents appointed by the Group, telecommunication operators, broadband service providers, Internet cafes and banks. The end users can register the prepaid cards and tokens to their user accounts in the Group's platforms and then access the Group's online products or relevant services. Receipts from the sales of prepaid cards and tokens are deferred and recorded as "Deferred revenue" in the statement of financial position (see Note 29). The amounts are then recognised as revenue based on the actual utilisation of the payment unit: (i) when the payment unit is used to purchase services, the revenue is recognised when the related services are rendered; (ii) when the payment unit is used to purchase virtual products/items in the Group's Internet platforms, the revenue is recognised over the estimated lifespan of the respective virtual products/items or over the expected user relationship, whichever is longer.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.24 Revenue recognition (Cont'd)

(b) Online advertising

Online advertising revenues are mainly derived from display advertising on instant messaging clients, portals and other platforms, and search advertising through the self-developed search engines of the Group. Commissions payable to advertising agencies are recognised as a component of the cost of revenues.

For advertising contracts based on the actual time period that the advertisements appear on the Group's instant messaging clients, portals and other platforms, the revenues are recognised ratably over the period in which the advertisements are displayed.

(c) Interest income

Interest income is recognised on a time proportion basis, taking into account of the principal outstanding and the effective interest rate over the period to maturity, when it is determined that such income will accrue to the Group.

(d) Dividend income

Dividend income is recognised when the right to receive payment is established.

2.25 Government grants/subsidies

Grants/subsidies from government are recognised at their fair value where there is a reasonable assurance that the grants/subsidies will be received and the Group will comply with all attached conditions.

Under these circumstances, the grants/subsidies are recognised as income or matched with the associated costs which the grants/subsidies are intended to compensate.

2.26 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by lessors are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

2.27 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group and Company's financial statements in the period in which the dividend is approved by the Company's shareholders.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.28 Research and development expenses

Research expenditure is recognised as an expense as incurred.

Costs incurred on development projects (relating to the design and testing of new or improved products) are capitalised as intangible assets when recognition criteria are fulfilled and tests for impairment are performed annually. Other development expenditures that do not meet those criteria are recognised as expenses as incurred. Development costs previously recognised as expenses are not recognised as assets in subsequent periods. Capitalised development costs are amortised from the point at which the assets are ready for use on a straight-line basis over their useful lives, not exceeding five years.

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group is subject to a variety of financial risks: market risk (including foreign exchange risk, price risk and interest rate risk) and credit risk. The Group's overall risk management strategy seeks to minimise the potential adverse effects on the financial performance of the Group. Risk management is carried out by the senior management of the Group including the executive directors of the Group.

(a) Market risk

i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government. Therefore, to maintain the flexibility in activities including payment of dividends, share repurchases and offshore investments, the Group holds some monetary assets denominated in USD, HKD or EUR subject to certain thresholds stated in its treasury mandate, and borrows some loans denominated in USD from time to time. This exposes the Group to foreign exchange risk.

There is no other written policy to manage the foreign exchange risk in relation to USD, HKD or EUR as management considers that such risk could not be effectively reduced in a low-cost way. However, the Group had entered into certain foreign exchange forward contracts arrangements for managing the foreign exchange risk in relation to short-term borrowings denominated in USD. Details are disclosed in Note 25.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

i) Foreign exchange risk (Cont'd)

As at 31 December 2011, the Group and the Company's non-RMB monetary assets and liabilities are listed below.

Group

	Denomination currency	As at 31 December 2011 RMB'000	2010 RMB'000
Monetary assets			
Current assets			
Receivables	USD	**194,171**	–
Receivables	HKD	**11,048**	–
Restricted cash	USD	**20,322**	–
Term deposits with initial term of over three months	USD	**1,676**	15,664
Term deposits with initial term of over three months	HKD	**–**	34,054
Cash and cash equivalents	USD	**5,429,054**	2,528,206
Cash and cash equivalents	HKD	**293,787**	231,608
Cash and cash equivalents	EUR	**194,705**	–
Monetary liabilities			
Non-current liabilities			
Long-term notes payable	USD	**3,733,331**	–
Long-term payables	USD	**1,796,306**	–
Current liabilities			
Payables	USD	**1,559,692**	502,427
Payables	HKD	**52,086**	–
Short-term borrowings	USD	**5,040,720**	3,973,620

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

i) *Foreign exchange risk (Cont'd)*

Company

	Denomination currency	As at 31 December 2011 RMB'000	2010 RMB'000
Monetary assets			
Current assets			
Receivables	USD	**1,260,180**	–
Term deposits with initial term of over three months	USD	**–**	635
Cash and cash equivalents	USD	**47,110**	35,281
Cash and cash equivalents	HKD	**140,681**	202,244
Monetary liabilities			
Non-current liabilities			
Long-term notes payable	USD	**3,733,331**	–

During the year ended 31 December 2011, the Group reported exchange gains of approximately RMB108,042,000 (2010: RMB34,189,000) as a result of RMB appreciation. The gains were recorded in "Finance income/(costs), net" in the consolidated income statement for the year ended 31 December 2011.

At 31 December 2011, if USD, EUR and HKD had strengthened/weakened by 5% (2010: 5%) against RMB with all other variables held constant, the profit before income tax for the year would have been approximately RMB301,869,000 lower/higher (2010: RMB83,326,000 lower/higher), mainly as a result of net foreign exchange losses/gains on translation of net monetary liabilities denominated in USD, EUR and HKD.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

ii) Price risk

The Group is exposed to price risk because of investments held by the Group, classified as available-for-sale financial assets and derivative financial instruments. The Group is not exposed to commodity price risk. To manage its price risk arising from the investments, the Group diversifies its portfolio. The investment made by the Group is either for the purpose of improving investment yield and maintaining high liquidity level simultaneously, or for strategic purpose. Each investment is managed by senior management, including the executive directors, on a case by case basis.

The available-for-sale financial assets are held for strategic rather than trading purposes. The Group does not actively trade these investments.

The sensitivity analysis is determined based on the exposure to equity price risks of available-for-sale financial assets at the end of the reporting period. If equity prices of the respective instruments held by the Group had been 5% (2010: 5%) higher/lower as at 31 December 2011, the other comprehensive income would have been approximately RMB212,909,000 (2010: RMB206,344,000) higher/lower.

iii) Interest rate risk

The Group has interest-bearing assets including loans to associates and a jointly controlled entity, term deposits with initial term of over three months and cash and cash equivalents, details of which have been disclosed in Notes 17, 18 and 19.

The Group's interest rate risk arises from borrowings (including short-term borrowings and long-term notes issued by the Group). Borrowings issued at variable rates expose the Group to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the group to fair value interest rate risk. There is no other written policy on managing the interest rate risk and management is to minimise its impact on the income statement.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

iii) Interest rate risk (Cont'd)

As mentioned in foreign exchange risk above, the Group had extended bank borrowings and issued long-term notes denominated in USD having fixed interest rate as at 31 December 2011. Concurrently upon the draw-down of certain short-term borrowings, the Group entered into forward foreign exchange contracts to buy USD by selling RMB at designated future periods which substantially coincide with the respective loan maturity dates (see Note 27 for details).

Other financial assets and liabilities do not have material interest rate risk.

For the year ended 31 December 2011, if the average interest rate on variable interest-bearing borrowings had been 5% (2010: 5%) higher/lower, the Group's profit before income tax for the year would have been approximately RMB3,165,000 (2010: RMB1,751,000) lower/higher.

The Company had no variable interest-bearing liabilities.

(b) Credit risk

The Group is exposed to credit risk in relation to its cash and deposits (including restricted cash) placed with banks and financial institutions, financial assets held for trading, and other investments, as well as accounts and other receivables.

The carrying amount of each class of the above financial assets represents the Group's maximum exposure to credit risk in relation to the corresponding class of financial assets.

To manage this risk, deposits are mainly placed with state-owned financial institutions in the PRC and reputable international financial institutions outside of the PRC. There has been no recent history of default in relation to these financial institutions.

For accounts receivable, as mentioned in Note 2.24(a), a large portion of Internet and Mobile Service Fees is derived from the co-operative arrangements with China Mobile, China Unicom and China Telecom. If the strategic relationship with the telecommunications operators is terminated or scaled-back; or if the telecommunications operators alter the co-operative arrangements; or if they experience financial difficulties in paying us, the Group's MVAS and IVAS might be adversely affected in terms of recoverability of receivables.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(b) Credit risk (Cont'd)

To manage this risk, the Group maintains frequent communication with the telecommunication operators to ensure the co-operation is effective. In view of the history of co-operation with the telecommunication operators and the sound collection history of receivables due from them, management believes that the credit risk inherent in the Group's outstanding accounts receivable balances from these telecommunications operators is low (see Note 16 for details).

For accounts receivable from advertising customers, which are mainly advertising agencies, the credit quality of each customer is assessed, which takes into account its financial position, past experience and other factors. Normally, prepayments representing a certain percentage of the total service fees for each advertising service are required.

(c) Liquidity risk

The Group aims to maintain sufficient cash and cash equivalents and marketable securities. Due to the dynamic nature of the underlying businesses, the Group's finance department maintains flexibility in funding by maintaining adequate cash and cash equivalent. For the year ended 31 December 2011, in order to improve liquidity, the Group also issued long-term notes (see Note 28).

The table below analyses the Group's and the Company's financial liabilities and net-settled derivative financial liabilities by relevant maturity groupings based on the remaining period since the end of the reporting period to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(c) Liquidity risk (Cont'd)

Group

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
At 31 December 2011					
Long-term notes payable	**174,850**	**174,850**	**4,305,090**	**–**	**4,654,790**
Long-term payables	**–**	**316,622**	**641,070**	**1,002,541**	**1,960,233**
Short-term borrowings	**7,999,440**	**–**	**–**	**–**	**7,999,440**
Derivative financial instruments	**20,993**	**–**	**–**	**–**	**20,993**
Accounts payable, other payables and accruals (excluding prepayments received from customers)	**7,155,609**	**–**	**–**	**–**	**7,155,609**
Total	**15,350,892**	**491,472**	**4,946,160**	**1,002,541**	**21,791,065**
At 31 December 2010					
Short-term borrowings	5,298,947	–	–	–	5,298,947
Derivative financial instruments	17,964	–	–	–	17,964
Accounts payable, other payables and accruals (excluding prepayment received from customers)	4,303,649	–	–	–	4,303,649
Total	9,620,560	–	–	–	9,620,560

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(c) Liquidity risk (Cont'd)

Company

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
At 31 December 2011					
Long-term notes payable	**174,850**	**174,850**	**4,305,090**	**–**	**4,654,790**
Amounts due to subsidiaries	**1,829,429**	**–**	**–**	**–**	**1,829,429**
Other payables and accruals	**86,528**	**–**	**–**	**–**	**86,528**
Total	**2,090,807**	**174,850**	**4,305,090**	**–**	**6,570,747**
At 31 December 2010					
Amounts due to subsidiaries	1,833,802	–	–	–	1,833,802
Other payables and accruals	56,279	–	–	–	56,279
Total	1,890,081	–	–	–	1,890,081

As of 31 December 2011, the Company reported net current liabilities amounting to approximately RMB464,280,000 on the statement of financial position of the Company. Nevertheless, certain subsidiaries held by the Company declared dividends in aggregate of HKD4,500,000,000 (equivalent to approximately RMB3,653,100,000), which would be paid to the Company subsequent to the end of the reporting period and the net current liabilities position was reversed subsequently. Accordingly, the directors of the Company consider it is appropriate to prepare the financial statements of the Company on the going concern basis.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to enhance shareholders' value in the long term.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or repurchase the Company's shares.

The Group monitors capital by regularly reviewing the gearing ratio. The gearing ratio is calculated as total liabilities divided by total assets. The total capital is the "total equity" of the Group as shown in the consolidation statement of financial position, which is also equal to total assets less total liabilities.

The gearing ratios as at 31 December 2011 and 2010 were as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Total liabilities	**27,716,021**	13,989,256
Total assets	**56,804,365**	35,830,114
Gearing ratio	**49%**	39%

The increase in gearing ratio as at 31 December 2011 was mainly due to the increase in short-term borrowings and long-term notes payable.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.3 Fair value estimation

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table presents the Group's assets and liabilities that are measured at fair value as at 31 December 2011.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Available-for-sale financial assets				
– Equity securities	**3,318,794**	**–**	**1,024,808**	**4,343,602**
Total	**3,318,794**	**–**	**1,024,808**	**4,343,602**
Liabilities				
Financial liabilities at fair value through profit or loss				
– Derivative financial instruments	**–**	**20,993**	**–**	**20,993**
Total	**–**	**20,993**	**–**	**20,993**

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.3 Fair value estimation (Cont'd)

The following table presents the Group's assets that are measured at fair value as at 31 December 2010.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Available-for-sale financial assets				
– Equity securities	3,869,033	–	257,845	4,126,878
Total	3,869,033	–	257,845	4,126,878
Liabilities				
Financial liabilities at fair value through profit or loss				
– Derivative financial instruments	–	17,964	–	17,964
Total	–	17,964	–	17,964

The fair value of financial instruments traded in active markets is determined based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required for evaluating the fair value of a financial instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.3 Fair value estimation (Cont'd)

Specific valuation techniques used to value financial instruments include:

- Dealer quotes for similar instruments;
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the end of the reporting period, with the resulting value discounted back to present value; and
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for financial instruments.

There were no transfers of financial assets between level 1 and level 2 fair value hierarchy classifications.

The following table presents the changes in level 3 instruments for the year ended 31 December 2011:

	Available-for-sale financial assets RMB'000
Opening balance	**257,845**
Additions	**802,963**
Impairment provision	**(36,000)**
Closing balance	**1,024,808**

The following table presents the changes in level 3 instruments for the year ended 31 December 2010:

	Available-for-sale financial assets RMB'000
Opening balance	153,462
Additions	131,192
Transfer to investment in associates	(26,809)
Closing balance	257,845

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Recognition of revenues and accounts receivables related to IVAS and MVAS

As mentioned in Note 2.24(a), for the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on the historical data.

As at 31 December 2011, the balance of accounts receivable not yet confirmed by China Mobile, China Unicom and China Telecom and their branches, subsidiaries and affiliates was estimated to be RMB746,471,000 (2010: RMB479,134,000).

Were the actual outcome to differ by 5% (2010: 5%) from management's estimates, the Group would need to:

- reduce the revenue and accounts receivable by RMB37,324,000 (2010: RMB23,957,000) if unfavourable; or
- increase the revenue and accounts receivable by RMB37,324,000 (2010: RMB23,957,000) if favourable.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont'd)

4.1 Critical accounting estimates and assumptions (Cont'd)

(b) Recognition of share-based compensation expenses

As mentioned in Note 2.22(c), the Group has granted share options to its employees. The directors have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement on parameters, such as risk free rate, dividend yield and expected volatility, is required to be made by the directors in applying the BS Model (Note 22).

The fair value of options granted for the year ended 31 December 2011 determined using the BS Model was approximately HKD63,000,000 (2010: HKD251,307,000).

In addition, the Group also granted awarded shares to its employees at fair value of HKD1,157,928,000 during 2011 (2010: HKD666,732,000).

The Group has to estimate the expected yearly percentage of grantees of share options/awarded shares who will stay within the Group at the end of the vesting periods ("Expected Retention Rate of Grantees") in order to determine the amount of share-based compensation expenses charged into the income statement. As at 31 December 2011, the Expected Retention Rate of Grantees was assessed to be 91% (2010: 91%).

If the Expected Retention Rate of Grantees had been increased/decreased by 5% (2010: 5%), the amount of share-based compensation expenses would be increased/decreased by RMB65,143,000 (2010: RMB32,315,000).

(c) The estimates of the lifespan of virtual products/items provided in the Group's Internet platforms

As mentioned in Note 2.24(a), the end users purchase certain virtual products/items provided in the Group's Internet platforms and the relevant revenue is recognised based on the lifespan of the virtual products/items. The Group uses the available information, including the historical user pattern and behavior and the stipulated period of validity of the relevant virtual products/items, to estimate the lifespan of these products/items.

The Group will continue to monitor the average lifespan of the virtual products/items (provided and to be provided), which may differ from the historical period, and any change in the estimates may result in the revenue being recognised on a different basis than in prior periods.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont'd)

4.1 Critical accounting estimates and assumptions (Cont'd)

(d) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact current income tax and deferred income tax liabilities in the period in which such determination is made.

Were the actual final outcome (on the judgement areas) to differ by 5% from management's estimates, the group would need to:

- Increase the income tax liabilities by RMB35,436,000 (2010: RMB17,055,000) and the deferred tax liabilities by RMB46,977,000 (2010: RMB48,361,000), if unfavourable; or

- Decrease the income tax liabilities by RMB35,436,000 (2010: RMB17,055,000) and the deferred tax liabilities by RMB46,977,000 (2010: RMB48,361,000), if favourable.

4.2 Critical judgments in applying the Group's accounting policies

Recognition of deferred tax assets

Certain intra-group software and technology sales have been transacted within the Group. The self-developed software and technology purchased by two subsidiary companies, Tencent Computer and Shiji Kaixuan Technology Limited ("Shiji Kaixuan"), from other group companies have been initially recorded at the purchase prices as costs and then amortised over their contracted useful lives (the "Amortisation") in their local statutory financial statements, while these transactions were eliminated at the group level.

The Amortisation has been treated as a deductible expense in ascertaining the assessable profits of Tencent Computer and Shiji Kaixuan for tax reporting purposes while the costs of purchase of these assets were eliminated in preparation of the consolidated financial statements of the Group. As a result, deferred tax assets have been recognised, based on temporary differences arising from the accounting base (at the group level, which is zero) and the tax base of the software and technology involved in these intra-group transactions, at the respective enacted corporate income tax rates of Tencent Computer and Shiji Kaixuan.

As at 31 December 2011, the relevant deferred tax assets were approximately RMB197,010,000 (2010: RMB219,019,000) (Note 30), which are expected to be recovered by the tax profits to be generated from Tencent Computer and Shiji Kaixuan in future.

5 SEGMENT INFORMATION

The chief operating decision-makers mainly include executive directors of the Company. They review the Group's internal reporting in order to assess performance and allocate resources, and determine the operating segments based on these reports.

The Group has following reportable segments for the years ended 31 December 2011 and 2010:

– IVAS;

– MVAS;

– Online advertising; and

– Others.

Other segments of the Group are mainly comprised of the provision of trademark licensing, software development services and software sales.

The chief operating decision-makers assess the performance of the operating segments mainly based on segment revenue and gross profit/(losses) of each operating segment. The selling and marketing expenses and general and administrative expenses are common costs incurred for the operating segments as a whole and therefore, they are not included in the measure of the segments' performance which is used by the chief operating decision-makers as a basis for the purpose of resource allocation and assessment of segment performance. Interest income, other gains, net, finance income/(costs), net and income tax expense are also not allocated to individual operating segment.

There were no material inter-segment sales during the years ended 31 December 2011 and 2010. The revenues from external customers reported to the chief operating decision-makers are measured in a manner consistent with that applied in the consolidated income statement.

Other information, together with the segment information, provided to the chief operating decision-makers, is measured in a manner consistent with that applied in this annual report. There were no segment assets and segment liabilities information provided to the chief operating decision-makers.

5 SEGMENT INFORMATION (Cont'd)

The segment information provided to the chief operating decision-makers for the reportable segments for the years ended 31 December 2011 and 2010 is as follows:

	Year ended 31 December 2011				
	IVAS	**MVAS**	**Online advertising**	**Others**	**Total**
	RMB'000	**RMB'000**	**RMB'000**	**RMB'000**	**RMB'000**
Segment revenues (revenues from external customers)	**23,042,758**	**3,270,841**	**1,992,216**	**190,257**	**28,496,072**
Gross profit/(losses)	**15,409,134**	**2,011,085**	**1,197,260**	**(49,715)**	**18,567,764**
Depreciation	**724,418**	**66,249**	**58,605**	**34,666**	**883,938**
Amortisation	**67,056**	**–**	**–**	**–**	**67,056**
Share of losses of associates	**(23,513)**	**(742)**	**–**	**–**	**(24,255)**
Share of losses of jointly controlled entities	**(165,731)**	**–**	**–**	**–**	**(165,731)**

	Year ended 31 December 2010				
	IVAS	MVAS	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenues (revenues from external customers)	15,482,301	2,715,931	1,372,522	75,277	19,646,031
Gross profit/(losses)	10,719,866	1,705,073	931,220	(30,328)	13,325,831
Depreciation	374,991	35,264	21,884	13,923	446,062
Amortisation	37,033	–	–	–	37,033
Share of profit of associates	67,563	4,796	–	–	72,359
Share of profit of jointly controlled entities	3,399	–	–	–	3,399

The reconciliation of gross profit to profit before tax is shown in the consolidated income statement.

5 SEGMENT INFORMATION (Cont'd)

The Company is domiciled in the Cayman Islands while the Group mainly operates its businesses in the PRC. For the year ended 31 December 2011, revenues from external customers in the PRC (excluding Hong Kong) were RMB28,027,516,000 (2010: RMB19,632,117,000), and revenues from external customers in other areas were RMB468,556,000 (2010: RMB13,914,000).

The Group also conducts operations in United States and Europe, and holds financial instruments as investments which are traded in other territories. The geographical information on the total assets is as follows:

	Total assets	
	2011	2010
	RMB'000	RMB'000
Operating assets		
– The PRC	**42,118,996**	27,720,196
– United States and Europe	**2,726,895**	13,772
Investments		
– The PRC (excluding Hong Kong)	**4,409,589**	446,608
– Hong Kong	**3,538,071**	2,734,762
– United States	**206,962**	159,719
– Europe	**2,658,526**	3,869,033
– Other countries	**1,145,326**	886,024
Consolidated	**56,804,365**	35,830,114

As at 31 December 2011, the total non-current assets other than financial instruments and deferred tax assets located in the PRC were RMB13,620,472,000 (2010: RMB5,282,748,000), and the total non-current assets located in other countries were RMB3,138,745,000 (2010: RMB827,728,000).

All the revenues derived from any single external customer were less than 10% of the Group's total revenues for the year ended 31 December 2011.

Turnover consists of revenues generated by the Group, which were RMB28,496,072,000 and RMB19,646,031,000 for the years ended 31 December 2011 and 2010, respectively.

6 FIXED ASSETS

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
At 1 January 2010						
Cost	1,299,071	1,955,282	68,837	8,118	90,368	3,421,676
Accumulated depreciation	(46,836)	(784,461)	(20,535)	(5,598)	(47,044)	(904,474)
Net book amount	1,252,235	1,170,821	48,302	2,520	43,324	2,517,202
Year ended 31 December 2010						
Opening net book amount	1,252,235	1,170,821	48,302	2,520	43,324	2,517,202
Business combinations	–	2,174	316	–	–	2,490
Other additions	68,761	1,273,450	57,135	575	42,486	1,442,407
Disposals	–	(338)	(23)	(75)	(255)	(691)
Depreciation	(59,458)	(574,870)	(17,072)	(1,065)	(16,115)	(668,580)
Closing net book amount	1,261,538	1,871,237	88,658	1,955	69,440	3,292,828
At 31 December 2010						
Cost	1,368,462	3,185,873	125,816	7,636	130,305	4,818,092
Accumulated depreciation	(106,924)	(1,314,636)	(37,158)	(5,681)	(60,865)	(1,525,264)
Net book amount	1,261,538	1,871,237	88,658	1,955	69,440	3,292,828

6 FIXED ASSETS (Cont'd)

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
Year ended 31 December 2011						
Opening net book amount	1,261,538	1,871,237	88,658	1,955	69,440	3,292,828
Business combinations	–	17,388	1,113	415	122	19,038
Other additions	363,067	3,030,367	129,038	4,947	256,018	3,783,437
Disposals	–	(1,870)	(104)	(37)	(282)	(2,293)
Depreciation	(77,438)	(1,046,924)	(34,396)	(1,183)	(47,791)	(1,207,732)
Exchange difference	–	(258)	(35)	–	(33)	(326)
Closing net book amount	1,547,167	3,869,940	184,274	6,097	277,474	5,884,952
At 31 December 2011						
Cost	1,731,913	6,159,151	255,073	12,631	385,638	8,544,406
Accumulated depreciation	(184,746)	(2,288,953)	(70,764)	(6,534)	(108,131)	(2,659,128)
Exchange difference	–	(258)	(35)	–	(33)	(326)
Net book amount	1,547,167	3,869,940	184,274	6,097	277,474	5,884,952

For the year ended 31 December 2011, depreciation of RMB883,938,000 (2010: RMB446,062,000), RMB13,377,000 (2010: RMB12,198,000) and RMB310,417,000 (2010: RMB210,320,000) were charged in cost of revenues, selling and marketing expenses and general and administrative expenses, respectively.

7 CONSTRUCTION IN PROGRESS

	2011	2010
	RMB'000	RMB'000
Opening net book amount	**386,943**	105,771
Additions	**500,268**	410,362
Transfer to fixed assets	**(728,555)**	(129,190)
Closing net book amount	**158,656**	386,943

8 INVESTMENT PROPERTIES

	2011	2010
	RMB'000	RMB'000
Opening net book amount	**37,229**	68,025
Additions	**–**	247
Transfer to fixed assets	**(14,829)**	(29,763)
Depreciation	**(529)**	(1,280)
Closing net book amount	**21,871**	37,229

The investment properties as at 31 December 2011 mainly represent certain units in office buildings in Chengdu, the PRC.

The fair value of the investment properties was estimated to be approximately RMB38,884,000 (31 December 2010: RMB53,492,000) as at 31 December 2011, which was determined based on current prices in an active market for similar buildings in the same district.

The period of leases whereby the Group leases its investment properties under operating leases is within 3 years.

9 LAND USE RIGHTS

	2011	2010
	RMB'000	RMB'000
Opening net book amount	229,890	35,296
Additions	5,950	198,318
Amortisation	(4,925)	(3,724)
Closing net book amount	230,915	229,890

The land use rights all relate to land in the PRC with remaining lease period of 44 to 49 years. For the year ended 31 December 2011, RMB4,925,000 (2010: RMB3,724,000) of the amortisation was charged as general and administrative expenses.

10 INTANGIBLE ASSETS

	Goodwill	Computer software and technology	Licences	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2010					
Cost	62,234	257,817	196,806	14,497	531,354
Accumulated amortisation	–	(107,750)	(145,140)	(9,751)	(262,641)
Net book amount	62,234	150,067	51,666	4,746	268,713
Year ended 31 December 2010					
Opening net book amount	62,234	150,067	51,666	4,746	268,713
Business combinations	240,467	32,134	324	26,116	299,041
Other additions	–	87,887	25,000	1,751	114,638
Amortisation	–	(39,091)	(62,975)	(7,345)	(109,411)
Closing net book amount	302,701	230,997	14,015	25,268	572,981
At 31 December 2010					
Cost	302,701	377,838	222,130	42,364	945,033
Accumulated amortisation	–	(146,841)	(208,115)	(17,096)	(372,052)
Net book amount	302,701	230,997	14,015	25,268	572,981

10 INTANGIBLE ASSETS (Cont'd)

	Goodwill RMB'000	Computer software and technology RMB'000	Licences RMB'000	Others RMB'000	Total RMB'000
Year ended 31 December 2011					
Opening net book amount	302,701	230,997	14,015	25,268	572,981
Business combinations (Note 43)	2,391,995	110,031	663,549	239,084	3,404,659
Other additions	–	141,792	469,392	1,187	612,371
Amortisation	–	(113,508)	(436,683)	(176,030)	(726,221)
Exchange difference	(78,918)	(332)	(3,074)	(1,490)	(83,814)
Closing net book amount	2,615,778	368,980	707,199	88,019	3,779,976
At 31 December 2011					
Cost	2,694,696	629,661	1,355,071	282,635	4,962,063
Accumulated amortisation	–	(260,349)	(644,798)	(193,126)	(1,098,273)
Exchange difference	(78,918)	(332)	(3,074)	(1,490)	(83,814)
Net book amount	2,615,778	368,980	707,199	88,019	3,779,976

Amortisation of RMB659,165,000 (2010: RMB72,378,000) and RMB67,056,000 (2010: RMB37,033,000) were charged as general and administrative expenses and cost of revenues respectively for the year ended 31 December 2011.

10 INTANGIBLE ASSETS (Cont'd)

Impairment tests for goodwill

Goodwill is allocated to the Group's CGUs identified according to operating segments. Most of the goodwill is related to the operating segment of IVAS.

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rate stated below. The growth rate does not exceed the long-term average growth rate for the IVAS business in which the CGU operates.

The key assumptions used for value-in-use calculations in 2011 and 2010 are as follows:

	2011	2010
Gross margin	**64%**	60%
Growth rate	**3%**	3%
Discount rate	**18%**	17%

Management determined budgeted gross margin based on past performance and its expectations of market development. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the relevant operating segments.

Based on the assessment made by management, no provision for impairment on goodwill was required as at 31 December 2011.

11 INVESTMENTS IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY

(a) Investments in subsidiaries

The amount represents investments in equity interests in subsidiaries of the Company. Details are as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Investments in subsidiaries:		
– investments in equity interests - at cost, unlisted	**69**	52
– deemed investments arising from share-based compensation (Note (i))	**1,827,855**	1,199,663
– advance to subsidiaries (Note (ii))	**3,954,457**	1,635,137
	5,782,381	2,834,852

The following is a list of principal subsidiaries of the Company as at 31 December 2011:

Name	Place and date of establishment and nature of legal entity	Particulars of issued/ paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2011		2010		
			Direct	**Indirect**	Direct	Indirect	
Tencent Computer	Established on 11 November 1998 in the PRC, private limited liability company	RMB30,000,000	**–**	**100% (Note (iii))**	–	100%	Provision of Internet and mobile and telecommunications value-added services, and Internet advertisement services
Tencent Technology	Established on 24 February 2000 in the PRC, wholly foreign owned enterprise	USD2,000,000	**–**	**100%**	–	100%	Development of computer software and provision of information service
Shiji Kaixuan	Established on 13 January 2004 in the PRC, private limited liability company	RMB11,000,000	**–**	**100% (Note (iii))**	–	100%	Provision of Internet advertisement service

11 INVESTMENTS IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(a) Investments in subsidiaries (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/ paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2011		2010		
			Direct	Indirect	Direct	Indirect	
Tencent Cyber (Tianjin) Company Limited ("Cyber Tianjin")	Established on 8 February 2004 in the PRC, wholly foreign owned enterprise	USD80,000,000	–	100%	–	100%	Development of computer software and provision of information technology services
Tencent Asset Management Limited	Established on 7 July 2004 in BVI, private limited liability company	USD100	100%	–	100%	–	Asset management
Tencent Technology (Beijing) Company Limited ("Tencent Beijing")	Established on 30 March 2005 in the PRC, wholly foreign owned enterprise	USD1,000,000	–	100%	–	100%	Development of computer software and provision of information technology services
Nanjing Wang Dian Technology Limited ("Wang Dian")	Established on 5 January 2000 in the PRC, private limited liability company	RMB10,290,000	–	100% (Note (iii))	–	100%	Provision of mobile and telecommunications value-added services
Beijing BIZCOM Technology Company Limited ("Beijing BIZCOM")	Established on 11 June 2002 in the PRC, private limited liability company	RMB16,500,000	–	100% (Note (iii))	–	100%	Provision of mobile and telecommunications value-added services
Beijing Starsinhand Technology Company Limited ("Beijing Starsinhand")	Established on 13 July 2005 in the PRC, private limited liability company	RMB10,000,000	–	100% (Note (iii))	–	100%	Provision of mobile and telecommunications value-added services

11 INVESTMENTS IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(a) Investments in subsidiaries (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/ paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2011		2010		
			Direct	Indirect	Direct	Indirect	
Tencent Cyber (Shenzhen) Company Limited ("Cyber Shenzhen")	Established on 17 January 2007 in the PRC, wholly foreign owned enterprise	USD30,000,000	–	100%	–	100%	Development of computer software
Tencent Technology (Shanghai) Company Limited ("Tencent Shanghai")	Established on 23 July 2008 in the PRC, wholly foreign owned enterprise	USD5,000,000	–	100%	–	100%	Development of computer software and provision of Internet information services
Tencent Technology (Chengdu) Company Limited ("Tencent Chengdu")	Established on 10 July 2008 in the PRC, wholly foreign owned enterprise	USD60,000,000	–	100%	–	100%	Development of computer software and provision of information technology services
Tencent Technology (Wuhan) Company Limited ("Tencent Wuhan")	Established on 18 November 2011 in the PRC, wholly foreign owned enterprise	USD30,000,000	–	100%	–	–	Development of computer software and provision of Internet information services
Riot Games, Inc. ("Riot Games")	Established in September 2006 in the United States, private limited liability company	USD43,068,238	–	91.8%	–	–	Development and operation of online games

11 INVESTMENTS IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(a) Investments in subsidiaries (Cont'd)

Note:

(i) The amount represents share-based compensation expenses arising from grant of share options and awarded shares of the Company to employees of subsidiaries in exchange for their services provided to the subsidiaries, which were deemed to be investment made by the Company into these subsidiaries.

(ii) All these balances are unsecured and interest-free and their repayments are neither planned nor likely to occur in the foreseeable future.

(iii) As described in Note 1, the Company does not have legal ownership in equity of these subsidiaries. Nevertheless, under certain contractual agreements entered into with the registered owners of these subsidiaries, the Company and its other legally owned subsidiaries control these companies by way of controlling the voting rights, governing their financial and operating policies, appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. In addition, such contractual agreements also transfer the risks and rewards of these companies to the Company and/or its legally owned subsidiaries. As a result, they are presented as consolidating subsidiaries of the Company.

(b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries as at 31 December 2011 represented current account balances maintained by the Company with certain subsidiaries. All balances are unsecured and interest-free and the balances are repayable on demand. As at 31 December 2011, the amounts due from subsidiaries were neither past due nor impaired.

(c) Consolidation of a special purpose entity

In connection with the implementation of the share award scheme of the Group mentioned in Note 22(b), the Company has set up a special purpose entity ("Share Scheme Trust"), and its particulars are as follows:

Special purpose entity	Principal activities
Share Scheme Trust	Administering and holding the Company's shares acquired for a share award scheme which is set up for the benefits of eligible persons of the scheme

As the Company has the power to govern the financial and operating policies of the Share Scheme Trust and can derive benefits from the contributions of the eligible persons who are awarded with the shares by the scheme, the directors of the Company consider that it is appropriate to consolidate the Share Scheme Trust.

For the year ended 31 December 2011, the Company contributed approximately RMB314,064,000 (2010: RMB163,395,000) to the Share Scheme Trust for financing its acquisition of the Company's shares.

12 INVESTMENT IN ASSOCIATES

	2011	2010
	RMB'000	RMB'000
At beginning of the year	**1,070,633**	477,622
Acquisitions (Note (i), (ii), (iii) and (iv))	**3,634,922**	412,094
Additional investments in existing associates	**99,537**	97,087
Transfer from available-for-sale financial assets	**–**	26,809
Transfer out as a result of step-up business combinations (Note 43)	**(257,585)**	–
Share of (losses)/profit of associates	**(24,255)**	72,359
Dividends received from associates	**(20,000)**	(15,338)
Impairment provision	**(165,177)**	–
At end of the year	**4,338,075**	1,070,633

Note:

(i) During the year ended 31 December 2011, the Group acquired 16.15% equity interest in eLong Incorporated ("eLong"), a company listed on NASDAQ, which is mainly engaged in the provision of online travel services, for a consideration of USD84,389,000 (equivalent to approximately RMB548,447,000). The Group accounted for eLong as an associate although the Group held less than 20% equity interest. This is because the Group has the ability to exercise significant influence over this investee with a representative on its board of directors.

(ii) During the year ended 31 December 2011, the Group acquired 15.28% equity interest in Kingsoft Corporation Limited ("Kingsoft"), a company listed on the Stock Exchange, for a consideration of approximately HKD892,036,000 (equivalent to approximately RMB741,817,000), and 10% equity interest in Beijing Kingsoft Internet Security Software Corporation Limited ("Kingsoft Security"), a subsidiary of Kingsoft, for a consideration of USD20,000,000 (equivalent to approximately RMB129,432,000). Kingsoft is principally engaged in the provision of games research, development, operation and distribution whilst Kingsoft Security specialises in the development and distribution of Internet securities software. The Group accounts for these two companies as associates although the Group holds less than 20% equity interest in them because the Group has the ability to exercise significant influence over these investees with a representative on their board of directors respectively.

(iii) During the year ended 31 December 2011, the Group acquired 20.20% equity interest in a securities investment analysis software company, which provides securities investment solutions to investors through its Internet platform, for a consideration of RMB380,000,000. In addition, the Group also acquired 21.70% and 33.37% equity interests in two e-commerce companies for a consideration of USD46,000,000 (equivalent to approximately RMB302,459,000) and RMB314,437,000 respectively.

(iv) In addition to the above, the Group acquired some other associates for an aggregate consideration of RMB1,218,330,000 during the year ended 31 December 2011. They are principally engaged in e-commerce and other Internet related businesses.

12 INVESTMENT IN ASSOCIATES (Cont'd)

The Group's share of the results, the revenues, the aggregated assets (including goodwill) and liabilities of its associates, as well as the fair value of the associates who are listed companies, are shown in aggregate as follows:

	Assets RMB'000	Liabilities RMB'000	Revenues RMB'000	Profit/ (Losses) RMB'000	Fair value of listed companies as at 31 December 2011 RMB'000
2011					
Listed companies:					
16.15% equity interest in eLong (Note (i))	**576,958**	**33,065**	**55,452**	**(4,554)**	**524,178**
15.28% equity interest in Kingsoft (Note (i))	**871,194**	**115,218**	**70,055**	**14,159**	**419,441**
	1,448,152	**148,283**	**125,507**	**9,605**	**943,619**
Non-listed companies:					
A Southeast Asia based online game company, 31.25% equity interest	**518,742**	**25,455**	**218,540**	**44,515**	
A PRC based securities investment analysis software company, 20.20% equity interest	**391,301**	**23,523**	**60,326**	**(12,222)**	
A PRC based e-commerce company, 33.37% equity interest	**327,299**	**19,809**	**59,166**	**(6,947)**	
A PRC based SNS company, 13.79% equity interest (Note (i))	**258,480**	**6,759**	**6,890**	**(2,475)**	
A PRC based e-commerce company, 21.70% equity interest	**317,360**	**48,771**	**64,963**	**(33,870)**	
Other associates (Note (ii))	**1,692,702**	**343,361**	**963,817**	**(22,861)**	
	3,505,884	**467,678**	**1,373,702**	**(33,860)**	
	4,954,036	**615,961**	**1,499,209**	**(24,255)**	

12 INVESTMENT IN ASSOCIATES (Cont'd)

	Assets RMB'000	Liabilities RMB'000	Revenues RMB'000	Profit RMB'000
2010				
Non-listed companies:				
A Southeast Asia based online game company, 30.02% equity interest	471,650	22,879	191,261	34,684
A United States based online game company, 22.34% equity interest	124,472	13,223	31,072	7,729
A PRC advertising media company, 10.00% equity interest (Note (i))	148,250	17,950	–	–
A PRC based online game company, 50.00% equity interest	98,272	3,465	20,794	7,681
Other associates (Note (ii))	318,079	32,573	96,386	22,265
	1,160,723	90,090	339,513	72,359

Note:

(i) Although the Group holds less than 20% equity interest in these investees, the Group treated them as associates because the Group is able to exercise its significant influence on the financial and operating policy decisions of these investees through its representatives on their board of directors.

(ii) The carrying amount of the investment made in each individual associate as at 31 December 2011 was below RMB250,000,000 (2010: Below RMB80,000,000).

As at 31 December 2011 and 2010, there were certain call options embedded in investments in associates. The directors of the Company considered that the fair value of such call options was insignificant and accordingly, the Group did not separately recognise these call options in the financial statements.

13 INVESTMENT IN JOINTLY CONTROLLED ENTITIES

	2011 RMB'000	2010 RMB'000
At beginning of the year	**74,542**	–
Additions	**194,915**	71,143
Share of (losses)/profit of jointly controlled entities	**(165,731)**	3,399
Impairment provision	**(41,823)**	–
At end of the year	**61,903**	74,542

14 FINANCIAL INSTRUMENTS BY CATEGORY

Group

	Loans and receivables RMB'000	Available-for-sale financial assets RMB'000	Total RMB'000
Assets			
At 31 December 2011			
Available-for-sale financial assets (Note 15)	**–**	**4,343,602**	**4,343,602**
Accounts receivable (Note 16)	**2,020,796**	**–**	**2,020,796**
Deposits and other receivables	**1,433,473**	**–**	**1,433,473**
Term deposits with initial term of over three months (Note 18)	**13,716,040**	**–**	**13,716,040**
Restricted cash	**4,942,595**	**–**	**4,942,595**
Cash and cash equivalents (Note 19)	**12,612,140**	**–**	**12,612,140**
Total	**34,725,044**	**4,343,602**	**39,068,646**

14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

Group (Cont'd)

	Loans and receivables RMB'000	Available-for-sale financial assets RMB'000	Total RMB'000
At 31 December 2010			
Available-for-sale financial assets	–	4,126,878	4,126,878
Accounts receivable	1,715,412	–	1,715,412
Deposits and other receivables	281,126	–	281,126
Term deposits with initial term of over three months	11,725,743	–	11,725,743
Restricted cash	1,036,457	–	1,036,457
Cash and cash equivalents	10,408,257	–	10,408,257
Total	25,166,995	4,126,878	29,293,873

	Liabilities at fair value through the profit or loss RMB'000	**Other financial liabilities at amortised cost RMB'000**	**Total RMB'000**
Liabilities			
At 31 December 2011			
Long-term notes payable (Note 28)	**–**	**3,733,331**	**3,733,331**
Long-term payables (Note 26)	**–**	**1,859,808**	**1,859,808**
Accounts payable (Note 23)	**–**	**2,244,114**	**2,244,114**
Other payables and accruals (excluded prepayment received from customers)	**–**	**4,911,495**	**4,911,495**
Short-term borrowings (Note 27)	**–**	**7,999,440**	**7,999,440**
Derivative financial instruments	**20,993**	**–**	**20,993**
Total	**20,993**	**20,748,188**	**20,769,181**

14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

Group (Cont'd)

	Liabilities at fair value through the profit or loss RMB'000	Other financial liabilities at amortised cost RMB'000	Total RMB'000
At 31 December 2010			
Accounts payable	–	1,380,464	1,380,464
Other payables and accruals (excluded prepayment received from customers)	–	2,923,185	2,923,185
Short-term borrowings	–	5,298,947	5,298,947
Derivative financial instruments	17,964	–	17,964
Total	17,964	9,602,596	9,620,560

Company

	Loans and receivables RMB'000
Assets	
At 31 December 2011	
Amounts due from subsidiaries (Note 11(b))	**1,260,180**
Deposits and other receivables	**2,702**
Cash and cash equivalents (Note 19)	**187,791**
Total	**1,450,673**

14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

Company (Cont'd)

	Loans and receivables RMB'000
At 31 December 2010	
Amounts due from subsidiaries	708,074
Deposits and other receivables	3,721
Term deposits with initial term of over three months	635
Cash and cash equivalents	237,525
Total	949,955

	Other financial liabilities at amortised cost RMB'000
Liabilities	
At 31 December 2011	
Long-term notes payable (Note 28)	**3,733,331**
Amounts due to subsidiaries	**1,829,429**
Other payables and accruals	**86,528**
Total	**5,649,288**
At 31 December 2010	
Amounts due to subsidiaries	1,833,802
Other payables and accruals	56,279
Total	1,890,081

15 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2011 RMB'000	2010 RMB'000
At beginning of the year	**4,126,878**	153,462
Additions (Notes (i), (ii), (iii) and (iv))	**1,487,645**	2,179,096
Transfer to investment in associates	**–**	(26,809)
(Losses)/gains from changes in fair value of available-for-sale financial assets	**(1,234,921)**	1,821,129
Impairment provision	**(36,000)**	–
At end of the year, all non-current	**4,343,602**	4,126,878

Note:

(i) During the year ended 31 December 2011, the Group acquired 4.60% equity interest in Huayi Brother Media Corporation ("Huayi"), a film producer listed on the Shenzhen Stock Exchange in the PRC, which is mainly engaged in the provision of movie and TV series production and entertainment brokerage, for a consideration of RMB444,933,000.

(ii) During the year ended 31 December 2011, the Group acquired 5.01% equity interest in Media Asia Group Holdings Limited ("Media Asia"), a company listed on the Growth Enterprise Market of the Stock Exchange, which is mainly engaged in movie production, for a consideration of approximately HKD132,090,000 (equivalent to approximately RMB108,208,000).

(iii) During the year ended 31 December 2011, the Group acquired 5.00% equity interest in an investment fund for a consideration of approximately USD49,875,000 (equivalent to approximately RMB321,709,000).

(iv) In addition to the above, the Group acquired some other available-for-sale financial assets for an aggregate consideration of RMB612,795,000 during the year ended 31 December 2011. They are principally engaged in software development, equity investments and content production.

15 AVAILABLE-FOR-SALE FINANCIAL ASSETS (Cont'd)

Available-for-sale financial assets include the following:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Listed equity interests:		
7.76% (2010: 7.56%) equity interest in Mail.ru Group Limited	**2,658,527**	3,869,033
4.60% (2010: nil) equity interest in Huayi	**439,518**	–
3.98% (2010: nil) equity interest in Hangzhou Shunwang Technology Co., Ltd.	**129,961**	–
5.01% (2010: nil) equity interest in Media Asia	**90,788**	–
	3,318,794	3,869,033
Unlisted equity interests:		
5.00% (2010: nil) equity interest in an investment fund in Hong Kong	**321,709**	–
20.31% (2010: nil) equity interest in an investment fund in the PRC (Note)	**160,000**	–
4.08% (2010: nil) equity interest in a film company in the PRC	**100,000**	–
20.50% (2010: nil) equity interest in an investment fund in the Cayman Islands (Note)	**56,435**	–
Others	**386,664**	257,845
	1,024,808	257,845
	4,343,602	4,126,878
Market value of listed securities	**3,318,794**	3,869,033

Note:

Although the Group holds over 20% equity interest in these two investment funds, the Group treats them as available-for-sale financial assets because the Group has no representative on the governing bodies of these investment funds, and accordingly, the Group is not able to exercise the significant influence on the financial and operating policy decisions of these investment funds.

16 ACCOUNTS RECEIVABLE

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
0 - 30 days	**1,103,261**	931,438
31 - 60 days	**443,555**	331,922
61 - 90 days	**246,501**	143,785
Over 90 days	**227,479**	308,267
	2,020,796	1,715,412

Accounts receivable was mainly denominated in RMB.

The carrying amounts of accounts receivable of the Group's major agents/customers are as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Telecommunications operators	**1,178,445**	1,030,549
Online advertising customers	**673,844**	613,427
Others	**168,507**	71,436
	2,020,796	1,715,412

While there are no contractual requirements for the telecommunication operators to pay amounts owing to the Group within a specified period of time, they usually settle the amounts due within a period of 30 to 120 days. Online advertising customers, which are mainly advertising agencies, are usually granted a credit period of 90 days after full execution of the contracted advertisement orders.

As at 31 December 2011, insignificant amounts of accounts receivable were past due. No impairment provision was considered necessary after management had performed assessment on their credit quality with reference to historical counterparty default rates.

The directors of the Company considered that the carrying amounts of the receivable balances approximated to their fair value as at 31 December 2011.

17 PREPAYMENTS, DEPOSITS AND OTHER ASSETS

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Included in non-current assets:		
Prepayment for land use rights	**258,237**	258,237
Prepayment for purchase of building	**510,425**	–
Prepayment for licensed content	**458,009**	187,193
Loans to associates and a jointly controlled entity (Note)	**111,063**	–
Non-current portion of running royalty fees for online games	**945,135**	–
	2,282,869	445,430
Included in current assets:		
Current portion of running royalty fees for online games	**405,915**	85,755
Prepaid expenses	**483,592**	120,991
Rental deposits and other deposits	**112,714**	46,466
Interest receivables	**143,370**	89,435
Refundable value-added tax	**270,028**	45,764
Loans advanced to associates (Note)	**6,052**	–
Others	**790,246**	99,461
	2,211,917	487,872
	4,494,786	933,302

Note:

During the year ended 31 December 2011, the Group made loans to its associates and a jointly controlled entity with an aggregate principal amount of RMB113,050,000. The loans to associates with an aggregate principal amount of RMB100,448,000 are required to be repaid in 1 to 3 years and the applicable interest rates were at 1.0% to 5.1% per annum or interest-free. The loan to a jointly controlled entity with aggregate principal amount of RMB12,602,000 has no fixed term of repayment, bearing applicable interest rate of 5.5%.

The directors of the Company considered that the carrying amounts of the prepayments, deposits and other assets approximated to their fair values as at 31 December 2011.

Deposits and other receivables (excluding prepayment for land use rights, prepayment for purchase of building, prepaid expenses, prepayment for online game licences and running royalty fees for online games) were neither past due nor impaired. Their recoverability was assessed with reference made to the credit status of the recipients.

18 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

The effective interest rate for the term deposits of the Group with initial term of over three months for the year ended 31 December 2011 was 2.95% (2010: 2.15%).

An analysis of the Group and the Company's term deposits denominated in USD and HKD with initial term of over three months as at 31 December 2011 were presented in Note 3.1(a).

The directors of the Company considered that the carrying value of the term deposits with initial term of over three months approximated their fair value as at 31 December 2011. Term deposits with initial term of over three months were neither past due nor impaired.

As at 31 December 2011, approximately 94% (2010: 94%) of these term deposits were placed in the Bank of China, Agricultural Bank of China, China Construction Bank, China Merchants Bank, Industrial and Commercial Bank of China, Morgan Stanley Bank International (China) Limited, The Hongkong and Shanghai Banking Corporation, Australian and New Zealand bank Group Ltd. and Sumitomo Mitsui Banking Corporation.

19 CASH AND CASH EQUIVALENTS

	Group As at 31 December		Company As at 31 December	
	2011	2010	**2011**	2010
	RMB'000	RMB'000	**RMB'000**	RMB'000
Bank balances and cash	**7,833,767**	5,688,087	**187,791**	237,525
Term deposits with initial terms within three months	**4,778,373**	4,720,170	**–**	–
	12,612,140	10,408,257	**187,791**	237,525
Maximum exposure to credit risk	**12,611,379**	10,407,767	**187,791**	237,525

The effective interest rates of the term deposits of the Group with initial term within three months for the year ended 31 December 2011 and 2010 were 1.16% and 1.62%, respectively.

Details of the balances denominated in USD, EUR and HKD maintained by the Group and the Company as at 31 December 2011 are presented in Note 3.1(a). Approximately RMB6,694,164,000 (2010: RMB7,648,272,000) of the total balance of the Group was denominated in RMB and it was deposited with banks in the PRC. The Company had no material cash balance denominated in RMB.

As at 31 December 2011, cash in bank and term deposits with initial terms within three months were neither past due nor impaired. In addition, approximately 89% (2010: approximately 88%) of cash and cash equivalents of the Group were placed in Standard Chartered Bank, The Hongkong and Shanghai Banking Corporation, Bank of China, Agricultural Bank of China, China Construction Bank, China Merchants Bank, Industrial and Commercial Bank of China, and China Citic Bank.

20 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE

The total authorised share capital of the Company comprises 10,000,000,000 ordinary shares (2010: same) with par value of HKD0.0001 per share (2010: HKD0.0001 per share).

As at 31 December 2011, the total number of issued ordinary shares of the Company was 1,839,814,008 shares (2010: 1,835,730,235 shares) which included 17,809,839 shares (2010: 13,562,814 shares) held under the share award scheme (Note 22(b)). They were all fully paid up.

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Total RMB'000
At 1 January 2010	1,818,890,059	197	1,244,425	(123,767)	703,563	1,824,418
Employee share option schemes:						
– value of employee services	–	–	–	–	139,621	139,621
– number of shares issued and proceeds received	15,801,201	1	199,248	–	–	199,249
Employee share award scheme:						
– value of employee services	–	–	–	–	356,479	356,479
– shares purchased for share award scheme	–	–	–	(167,519)	–	(167,519)
– shares allotted for share award scheme	3,662,975	–	–	–	–	–
– shares vested from share award scheme and transferred to the grantees	–	–	(33,149)	33,149	–	–
Repurchase and cancellation of shares	(2,624,000)	–	(310,222)	–	–	(310,222)
At 31 December 2010	1,835,730,235	198	1,100,302	(258,137)	1,199,663	2,042,026

20 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Total RMB'000
At 1 January 2011	**1,835,730,235**	**198**	**1,100,302**	**(258,137)**	**1,199,663**	**2,042,026**
Employee share option schemes:						
– value of employee services	–	–	–	–	159,233	159,233
– number of shares issued and proceeds received (Note (i))	7,624,113	–	159,729	–	–	159,729
Employee share award scheme:						
– value of employee services	–	–	–	–	576,134	576,134
– shares acquired and withheld for share award scheme (Note (ii))	–	–	–	(438,714)	–	(438,714)
– shares allotted for share award scheme (Note (iv))	4,045,360	–	–	–	–	–
– shares vested from share award scheme and transferred to the grantees	–	–	(89,977)	89,977	–	–
Repurchase and cancellation of shares	(7,585,700)	–	(1,047,033)	–	–	(1,047,033)
At 31 December 2011	**1,839,814,008**	**198**	**123,021**	**(606,874)**	**1,935,030**	**1,451,375**

20 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

Note:

(i) During the year ended 31 December 2011, 7,060,933 Post-IPO options with exercise prices ranging from HKD3.6650 to HKD90.3000; and 563,180 Pre-IPO options with exercise prices ranging from USD0.0497 to USD0.4396 were exercised.

(ii) During the year ended 31 December 2011, the Share Scheme Trust acquired and withheld 2,773,810 ordinary shares of the Company for a total consideration of HKD524,805,000 (equivalent to approximately RMB438,714,000), which had been deducted from shareholders' equity.

(iii) During the year ended 31 December 2011, the Share Scheme Trust transferred 2,572,145 ordinary shares of the Company (2010: 1,696,478 shares) to the share awardees upon vesting of the awarded shares.

(iv) During the year ended 31 December 2011, the Company allotted 4,045,360 ordinary shares (2010: 3,662,975 shares) to the Share Scheme Trust for the purpose of granting awarded shares under the share award scheme.

(v) As at 31 December 2011, included in "Shares held for share award scheme", 1,970,840 shares (2010: 80 shares) held by the Share Scheme Trust had not yet been granted to employees.

21 OTHER RESERVES

	Capital reserve (Note i) RMB'000	Available-for-sale financial assets RMB'000	Currency translation differences RMB'000	Statutory surplus reserve fund (Note (ii)) RMB'000	Reserve fund (Note (ii)) RMB'000	Total RMB'000
Balance at 1 January 2010	(236,693)	–	–	57,924	12,405	(166,364)
Reversal of the liabilities in respect of the put options granted to non-controlling interests owners	94,246	–	–	–	–	94,246
Acquisition of additional interests in a subsidiary	154,198	–	–	–	–	154,198
Profit appropriations to statutory reserves	–	–	–	8,237	–	8,237
Net gains from changes in fair value of available-for-sale financial assets	–	1,821,129	–	–	–	1,821,129
Transfer from retained earnings	8,249	–	–	–	–	8,249
Balance at 31 December 2010	20,000	1,821,129	–	66,161	12,405	1,919,695

21 OTHER RESERVES (Cont'd)

	Capital reserve (Note (i)) RMB'000	Available-for-sale financial assets RMB'000	Currency translation differences RMB'000	Statutory surplus reserve fund (Note (ii)) RMB'000	Reserve fund (Note (ii)) RMB'000	Total RMB'000
Balance at 1 January 2011	**20,000**	**1,821,129**	**–**	**66,161**	**12,405**	**1,919,695**
Recognition of financial liabilities in respect of the put options granted to non-controlling interests (Note 43(a)(ii))	(670,985)	–	–	–	–	(670,985)
Non-controlling interests and deemed consideration arising from business combinations (Note 43(a) and (b))	(154,732)	–	–	–	–	(154,732)
Changes in equity interests in subsidiaries without change of control	23,919	–	–	–	–	23,919
Profit appropriations to statutory reserves	–	–	–	439,650	–	439,650
Net losses from changes in fair value of available-for-sale financial assets	–	(1,233,873)	–	–	–	(1,233,873)
Currency translation differences	–	–	(31,583)	–	–	(31,583)
Transfer from retained earnings	10,000	–	–	–	–	10,000
Balance at 31 December 2011	**(771,798)**	**587,256**	**(31,583)**	**505,811**	**12,405**	**302,091**

21 OTHER RESERVES (Cont'd)

Note:

(i) The capital reserve mainly arises from transactions with non-controlling interests.

(ii) In accordance with the Companies Laws of the PRC and the stipulated provisions of the articles of association of subsidiaries with limited liabilities in the PRC, appropriation of net profits (after offsetting accumulated losses from prior years) should be made by these companies to their respective Statutory Surplus Reserve Funds and the Discretionary Reserve Funds before distributions are made to the owners. The percentage of appropriation to Statutory Surplus Reserve Fund is 10%. The amount to be transferred to the Discretionary Reserve Fund is determined by the equity owners of these companies. When the balance of the Statutory Surplus Reserve Fund reaches 50% of the registered capital, such transfer needs not to be made. Both the Statutory Surplus Reserve Fund and Discretionary Reserves Fund can be capitalised as capital of an enterprise, provided that the remaining Statutory Surplus Reserve Fund shall not be less than 25% of the registered capital.

In addition, in accordance with the Law of the PRC on Enterprises with Foreign Investments and the stipulated provisions of the articles of association of wholly owned foreign subsidiaries in the PRC, appropriation from net profits (after offsetting accumulated losses brought forward from prior years) should be made by these companies to their respective Reserve Funds. The percentage of net profit to be appropriated to the Reserve Fund is not less than 10% of the net profit. When the balance of the Reserve Fund reaches 50% of the registered capital, such transfer needs not be made.

With approvals obtained from their respective boards of directors of these companies, the Reserve Fund can be used to offset accumulated deficit or to increase capital.

22 SHARE-BASED PAYMENTS

(a) Share option schemes

The Company has adopted four share option schemes, namely, the Pre-IPO Option Scheme, the Post-IPO Option Scheme I, the Post-IPO Option Scheme II and Post-IPO Option Scheme III, under which the directors may, at their discretion, grant options to any qualifying participants to subscribe for shares in the Company, subject to the terms and conditions stipulated therein. No further options will be granted under the Pre-IPO Option Scheme and the Post-IPO Option Scheme I.

In respect of Post-IPO Option Scheme II and Post-IPO Option Scheme III, the exercise price must be at least the higher of: (i) the closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; (ii) the average closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's shares. In addition, the option vesting period is determined by the Board provided that it is not later than the last day of a 7-year or 10-year period after the date of grant of option.

22 SHARE-BASED PAYMENTS(Cont'd)

(a) Share option schemes (Cont'd)

(1) Movements in share options

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	Pre-IPO Option Scheme		Post-IPO Option Scheme I		Post-IPO Option Scheme II		Post-IPO Option Scheme III		Total
	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	No. of options
At 1 January 2010	USD0.0812	1,865,068	HKD11.5050	24,941,918	HKD45.1756	28,991,419	—	—	55,798,405
Granted	—	—	—	—	HKD138.3689	2,708,350	HKD158.5000	1,000,000	3,708,350
Exercised	USD0.0759	(1,301,875)	HKD9.9387	(11,925,949)	HKD32.3254	(2,573,377)	—	—	(15,801,201)
Lapsed	—	—	HKD17.9512	(210,206)	HKD58.2388	(331,224)	—	—	(541,430)
At 31 December 2010	USD0.0935	563,193	HKD12.8579	12,805,763	HKD54.9391	28,795,168	HKD158.5000	1,000,000	43,164,124
Exercisable as at 31 December 2010	USD0.0935	563,193	HKD11.2750	11,069,343	HKD41.4494	6,210,804	—	—	17,843,340
At 1 January 2011	**USD0.0935**	**563,193**	**HKD12.8579**	**12,805,763**	**HKD54.9391**	**28,795,168**	**HKD158.5000**	**1,000,000**	**43,164,124**
Granted	—	—	—	—	**HKD191.1886**	**771,175**	—	—	**771,175**
Exercised	**USD0.0935**	**(563,180)**	**HKD13.8888**	**(4,038,282)**	**HKD44.9126**	**(3,022,651)**	—	—	**(7,624,113)**
Lapsed	**USD0.1967**	**(13)**	**HKD6.0210**	**(5,544)**	**HKD64.9539**	**(387,604)**	—	—	**(393,161)**
At 31 December 2011	—	—	**HKD12.3871**	**8,761,937**	**HKD59.9665**	**26,156,088**	**HKD158.5000**	**1,000,000**	**35,918,025**
Exercisable as at 31 December 2011	—	—	**HKD11.4611**	**8,173,937**	**HKD42.9814**	**8,996,582**	—	—	**17,170,519**

During the year ended 31 December 2011, no share options (2010: 1,000,000 options) was granted to any directors of the Company.

As a result of the options exercised during the year ended 31 December 2011, 7,624,113 ordinary shares (2010: 15,801,201 ordinary shares) were issued by the Company (Note 20). The weighted average price of the shares at the time these options were exercised was HKD187.26 (equivalent to approximately RMB155.40) per share (2010: HKD161.12 per share).

22 SHARE-BASED PAYMENTS (Cont'd)

(a) Share option schemes (Cont'd)

(2) Outstanding share options

Details of the expiry dates, exercise prices and the respective numbers of share options which remained outstanding as at 31 December 2011 and 31 December 2010 are as follows:

Expiry Date	Range of exercise price	Number of share options 31 December 2011	Number of share options 31 December 2010
31 December 2011	USD0.0497	**–**	482,700
(Pre-IPO Option Scheme)	USD0.1967-USD0.4396	**–**	80,493
		–	563,193
10 years commencing from the adoption date of 24 March 2004 (Post-IPO	HKD3.6650-HKD8.3500	**4,164,319**	5,553,585
Option Scheme I)	HKD11.5500-HKD25.2600	**4,597,618**	7,252,178
		8,761,937	12,805,763
7 years commencing from the date of grant of	HKD31.7500-HKD43.5000	**12,715,582**	14,186,579
options (Post-IPO	HKD45.5000-HKD90.3000	**9,733,781**	11,660,539
Option Scheme II)	HKD128.4000-HKD194.4000	**3,706,725**	2,948,050
		26,156,088	28,795,168
10 years commencing from the date of grant of options (Post-IPO Option Scheme III)	HKD158.5000	**1,000,000**	1,000,000
		35,918,025	43,164,124

22 SHARE-BASED PAYMENTS (Cont'd)

(a) Share option schemes (Cont'd)

(3) Fair value of options

The directors of the Company have used the BS Model to determine the fair value of the options granted, which is to be expensed over the vesting period. The weighted average fair value of options granted during the year ended 31 December 2011 was HKD81.69 per option (2010: HKD67.77 per option).

Other than the exercise price mentioned above, significant judgement on parameters, such as risk free rate, dividend yield and expected volatility, is required to be made by the directors in applying the BS Model, which are summarised as below.

	2011	2010
Weighted average share price at the grant dates	**HKD191.19**	HKD143.66
Risk free rate	**1.35% - 2.31%**	1.72% - 2.73%
Dividend yield	**0.36%**	0.63%
Expected volatility (Note)	**49.10% - 49.90%**	51.10% - 52.10%

Note:

The expected volatility, measured as the standard deviation of expected share price returns, is determined based on the average daily trading price volatility of the shares of the Company.

The share options granted during the year ended 31 December 2011 were divided into three or five tranches on an equal basis. The first tranche can be exercised after a specified period ranging from one to four years from the grant date, and then the remaining tranches will become exercisable in each subsequent year.

22 SHARE-BASED PAYMENTS (Cont'd)

(b) Share award scheme

The Company has adopted a share award scheme (the "Share Award Scheme"), which is managed by an independent trustee appointed by the Group (the "Trustee"). The vesting period of the awarded shares is determined by the Board.

Movements in the number of shares held for the Share Award Scheme and awarded shares for the years ended 31 December 2011 and 2010 are as follows:

	Number of shares held for the Share Award Scheme	Number of awarded shares
At 1 January 2010	10	10,411,424
Purchased	1,184,883	–
Allotted	3,662,975	–
Granted	(4,847,788)	4,847,788
Vested	–	(1,696,478)
At 31 December 2010	80	13,562,734
Exercisable as at 31 December 2010		101,337
At 1 January 2011	**80**	**13,562,734**
Purchased and withheld (Note 20)	**2,773,810**	**–**
Allotted	**4,045,360**	**–**
Granted (Note)	**(5,995,410)**	**5,995,410**
Lapsed	**1,147,000**	**(1,147,000)**
Vested	**–**	**(2,572,145)**
At 31 December 2011	**1,970,840**	**15,838,999**
Exercisable as at 31 December 2011		**14,406**

Note:

During the year ended 31 December 2011, 35,000 awarded shares (2010: Nil) were granted to independent non-executive directors of the Company.

22 SHARE-BASED PAYMENTS (Cont'd)

(b) Share award scheme (Cont'd)

The fair value of the awarded shares was calculated based on the market price of the Company's shares at the respective grant date. The expected dividends during the vesting period have been taken into account when assessing the fair value of these awarded shares.

The weighted average fair value of awarded shares granted during the year ended 31 December 2011 was HKD193.14 per share (2010: HKD137.53 per share). In addition, such awarded shares were divided into two to five tranches on an equal basis. The first tranche can be exercised immediately or after a specified period ranging from six months to four years from the grant date, and the remaining tranches will become exercisable in each subsequent year.

(c) Employee incentive scheme

During the year ended 31 December 2011, the Group established an employee incentive scheme in a form of limited liability partnership (the "EIS") for incentive purpose pursuant to the relevant resolution passed at the 2011 general meeting of the Company. The Board may, at its absolute discretion, select any employees to participate in the EIS by subscribing for partnership interest for consideration. The total cash contribution by selected employees is limited to approximately RMB80,000,000. The participating employees are entitled to all the economic benefits generated by the EIS (if any) after a specified vesting period under the EIS ranging from 4 to 7 years. A wholly-owned subsidiary of the Company acts as a general partner of the EIS to manage, and in essence, control it. The EIS is therefore consolidated by the Company. Further, because certain continuous service conditions are attached to the partnership interest subscribed by the employees, the EIS is accounted for as an equity-settled share-based payment transaction, the expense of which for the year ended 31 December 2011 was considered not material to the Group by the directors of the Company.

(d) Share options and restricted share award scheme adopted by non-wholly owned subsidiaries

Other than the above, certain non-wholly owned subsidiaries (including Riot Games as mentioned in Note 43(a)) of the Company operate their own share-based compensation plans (share option and/or restricted share award schemes). Their exercise prices of the share options, as well as the vesting periods of the share options and awarded shares are determined by the board of directors of these subsidiaries at their sole discretion. Similar to the share option/award schemes adopted by the Company, the share options or restricted shares of the subsidiaries so granted are normally vested by several tranches.

The directors of the Company considered that the fair value of share options/restricted shares granted under the share-based compensation plans of the non-wholly owned subsidiaries, and the relevant share-based compensation expenses charged into the income statement of the Group for the year ended 31 December 2011, are not significant to the Group.

22 SHARE-BASED PAYMENTS (Cont'd)

(e) Expected retention rate of grantees

The Group has to estimate the expected yearly percentage of grantees that will stay within the Group at the end of the vesting periods of the options and awarded shares (the "Expected Retention Rate") in order to determine the amount of share-based compensation expenses charged to the income statement. As at 31 December 2011, the Expected Retention Rate was assessed to be 91% (31 December 2010: 91%).

23 ACCOUNTS PAYABLE

Accounts payable and their ageing analysis are as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
0 - 30 days	**1,514,155**	975,869
31 - 60 days	**351,587**	242,547
61 - 90 days	**108,337**	68,632
Over 90 days	**270,035**	93,416
	2,244,114	1,380,464

24 OTHER PAYABLES AND ACCRUALS

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Staff costs and welfare accruals	**1,478,391**	1,337,627
Marketing and administrative expense accruals	**731,571**	533,631
Prepayments received from customers and e-commerce business	**1,840,947**	841,095
Current portions of running royalty fee for online games	**315,045**	–
Purchase consideration payables for business combinations and associates	**252,952**	–
Others	**395,375**	285,455
	5,014,281	2,997,808

25 DERIVATIVE FINANCIAL INSTRUMENTS

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Foreign exchange forward contracts - held for trading	**20,993**	17,964

The Group entered into a number of foreign exchange forward contracts with RMB to purchase a total notional amount of USD475,000,000. The contracted amount of US dollars was equal to the aggregate principal amounts of USD bank borrowings and bonds (details were disclosed in Notes 27(b) and (c)). These forward contracts will mature within one year, and they will be settled at the difference between the forward rates stated in the contracts and the spot rates as at the respective maturity dates, multiplied by the notional amounts of the face value of the contracts.

26 LONG-TERM PAYABLES

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Non-current portion of the present value of running royalty fee for online games	**945,135**	–
Present value of liabilities in relation to the put options granted to non-controlling shareholders of a subsidiary (Note 43 (a)(ii))	**670,985**	–
Purchase consideration payable for business combinations	**131,180**	–
Others	**112,508**	–
	1,859,808	–

27 SHORT-TERM BORROWINGS

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
RMB bank borrowings		
– Secured (Note (a))	**2,958,720**	990,887
– Unsecured	**–**	334,440
	2,958,720	1,325,327
USD bank borrowings		
– Unsecured (Note (b))	**4,410,630**	3,973,620
Bonds		
– Unsecured (Note (c))	**630,090**	–
	7,999,440	5,298,947

Note:

(a) Bank borrowings of carrying amounts of RMB2,958,720,000 were secured by pledge of bank deposits of RMB3,071,621,000.

(b) Unsecured bank borrowings of carrying amount of RMB4,410,630,000 as at 31 December 2011 were denominated in USD. The aggregate principal amount was USD700,000,000 and the interest rates were fixed at 1.43% to 2.09% per annum. In addition, the Group entered into foreign exchange forward contracts to purchase the required amount of USD with RMB for settling some of the bank borrowings with an aggregate principal amount of USD375,000,000 upon the respective borrowing due dates (Note 25). However, the Group arranged the bank borrowings and the forward contracts with different banks, and the Group did not adopt hedge accounting. As a result, these bank borrowings and the relevant foreign exchange forward contracts were accounted for separately. The bank borrowings were accounted for as USD denominated bank borrowings and stated at amortised cost, while the forward contracts were accounted for as derivative financial instruments stated at fair value with their gains or losses recorded in "Other gains, net" in the consolidated income statement.

(c) During the year ended 31 December 2011, the Group issued USD denominated unsecured bonds at par value of USD100,000,000 (equivalent to approximately RMB630,090,000). The bonds bear a floating rate of LIBOR plus 0.25% per annum and will mature in March 2012. The Group also entered into foreign exchange forward contracts to purchase the required amount of USD with RMB for settling the principal amount of the bonds upon their due dates (Note 25). The accounting treatments for the bonds and related foreign exchange forward contacts are the same as those mentioned in (b) above.

The fair value of the short-term borrowings approximated to their carrying amounts as at 31 December 2011.

28 LONG-TERM NOTES PAYABLE

On 12 December 2011, the Company completed the issue of long-term notes (the "Notes") with an initial aggregate principal amount of USD600,000,000 for general corporate purpose. The Notes bear an interest at 4.625% per annum from 12 December 2011, payable semi-annually in arrears on 12 June and 12 December of each year, beginning on 12 June 2012. The Notes will mature on 12 December 2016.

The issue price of the Notes is 99.74% of the initial aggregate principal amount. The net proceeds from the issue of the Notes, after deduction of underwriting fees, discounts, commissions and other expenses payable in connection with the issue of the Notes, amounted to approximately USD592,440,000 (equivalent to approximately RMB3,760,928,000).

The Notes are senior unsecured obligations of the Company. The Notes: (1) rank senior in right of payment to all of the Company's existing and future indebtedness expressly subordinated in right of payment to the Notes; (2) rank at least equally in right of payment with all of the Company's existing and future unsecured unsubordinated indebtedness (subject to any priority rights pursuant to applicable law); (3) are effectively subordinated to all of the Company's existing and future secured indebtedness, to the extent of the value of the assets serving as security therefor; and (4) are structurally subordinated to all existing and future indebtedness and other liabilities of the Group.

The Notes are listed on Singapore Exchange Securities Trading Limited. The Notes have been rated "Baa1" by Moody's Investors Services, Inc. and "BBB+" by Standard & Poor's Ratings Services, a division of McGraw-Hill Companies, Inc..

29 DEFERRED REVENUE

Deferred revenue mainly represents service fees prepaid by customers for certain IVAS and MVAS in the form of pre-paid tokens or cards, virtual items and subscription, for which the related services had not been rendered as at 31 December 2011. It also includes customer loyalty incentives offered by the Group to its customers which were valued at their respective fair values.

30 DEFERRED INCOME TAXES

Deferred income taxes are calculated in full on temporary differences under the liability method using the tax rates which are expected to apply at the time of reversal of the temporary differences.

There was no offsetting of deferred income tax assets and liabilities in 2011 and 2010.

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Deferred income tax assets:		
– to be recovered after more than 12 months	**150,211**	164,442
– to be recovered within 12 months	**47,847**	54,577
	198,058	219,019
Deferred income tax liabilities:		
– to be recovered after more than 12 months	**(50,461)**	(14,633)
– to be recovered within 12 months	**(889,073)**	(952,578)
	(939,534)	(967,211)

The movements of the deferred income tax assets/liabilities account were as follows:

	2011	2010
	RMB'000	RMB'000
At beginning of the year	**(748,192)**	(68,967)
Business combinations	**(326,434)**	(8,691)
Charge to income statement relating to origination and reversal of temporary differences (Note 39(a))	**(10,299)**	(615,639)
Withholding tax paid in related to the remittance of dividends	**339,946**	–
Effect of change in tax rates recognised in income statement (Note 39(a))	**–**	(54,895)
Credit to other comprehensive income	**1,048**	–
Exchange difference	**2,455**	–
At end of the year	**(741,476)**	(748,192)

30 DEFERRED INCOME TAXES (Cont'd)

The movements of deferred tax assets were as follows:

	Deferred tax assets arising from intra-group software and technology sales	Deferred tax assets arising from change in fair value of available-for -sale financial assets	Total
	RMB'000 (Note)	RMB'000	RMB'000
At 1 January 2010	301,016	–	301,016
Credit to income statement relating to origination of temporary differences	29,709	–	29,709
Effect of change in tax rates recognised in income statement	(54,895)	–	(54,895)
Charge to income statement relating to reversal of temporary differences	(56,811)	–	(56,811)
At 31 December 2010	219,019	–	219,019
At 1 January 2011	**219,019**	**–**	**219,019**
Credit to income statement relating to origination of temporary differences	**32,832**	**–**	**32,832**
Charge to income statement relating to reversal of temporary differences	**(54,841)**	**–**	**(54,841)**
Credit to other comprehensive income	**–**	**1,048**	**1,048**
At 31 December 2011	**197,010**	**1,048**	**198,058**

Note:

The deferred tax assets recognised are mainly related to the temporary differences arising from certain intra-group software and technology transfer transactions (Note 4.2). The credit to income statement represents tax impacts of originating temporary differences arising from these software and technology transfer, while the charge to income statement represents tax impacts of the reversal of the temporary differences as a result of the amortisation of the costs of these software and technology.

30 DEFERRED INCOME TAXES (Cont'd)

As at 31 December 2011, the Group did not recognise deferred income tax assets of RMB347,355,000 (2010: RMB66,459,000) in respect of cumulative tax losses amounting to RMB1,102,264,000 (2010: RMB265,836,000). These tax losses will expire from 2012 to 2016.

The movements of deferred tax liabilities were as follows:

	Intangible assets acquired in business combinations at fair value	Withholding tax on the earnings anticipated to be remitted by PRC subsidiaries	Total
	RMB'000	RMB'000 (Note)	RMB'000
At 1 January 2010	(19,983)	(350,000)	(369,983)
Business combinations	(8,691)	–	(8,691)
Credit /(charge) to income statement relating to origination of temporary differences	6,625	(595,162)	(588,537)
At 31 December 2010	(22,049)	(945,162)	(967,211)
At 1 January 2011	**(22,049)**	**(945,162)**	**(967,211)**
Business combinations	**(326,434)**	–	**(326,434)**
Credit/(charge) to income statement relating to origination and reversal of temporary differences	**234,210**	**(222,500)**	**11,710**
Withholding tax paid in related to the remittance of dividends	–	**339,946**	**339,946**
Exchange difference	**2,455**	–	**2,455**
At 31 December 2011	**(111,818)**	**(827,716)**	**(939,534)**

Note:

According to applicable PRC tax regulations, withholding tax will be levied on the dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 (Note 39 (a) (v)).

30 DEFERRED INCOME TAXES (Cont'd)

As at 31 December 2011, the Group recognised the relevant deferred tax liabilities of RMB827,716,000 (2010: RMB945,162,000) on the earnings anticipated to be remitted by certain PRC subsidiaries in the foreseeable future. No withholding tax had been provided for the earnings of approximately RMB4,264,270,000 (2010: RMB3,610,269,000) expected to be retained by the PRC subsidiaries and not to be remitted to a foreign investor in the foreseeable future based on management's estimation of overseas funding requirements.

31 COST OF REVENUES

Cost of revenues mainly comprises the Mobile and Telecom Charges (Note 2.24(a)), bandwidth and server custody fees, staff costs, sharing and content subscription costs incurred in deriving the revenues.

32 INTEREST INCOME

Interest income mainly represents interest income from bank deposits, including current deposit, restricted cash, term deposits with initial term of three months or less, and term deposits with initial term of over three months.

33 OTHER GAINS, NET

	2011	2010
	RMB'000	RMB'000
Gains on deemed disposal of associates (Note 43)	**708,486**	–
Government subsidies	**101,406**	96,537
Losses from derivative financial instruments	**(96,790)**	(17,964)
Donation to a charity fund established by the Group	**(100,000)**	(70,000)
(Losses)/gains on disposal of fixed assets	**(1,694)**	883
Impairment provision for available-for-sale financial assets, associates and jointly controlled entities	**(243,000)**	–
Others	**52,395**	28,600
	420,803	38,056

34 EXPENSES BY NATURE

	2011	2010
	RMB'000	RMB'000
Employee benefits expenses (Note)/(Note 35)	**4,865,744**	3,143,967
Mobile and telecommunications charges and bandwidth and server custody fees	**2,627,106**	2,089,273
Content costs and agency fees	**4,843,784**	2,797,872
Promotion and advertising expenses	**1,403,699**	557,601
Depreciation of fixed assets (Note)/(Note 6)	**1,207,732**	668,580
Amortisation of intangible assets (Note 10)	**726,221**	109,411
Amortisation of land use rights (Note 9)	**4,925**	3,724
Travelling and entertainment expenses	**224,748**	124,320
Operating lease rentals in respect of office buildings	**342,957**	116,378
Auditor's remunerations:		
– Audit services	**10,760**	8,000
– Non-audit services	**7,575**	3,564
Other expenses	**867,064**	479,106
	17,132,315	10,101,796

Note:

Research and development expenses for the year ended 31 December 2011 were RMB2,684,821,000 (2010: RMB1,685,525,000) which included employee benefit expenses of RMB2,243,793,000 (2010: RMB1,407,948,000) and depreciation of fixed assets of RMB287,968,000 (2010: RMB194,090,000).

35 EMPLOYEE BENEFITS EXPENSES (INCLUDING DIRECTORS' EMOLUMENTS)

	2011	2010
	RMB'000	RMB'000
Wages, salaries and bonuses	**3,450,307**	2,223,725
Welfare, medical and other expenses	**247,109**	207,495
Share-based compensation expenses	**814,771**	495,772
Contributions to pension plans (Note)	**321,801**	197,238
Training expenses	**31,756**	19,737
	4,865,744	3,143,967

Note:

All local employees of the subsidiaries in the PRC participate in employee social security plans established in the PRC, which cover pension, medical and other welfare benefits. The plans are organised and administered by the governmental authorities. Except for the contribution to these social security plans, the Group has no other material commitments owing to the employees. According to the relevant regulations, the portion of premium and welfare benefit contributions that should be borne by the companies within the Group as required by the above social security plans are principally determined based on percentages of the basic salaries of employees, subject to a certain ceiling, and are paid to the respective labour and social welfare authorities. Contributions to the plans are expensed as incurred. The applicable percentages used to provide for insurance premium and welfare benefit funds are listed below:

	Percentage
Pension insurance	10% – 22%
Medical insurance	6% – 12%
Unemployment insurance	0% – 2%
Housing fund	10% – 12%

36 DIRECTORS' EMOLUMENTS

The aggregate amounts of emoluments paid/payable to directors of the Company for the year ended 31 December 2011 and 2010 are as follows:

	2011	2010
	RMB'000	RMB'000
Fees - independent non-executive directors	2,053	2,157
Salaries, bonuses, allowances and benefits in kind	44,622	39,919
Contributions to pension plans	108	48
Share-based compensation expenses charged to income statement	20,474	21,796
	67,257	63,920
Number of directors		
– with emoluments	6	6
– without emoluments	2	2
Number of directors	8	8

36 DIRECTORS' EMOLUMENTS (Cont'd)

The remuneration of every director for the year ended 31 December 2011 is set out below.

Name of director	Fees	Salaries, bonuses, allowances and benefits in kind	Contributions to pension plans	Share-based compensation expenses	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Ma Huateng	–	20,615	54	–	20,669
Zhang Zhidong	–	14,741	54	–	14,795
Lau Chi Ping Martin	756	9,266	–	18,564	28,586
Iain Ferguson Bruce	567	–	–	1,059	1,626
Ian Charles Stone	365	–	–	806	1,171
Li Dong Sheng	365	–	–	45	410
Antonie Andries Roux	–	–	–	–	–
Charles St Leger Searle	–	–	–	–	–
	2,053	44,622	108	20,474	67,257

The remuneration of every director for the year ended 31 December 2010 is set out below.

Name of director	Fees	Salaries, bonuses, allowances and benefits in kind	Contributions to pension plans	Share-based compensation expenses	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Ma Huateng	–	18,419	24	–	18,443
Zhang Zhidong	–	13,282	24	–	13,306
Lau Chi Ping Martin	795	8,218	–	21,523	30,536
Iain Ferguson Bruce	596	–	–	91	687
Ian Charles Stone	383	–	–	91	474
Li Dong Sheng	383	–	–	91	474
Antonie Andries Roux	–	–	–	–	–
Charles St Leger Searle	–	–	–	–	–
	2,157	39,919	48	21,796	63,920

36 DIRECTORS' EMOLUMENTS (Cont'd)

During the year ended 31 December 2011, 35,000 awarded shares were granted to independent non-executive directors (2010: 1,000,000 share options were granted to Mr Lau Chi Ping, Martin). Other than that, no options/awarded shares were granted to other executive, non-executive or independent non-executive directors of the Company (2010: Nil).

No director received any emolument from the Group as an inducement to join or leave the Group or compensation for loss of office. No director waived or has agreed to waive any emoluments during the year ended 31 December 2011 (2010: Nil).

37 FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Group during the year included two (2010: two) directors whose details have been reflected in the analysis presented in Note 36. The emoluments paid/payable to the remaining three (2010: three) individuals during the year were as follows:

	2011	2010
	RMB'000	RMB'000
Salaries, bonuses, allowances and benefits in kind	**33,661**	28,832
Share-based compensation expenses charged to income statement	**21,378**	22,042
Contributions to pension plans	**160**	70
	55,199	50,944

The emoluments of the above three individuals (2010: three) fell within the following bands:

	Number of individuals	
	2011	2010
Emolument bands		
HKD16,000,001 – HKD16,500,000	**–**	1
HKD18,500,001 – HKD19,000,000	**1**	–
HKD21,000,001 – HKD21,500,000	**–**	2
HKD22,000,001 – HKD22,500,000	**1**	–
HKD25,000,001 – HKD25,500,000	**1**	–

38 FINANCE INCOME/(COSTS), NET

	2011	2010
	RMB'000	RMB'000
Exchange gains	**108,042**	34,189
Interest and related expenses	**(72,537)**	(35,027)
	35,505	(838)

Interest expenses mainly arose from the short-term borrowings and long-term notes mentioned in Note 27 and Note 28, respectively.

39 TAX EXPENSE

(a) Income tax

(i) Cayman Islands and British Virgin Islands profits tax

The Group was not subject to any taxation in these jurisdictions for the year ended 31 December 2011 (2010: Nil).

(ii) Hong Kong profits tax

No Hong Kong profits tax provision was made for the year ended 31 December 2011 (2010: Nil).

(iii) PRC Corporate Income Tax ("CIT")

CIT provision was made on the assessable income of entities within the Group incorporated in the PRC, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

Pursuant to the PRC Corporate Income Tax Law passed by the Tenth National People's Congress on 16 March 2007 (the "CIT Law"), the CIT rate for domestic and foreign enterprises has been unified at 25%, effective from 1 January 2008.

The CIT Law also provides a five-year transitional period starting from its effective date for those enterprises which were established before the promulgation of the CIT Law and which were entitled to preferential income tax rates under the then effective tax laws or regulations.

On 26 December 2007, the State Council issued the "Circular to Implementation of the Transitional Preferential Policies for the Corporate Income Tax". Pursuant to this circular, the transitional CIT rates for the Group's subsidiaries established in the Shenzhen Special Economic Zone or the Beijing High Technology Zone before 16 March 2007 are 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011 and 2012, respectively. Other tax preferential treatments such as reduction of 50% in income tax rates shall be based on the above transitional income tax rates for the respective years.

39 TAX EXPENSE (Cont'd)

(a) Income tax (Cont'd)

(iii) PRC Corporate Income Tax ("CIT") (Cont'd)

In 2011, certain subsidiaries of the Company in the PRC were approved as High and New Technology Enterprise, and accordingly, they were subject to a reduced preferential CIT rate of 15% for a 3-year period from 2011 to 2013 according to the applicable CIT Law.

In addition, according to relevant tax circulars issued by the PRC tax authorities, certain subsidiaries of the Company are exempt from CIT for either two or three years, in either case followed by a 50% reduction in the applicable tax rates for the next three years, commencing either from the first year of commercial operations or from the first year of profitable operation after offsetting tax losses generated in prior years.

(iv) United States corporate income tax

No United States corporate income tax provision was made for the year ended 31 December 2011 (2010: Nil).

(v) PRC withholding tax

According to applicable PRC tax regulations, dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 are generally subject to a 10% withholding tax. If a foreign investor is incorporated in Hong Kong and meets the conditions or requirements under the double taxation arrangement entered into between the PRC and Hong Kong, the relevant withholding tax rate will be reduced from 10% to 5%.

The income tax expense of the Group for the years ended 31 December 2011 and 2010 are analysed as follows:

	2011	2010
	RMB'000	RMB'000
Current tax	**1,863,939**	1,127,390
Deferred income tax (Note 30)	**10,299**	670,534
	1,874,238	1,797,924

39 TAX EXPENSE (Cont'd)

(a) Income tax (Cont'd)

The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the tax rate of 24% for the year ended 31 December 2011 (2010: 22%), being the tax rate of the major subsidiaries of the Company before preferential tax treatments. The difference is analysed as follows:

	2011	2010
	RMB'000	RMB'000
Profit before income tax	**12,099,069**	9,913,133
Add: Share of losses/(profit) of associates and jointly controlled entities	**189,986**	(75,758)
	12,289,055	9,837,375
Tax calculated at a tax rate of 24% (2010: 22%)	**2,949,373**	2,164,223
Effects of different tax rates available to different subsidiaries of the Group	**(1,087,518)**	(575,213)
Effect of tax holiday on assessable profits of subsidiaries	**(464,371)**	(556,561)
Effect of changes in tax rates (Note 30)	**–**	54,895
Income not subject to tax	**(13,752)**	(29,217)
Expenses not deductible for tax purposes	**186,196**	110,391
Adjustments in respect of prior year	**(62,244)**	5,869
Withholding tax on earnings expected to be remitted by PRC subsidiaries (Note 30)	**222,500**	595,162
Unrecognised deferred income tax assets	**144,054**	28,375
Income tax expense	**1,874,238**	1,797,924

39 TAX EXPENSE (Cont'd)

(b) Value-added tax, business tax and related taxes

The operations of the Group are also subject to the following taxes in the PRC:

Category	Tax rate	Basis of levy
Value-added tax ("VAT")	17%	Sales value of goods sold, offsetting by VAT on purchases
	3%	Sales value of goods sold
Business tax ("BT")	3% - 5%	Services fee income
City construction tax	1% - 7%	Net VAT and BT payable amount
Educational surcharge	3% - 5%	Net VAT and BT payable amount

40 PROFIT ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE COMPANY

The profit attributable to the equity holders of the Company for the year ended 31 December 2011 is dealt with in the financial statements of the Company to the extent of RMB1,279,795,000 (2010: loss of RMB59,255,000).

41 EARNINGS PER SHARE

(a) Basic

Basic earnings per share ("EPS") are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2011	2010
Profit attributable to equity holders of the Company for the year (RMB'000)	**10,203,083**	8,053,625
Weighted average number of ordinary shares in issue (thousand shares)	**1,818,966**	1,816,954
Basic EPS (RMB per share)	**5.609**	4.432

41 EARNINGS PER SHARE (Cont'd)

(b) Diluted

The share options and awarded shares granted by the Company have potential dilutive effect on the EPS. Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options and awarded shares granted by the Company (collectively forming the denominator for computing the diluted EPS). No adjustment is made to earnings (numerator).

In addition, the share options and restricted shares granted by the Company's non-wholly owned subsidiaries and associates should also have potential dilutive effect on the EPS. During the year ended 31 December 2011, these share options and restricted shares either had anti-dilutive effect or their dilutive effect was insignificant to the Group.

	2011	2010
Profit attributable to equity holders of the Company for the year (RMB'000)	**10,203,083**	8,053,625
Weighted average number of ordinary shares in issue (thousand shares)	**1,818,966**	1,816,954
Adjustments for share options (thousand shares)	**28,897**	35,252
Adjustments for awarded shares (thousand shares)	**10,683**	8,777
Weighted average number of ordinary shares for the calculation of diluted EPS (thousand shares)	**1,858,546**	1,860,983
Diluted EPS (RMB per share)	**5.490**	4.328

42 DIVIDEND

The dividend paid in 2011 was RMB838,290,000 (2010: RMB639,264,000), which excluded the dividend of RMB6,720,000 (2010: RMB3,717,000) related to the shares held by the Share Scheme Trust for the purposes of the Share Award Scheme.

A final dividend in respect of the year ended 31 December 2011 of HKD0.75 per share (2010: HKD0.55 per share) was proposed pursuant to a resolution passed by the Board on 14 March 2012 and subject to the approval of the shareholders at the annual general meeting to be held on 16 May 2012. The consolidated financial statements do not reflect this dividend payable.

43 BUSINESS COMBINATIONS

(a) The Riot Games Acquisition

(i) Step-up business combination

On 18 February 2011 (the "Closing Date"), the Group acquired a majority equity interest in Riot Games from its existing stakeholders including the founders of Riot Games, for a cash consideration of USD231,465,000 (equivalent to approximately RMB1,524,632,000), together with other cash and non-cash consideration related to the put options mentioned below. Immediately before the Riot Games Acquisition, the Group held 22.34% equity interest (the "Previously Held Interest") in Riot Games and it was reported as an investment in associate. Immediately after the Riot Games Acquisition, the Group held 8,209,473 shares, representing 92.78% equity interest in Riot Games. Riot Games operates a stock plan established before the Closing Date, pursuant to which, Riot Games may grant share options or special restricted share units ("RSUs") to its eligible employees (the "Eligible Persons"). As at the Closing Date, all share options and RSUs held by the Eligible Persons, both vested and unvested, amounted to a total of 2,040,456 shares in addition to the issued shares. In addition, according to the stock plan, 2,009,000 share options or RSUs may be further granted to the Eligible Persons as appropriate. After the Riot Games Acquisition, Riot Games was accounted for as a subsidiary of the Company. Riot Games continues to operate independently under the leadership of its founders and local management team.

Goodwill of RMB1,932,376,000 was recognised as a result of the Riot Games Acquisition. It was mainly attributable to the operating synergies and economies of scale expected to be derived from combining the operations of the Group and Riot Games. None of the goodwill recognised is expected to be deductible for income tax purposes.

The Group chose to record the non-controlling equity interest in Riot Games (the "Non-controlling interests") at fair value on the Closing Date, which was estimated by making reference to the above purchase price paid for Riot Games Acquisition. The following table summarises the consideration paid for the acquisition and the fair value of the assets acquired and liabilities assumed or recognised as at the Closing Date.

43 BUSINESS COMBINATIONS (Cont'd)

(a) The Riot Games Acquisition (Cont'd)

(i) Step-up business combination (Cont'd)

	RMB'000
Considerations:	
Cash consideration paid/payable for additional equity interest in Riot Games	**1,524,632**
Deemed consideration arising from the grant of put options on Riot Games' existing share options	**154,732**
Total considerations	**1,679,364**
Fair value of the Previously Held Interest	**576,539**
Fair value of the Non-controlling interests	**187,092**
	2,442,995
Recognised amounts of identifiable assets acquired and liabilities assumed:	
Current assets	**101,135**
Fixed assets	**14,690**
Existing game licenses and other acquired intangible assets	**671,803**
Deferred revenue	**(2,627)**
Other payables and accruals	**(4,589)**
Deferred income tax liabilities (Note 30)	**(269,793)**
Total identifiable net assets	**510,619**
Goodwill	**1,932,376**
	2,442,995
Acquisition-related costs (Note)	**54,400**

Note:

The acquisition-related costs were included in general and administrative expenses in the consolidated income statement for the year ended 31 December 2011.

43 BUSINESS COMBINATIONS (Cont'd)

(a) The Riot Games Acquisition (Cont'd)

(i) Step-up business combination (Cont'd)

The Riot Games Acquisition was treated as a step-up business combination. As a result, a deemed disposal gain of RMB459,037,000, being the difference between the fair value of the Previously Held Interest as at the Closing Date and its then carrying value of RMB117,502,000, was recorded as "Other gains, net" in the consolidated income statement for the year ended 31 December 2011 (Note 33).

For the period from the Closing Date to 31 December 2011, Riot Games contributed revenues of RMB413,010,000 and a net loss of RMB821,375,000 to the Group, which included expenses arising from the Riot Games Acquisition, including amortisation of intangible assets acquired, related deferred tax impact and share-based compensation related to the arrangements mentioned below. The revenue and net loss contributed by Riot Games to the Group would not be materially different from the aforesaid reported figures if the Riot Games Acquisition had occurred on 1 January 2011.

(ii) Other arrangements associated with the Riot Games Acquisition

In connection with the Riot Games Acquisition, the Group offered, among others, certain share options and RSUs of Riot Games to the Eligible Persons before the Closing Date. Certain Eligible Persons were also granted by the Group cash bonus and put options so that they are entitled to sell to the Group their respective retained equity interests in Riot Games, and all the Eligible Persons are entitled to sell to the Group their shares acquired after the exercise of the vested share options and RSUs granted on or before the Closing Date by Riot Games. These put options will be exercisable for a period of up to 10 years following the Closing Date, subject to certain conditions.

The grant of the put options on the share options owned by the Eligible Persons before the acquisition (the "Existing Share Options") was accounted for as a modification of the options as at the Riot Games Acquisition. The portion of fair value of the Existing Share Options, assessed at the Closing Date, attributable to the service period before the acquisition (amounting to RMB154,732,000) was treated as part of the purchase consideration of the acquisition. The remaining portion of the fair value will be recorded as employee costs throughout the future vesting period.

In addition, the grant of share options and RSUs of Riot Games, together with the put feature mentioned above, as at the Closing Date have been accounted for as a grant of a compound instrument granted to the Eligible Persons. They are accounted for as employee costs throughout the vesting period.

43 BUSINESS COMBINATIONS (Cont'd)

(a) The Riot Games Acquisition (Cont'd)

(ii) Other arrangements associated with the Riot Games Acquisition (Cont'd)

The aforesaid cash bonus and share-based compensation expense recorded as employee costs in the consolidated income statement for the year ended 31 December 2011 were not material.

The grant of the put options for the retained interest of the Eligible Persons was accounted for as a transaction undertaken with the non-controlling shareholders. The Group recognised, as at the Closing Date, the relevant financial liabilities based on the present value of estimated future cash out flow that the Group is required to honour the put option obligations, together with a debit to other reserve within equity of the Group.

(b) The Gamegoo Acquisition

On 4 November 2011 (the "Gamegoo Closing Date"), the Group acquired ordinary shares representing an additional 15% equity interest in Gamegoo Group Limited ("Gamegoo") from its existing shareholders for a cash consideration of RMB134,878,000 (the "Gamegoo Acquisition"). Gamegoo is a China-based online game developer. Before the Gamegoo Acquisition, the Group held 37% preference shares and 13% ordinary shares in Gamegoo's issued share capital and it was accounted for as an associate of the Group. After the Gamegoo Acquisition, the Group held 62.5% equity interest on a fully diluted basis in Gamegoo and Gamegoo started to be accounted for as a subsidiary of the Company.

Goodwill of RMB401,678,000 was recognised as a result of the Gamegoo Acquisition. It was mainly attributable to the operating synergies and economies of scale expected to be derived from combining operations of the Group and Gamegoo. None of the goodwill recognised is expected to be deductible for income tax purposes.

The Group chose to record the non-controlling equity interests in Gamegoo at fair value on the Gamegoo Closing Date, which was estimated by making reference to the purchase price paid for the Gamegoo Acquisition. The following table summarises the consideration paid for the acquisition and the fair value of the assets acquired and liabilities assumed or recognised as at the Gamegoo Closing Date.

43 BUSINESS COMBINATIONS (Cont'd)

(b) The Gamegoo Acquisition (Cont'd)

	RMB'000
Consideration:	
Cash consideration paid for additional equity interest	**134,878**
Fair value of the interest previously held by the Group	**389,532**
Fair value of the non-controlling interests	**239,901**
	764,311
Recognised amounts of identifiable assets acquired and liabilities assumed:	
Current assets	**136,293**
Fixed assets	**3,700**
Existing game licenses and other acquired intangible assets	**283,910**
Other payables and accruals	**(18,745)**
Deferred income tax liabilities (Note 30)	**(42,525)**
Total identifiable net assets	**362,633**
Goodwill	**401,678**
	764,311
Acquisition-related costs (Note)	**324**

Note:

The acquisition-related costs were included in general and administrative expenses in the consolidated income statement for the year ended 31 December 2011.

The Gamegoo Acquisition was treated as a step-up business combination. As a result, a deemed disposal gain of RMB249,449,000, being the difference between the fair value of the interest previously held by the Group as at the Gamegoo Closing Date and its then carrying value of RMB140,083,000, was recorded as "Other gains, net" in the consolidated income statement for the year ended 31 December 2011 (Note 33).

For the period from the Gamegoo Closing Date to 31 December 2011, Gamegoo contributed revenues of RMB42,587,000 and a net profit of RMB22,581,000 to the Group, which included expenses arising from the Gamegoo Acquisition, including amortisation of intangible assets acquired and the related deferred tax impact. The revenue and net profit contributed by Gamegoo to the Group would be RMB228,019,000 and RMB129,269,000, respectively, if the Gamegoo Acquisition had occurred on 1 January 2011.

43 BUSINESS COMBINATIONS (Cont'd)

(c) Acquisition of 100% equity interest in another three companies

During the year ended 31 December 2011, the Group acquired 100% equity interests in a mobile security software development company, an Internet service providing company and a mobile synchronisation software company respectively.

The aggregate considerations and the allocation of such considerations to the fair value of the net assets acquired and goodwill recognised as at the dates of these acquisitions are as follows:

	RMB'000
Purchase considerations	102,800
Fair value of net assets acquired	44,859
Goodwill	57,941
	102,800

The revenues and net profits contributed by these three subsidiaries from their respective acquisition dates to 31 December 2011 to the Group were not material.

44 CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of net profit to net cash inflow from operating activities:

	2011 RMB'000	2010 RMB'000
Profit for the year	**10,224,831**	8,115,209
Adjustments for:		
Income tax expense	**1,874,238**	1,797,924
Gains on deemed disposal of associates	**(708,486)**	–
Depreciation of fixed assets and investment properties	**1,208,261**	669,860
Amortisation of intangible assets	**726,221**	109,411
Amortisation of land use rights	**4,925**	3,724
Losses/(gains) on disposals of fixed assets	**1,694**	(883)
Losses from derivative financial liabilities	**96,790**	17,964
Interest income	**(468,990)**	(255,922)
Share-based compensation expenses	**732,691**	495,772
Share of losses/(profit) of associates	**24,255**	(72,359)
Share of losses/(profit) of jointly controlled entities	**165,731**	(3,399)
Impairment provision for available-for-sale financial assets, associates and jointly controlled entities	**243,000**	–
Exchange gains	**(108,042)**	(34,189)
Changes in working capital:		
Accounts receivable	**(250,693)**	(483,712)
Prepayments, deposits and other receivables	**(2,630,368)**	(51,936)
Long-term payables	**1,057,643**	(179,804)
Accounts payable	**827,573**	478,330
Other payables and accruals	**1,816,339**	1,551,226
Other tax liabilities	**(45,689)**	9,942
Restricted cash	**(1,850,652)**	–
Deferred revenue	**2,253,098**	1,024,570
Net cash generated from operating activities	**15,194,370**	13,191,728

44 CONSOLIDATED CASH FLOW STATEMENT (Cont'd)

(a) Reconciliation of net profit to net cash inflow from operating activities: (Cont'd)

In the consolidated cash flow statement, proceeds from disposals of fixed assets comprise:

	2011	2010
	RMB'000	RMB'000
Net book amount	**2,293**	691
(Losses)/gains on disposals of fixed assets	**(1,694)**	883
Proceeds from disposals of fixed assets	**599**	1,574

(b) Major non-cash transactions

There were no material non-cash transactions for the year ended 31 December 2011.

45 CONTINGENCIES

The Group had no material contingent liabilities outstanding as at 31 December 2011.

46 COMMITMENTS

(a) Capital commitments

Capital commitments as at 31 December 2011 and 2010 are analysed as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Contracted:		
Construction/purchase of building and purchase of land use rights	**463,046**	211,558
Purchase of other fixed assets	**132,260**	135,165
Capital investment in investees	**816,910**	100,996
	1,412,216	447,719
Authorised but not contracted:		
Construction/purchase of building and purchase of land use rights	**1,186,867**	373,277
Capital investment in investees	**651,927**	385,000
	1,838,794	758,277
	3,251,010	1,205,996

(b) Operating lease commitments

The future aggregate minimum lease payments under non-cancellable operating leases in respect of buildings are as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Contracted:		
Not later than one year	**520,396**	236,343
Later than one year and not later than five years	**1,462,788**	572,818
Later than five years	**286,135**	18,845
	2,269,319	828,006

46 COMMITMENTS (Cont'd)

(c) Other commitments

The future aggregate minimum payments under non-cancellable bandwidth and server custody leases and online game licensing agreements are as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Contracted:		
Not later than one year	**596,031**	1,064,792
Later than one year and not later than five years	**768,291**	1,981,543
	1,364,322	3,046,335

47 RELATED PARTIES TRANSACTIONS

Except as disclosed in Note 17 (loans to associates and jointly controlled entity), Note 22 (Share options and share award scheme) and Note 36 (Directors' emoluments) to the consolidated financial statements, the Group had no other material transactions with related parties for the year ended 31 December 2011, and no other related parties' balances as at 31 December 2011. The key management compensation has already been disclosed in Note 36 (Directors' emoluments).

48 SUBSEQUENT EVENTS

(a) On 19 January 2012, the Group entered into sales and purchase agreement (the "Level Up SPA") with a related party, pursuant to which, the Group agreed to purchase 320,722 shares of Level Up! International Holdings Pte. Ltd. ("Level Up"), representing 49% of its issued share capital at the date of Level Up SPA, with a cash consideration of USD26,950,000 (equivalent to approximately RMB169,567,000) (the "Level Up Acquisition"). On the same date, the Group entered into a call option agreement, pursuant to which, the Group was granted an option to acquire such number of shares in Level Up that, together with the shares acquired pursuant to the Level Up SPA, will represent 67% of the issued share capital of Level Up as of the date of the exercise of the option. Closing of the Level Up Acquisition is subject to certain conditions, which have not been fulfilled at the date of this annual report. Level Up, through its operating subsidiaries and affiliates in Brazil and the Philippines and through its joint-venture in the United States, is principally engaged in online game and game magazine publishing. Upon the completion of the acquisition, Level Up will be accounted for as a subsidiary of the Company.

(b) On 31 January 2012, the Group acquired 619,400,000 ordinary shares of ChinaVision Media Group Limited ("ChinaVision"), representing approximately 8% of its total outstanding shares on a fully diluted basis, for a cash consideration of HKD247,760,000 (equivalent to approximately RMB201,578,000). ChinaVision is principally engaged in production and licensing of film and television programmes, and printed media and television advertising business.

INDEPENDENT AUDITOR'S REPORT

PRICEWATERHOUSECOOPERS

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TO THE SHAREHOLDERS OF TENCENT HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Tencent Holdings Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 64 to 189, which comprise the consolidated and company statements of financial position as at 31 December 2010, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

INDEPENDENT AUDITOR'S REPORT

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

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

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2010, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

OTHER MATTERS

This report, including the opinion, has been prepared for and only for you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 16 March 2011

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Note	As at 31 December 2010 RMB'000	2009 RMB'000
ASSETS			
Non-current assets			
Fixed assets	6	**3,292,828**	2,517,202
Construction in progress	7	**386,943**	105,771
Investment properties	8	**37,229**	68,025
Land use rights	9	**229,890**	35,296
Intangible assets	10	**572,981**	268,713
Investment in associates	12	**1,070,633**	477,622
Investment in a jointly controlled entity	13	**74,542**	–
Deferred income tax assets	30	**219,019**	301,016
Held-to-maturity investments	15	**–**	341,410
Available-for-sale financial assets	16	**4,126,878**	153,462
Prepayments, deposits and other assets	18	**445,430**	80,306
		10,456,373	4,348,823
Current assets			
Accounts receivable	17	**1,715,412**	1,229,436
Prepayments, deposits and other assets	18	**487,872**	373,642
Term deposits with initial term of over three months	19	**11,725,743**	5,310,168
Restricted cash	28	**1,036,457**	200,000
Cash and cash equivalents	20	**10,408,257**	6,043,696
		25,373,741	13,156,942
Total assets		**35,830,114**	17,505,765

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Note	As at 31 December 2010 RMB'000	2009 RMB'000
EQUITY			
Equity attributable to the Company's equity holders			
Share capital	21	**198**	197
Share premium	21	**1,100,302**	1,244,425
Shares held for share award scheme	21	**(258,137)**	(123,767)
Share-based compensation reserve	21	**1,199,663**	703,563
Other reserves	22	**1,919,695**	(166,364)
Retained earnings		**17,795,225**	10,520,453
		21,756,946	12,178,507
Non-controlling interests		**83,912**	120,146
Total equity		**21,840,858**	12,298,653
LIABILITIES			
Non-current liabilities			
Deferred income tax liabilities	30	**967,211**	369,983
Long-term payables	27	**–**	274,050
		967,211	644,033

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Note	As at 31 December 2010 RMB'000	2009 RMB'000
Current liabilities			
Accounts payable	24	**1,380,464**	696,511
Other payables and accruals	25	**2,997,808**	1,626,051
Derivative financial instruments	26	**17,964**	–
Short-term bank borrowings	28	**5,298,947**	202,322
Current income tax liabilities	39(a)	**341,103**	85,216
Other tax liabilities	39(b)	**225,188**	216,978
Deferred revenue	29	**2,760,571**	1,736,001
		13,022,045	4,563,079
Total liabilities		**13,989,256**	5,207,112
Total equity and liabilities		**35,830,114**	17,505,765
Net current assets		**12,351,696**	8,593,863
Total assets less current liabilities		**22,808,069**	12,942,686

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 64 to 189 were approved by the Board of Directors on 16 March 2011 and were signed on its behalf.

Ma Huateng
Director

Zhang Zhidong
Director

STATEMENT OF FINANCIAL POSITION - THE COMPANY

As at 31 December 2010

	Note	As at 31 December 2010 RMB'000	2009 RMB'000
ASSETS			
Non-current assets			
Fixed assets		**342**	445
Intangible assets		**4,809**	3,245
Investments in subsidiaries	11(a)	**2,834,852**	1,981,736
Available-for-sale financial assets		**–**	14,758
Contribution to Share Scheme Trust	11(c)	**287**	794
Amounts due from subsidiaries	11(b)	**–**	341,410
		2,840,290	2,342,388
Current assets			
Amounts due from subsidiaries	11(b)	**708,074**	1,060,822
Prepayments, deposits and other receivables		**4,584**	8,349
Term deposits with initial term of over three months	19	**635**	–
Cash and cash equivalents	20	**237,525**	102,081
		950,818	1,171,252
Total assets		**3,791,108**	3,513,640
EQUITY			
Equity attributable to the Company's equity holders			
Share capital	21	**198**	197
Share premium	21	**1,100,302**	1,244,425
Shares held for share award scheme	21	**(258,137)**	(123,767)
Share-based compensation reserve	21	**1,199,663**	703,563
(Accumulated deficit)/retained earnings		**(140,999)**	557,521
Total equity		**1,901,027**	2,381,939

STATEMENT OF FINANCIAL POSITION - THE COMPANY

As at 31 December 2010

	Note	As at 31 December **2010** **RMB'000**	 2009 RMB'000
LIABILITIES			
Current liabilities			
Amounts due to subsidiaries	11(b)	**1,833,802**	1,107,184
Other payables and accruals		**56,279**	24,517
		1,890,081	1,131,701
Total equity and liabilities		**3,791,108**	3,513,640
Net current (liabilities)/assets		**(939,263)**	39,551
Total assets less current liabilities		**1,901,027**	2,381,939

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 64 to 189 were approved by the Board of Directors on 16 March 2011 and were signed on its behalf.

Ma Huateng
Director

Zhang Zhidong
Director

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2010

	Note	Year ended 31 December 2010 RMB'000	2009 RMB'000
Revenues			
Internet value-added services		**15,482,301**	9,530,711
Mobile and telecommunications value-added services		**2,715,931**	1,905,599
Online advertising		**1,372,522**	962,171
Others		**75,277**	41,479
	5	**19,646,031**	12,439,960
Cost of revenues	31, 34	**(6,320,200)**	(3,889,468)
Gross profit		**13,325,831**	8,550,492
Interest income	32	**255,922**	136,014
Other gains/(losses), net	33	**38,056**	(58,213)
Selling and marketing expenses	34	**(945,370)**	(581,468)
General and administrative expenses	34	**(2,836,226)**	(2,026,347)
Operating profit		**9,838,213**	6,020,478
Finance costs, net	38	**(838)**	(1,953)
Share of profit of associates		**72,359**	22,206
Share of profit of a jointly controlled entity		**3,399**	–
Profit before income tax		**9,913,133**	6,040,731
Income tax expense	39(a)	**(1,797,924)**	(819,120)
Profit for the year		**8,115,209**	5,221,611
Attributable to:			
Equity holders of the Company		**8,053,625**	5,155,646
Non-controlling interests		**61,584**	65,965
		8,115,209	5,221,611

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2010

		Year ended 31 December	
		2010	2009
	Note	**RMB'000**	RMB'000
Earnings per share for profit attributable to equity holders of the Company during the year (expressed in RMB per share)			
– basic	41(a)	**4.432**	2.862
– diluted	41(b)	**4.328**	2.791
Dividend per share			
Final dividend proposed	42	**HKD0.55**	HKD0.40

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2010

	Year ended 31 December	
	2010	2009
	RMB'000	RMB'000
Profit for the year	**8,115,209**	5,221,611
Other comprehensive income:		
Income from changes in fair value of available-for-sale financial assets	**1,821,129**	–
Other comprehensive income for the year, net of tax	**1,821,129**	–
Total comprehensive income for the year	**9,936,338**	5,221,611
Attributable to:		
Equity holders of the Company	**9,874,754**	5,155,646
Non-controlling interests	**61,584**	65,965
Total comprehensive income for the year	**9,936,338**	5,221,611

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

	Attributable to equity holders of the Company								
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2010	197	1,244,425	(123,767)	703,563	(166,364)	10,520,453	12,178,507	120,146	12,298,653
Comprehensive income									
Profit for the year	–	–	–	–	–	8,053,625	8,053,625	61,584	8,115,209
Other comprehensive income									
– income from changes in fair value of available-for-sale financial assets	–	–	–	–	1,821,129	–	1,821,129	–	1,821,129
Total comprehensive income for the year	–	–	–	–	1,821,129	8,053,625	9,874,754	61,584	9,936,338
Transactions with owners									
Employee share option schemes:									
- value of employee services	–	–	–	139,621	–	–	139,621	–	139,621
- proceeds from shares issued	1	199,248	–	–	–	–	199,249	–	199,249
Employee share award scheme:								–	
- value of employee services	–	–	–	356,479	–	–	356,479	–	356,479
- shares purchased for share award scheme	–	–	(167,519)	–	–	–	(167,519)	–	(167,519)
- vesting of awarded shares	–	(33,149)	33,149	–	–	–	–	–	–
Profit appropriations to statutory reserves	–	–	–	–	8,237	(8,237)	–	–	–
Dividend (Note 42)	–	–	–	–	–	(639,264)	(639,264)	(66,723)	(705,987)
Repurchase and cancellation of shares	–	(310,222)	–	–	–	–	(310,222)	–	(310,222)
Reversal of the liabilities in respect of put options granted to non-controlling interest owners	–	–	–	–	94,246	–	94,246	–	94,246
Acquisition of additional interests in a subsidiary (Note 44)	–	–	–	–	154,198	(123,103)	31,095	(31,095)	–
Transfer	–	–	–	–	8,249	(8,249)	–	–	–
Total transactions with owners for the year	1	(144,123)	(134,370)	496,100	264,930	(778,853)	(296,315)	(97,818)	(394,133)
Balance at 31 December 2010	198	1,100,302	(258,137)	1,199,663	1,919,695	17,795,225	21,756,946	83,912	21,840,858

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

	Attributable to equity holders of the Company								
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2009	195	1,155,209	(21,809)	381,439	(433,038)	5,938,930	7,020,926	98,406	7,119,332
Profit/Total comprehensive Income for the year	–	–	–	–	–	5,155,646	5,155,646	65,965	5,221,611
Transactions with owners									
Employee share option schemes:									
- value of employee services	–	–	–	167,178	–	–	167,178	–	167,178
- proceeds from shares issued	2	165,446	–	–	–	–	165,448	–	165,448
Employee share award scheme:									
- value of employee services	–	–	–	154,946	–	–	154,946	–	154,946
- shares purchased for share award scheme	–	–	(103,618)	–	–	–	(103,618)	–	(103,618)
- vesting of awarded shares	–	(1,660)	1,660	–	–	–	–	–	–
Profit appropriations to statutory reserves	–	–	–	–	2,193	(2,193)	–	–	–
Dividend (Note 42)	–	–	–	–	–	(554,604)	(554,604)	(32,088)	(586,692)
Repurchase and cancellation of shares	–	(74,570)	–	–	–	–	(74,570)	–	(74,570)
Equity interest purchased for an employee restricted equity interest plan in a non-wholly owned subsidiary	–	–	–	–	–	(17,326)	(17,326)	(11,856)	(29,182)
Exercise of put option granted to non-controlling interest owners	–	–	–	–	281	–	281	(281)	–
Reversal of the liabilities in respect of the put options granted to non-controlling interest owners	–	–	–	–	264,200	–	264,200	–	264,200
Total transactions with owners for the year	2	89,216	(101,958)	322,124	266,674	(574,123)	1,935	(44,225)	(42,290)
Balance at 31 December 2009	197	1,244,425	(123,767)	703,563	(166,364)	10,520,453	12,178,507	120,146	12,298,653

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

	Note	Year ended 31 December 2010 RMB'000	2009 RMB'000
Cash flows from operating activities			
Cash generated from operations	45(a)	**13,191,728**	8,854,813
Income tax paid		**(872,435)**	(456,448)
Net cash flows generated from operating activities		**12,319,293**	8,398,365
Cash flows from investing activities			
Payments for business combinations		**(268,852)**	(140)
Purchase of fixed assets, construction in progress and investment properties		**(1,488,220)**	(788,824)
Proceeds from disposals of fixed assets	45(a)	**1,574**	595
Payments for investment in associates		**(511,967)**	(148,417)
Payment for investment in a jointly controlled entity		**(71,143)**	–
Purchase of intangible assets		**(114,638)**	(31,950)
Prepayment for online game licenses		**(187,193)**	–
Payments for land use rights		**(456,555)**	–
Purchase of available-for-sale financial assets		**(2,179,096)**	(68,782)
Payment for acquisition of non-controlling interests in a non-wholly owned subsidiary		**(118,260)**	(717)
Proceeds from the redemption of held-to-maturity investments		**341,410**	68,346
Payments for held-to-maturity investments		**–**	(341,795)
Receipt from the repayments of term deposits with initial term of over three months		**114,662**	564,729
Payments for term deposits with initial term of over three months		**(6,530,237)**	(4,212,396)
Payment for the restricted cash		**(836,457)**	(200,000)
Receipt from loan made to a related party		**54,700**	18,394
Interest received		**219,937**	116,162
Dividend received		**15,338**	–
Net cash flows used in investing activities		**(12,014,997)**	(5,024,795)

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

	Year ended 31 December	
	2010	2009
	RMB'000	RMB'000
Cash flows from financing activities		
Proceeds from short-term bank borrowings	**5,298,947**	202,322
Repayment of short-term bank borrowings	**(202,322)**	–
Proceeds from issuance of ordinary shares	**199,249**	165,448
Payments for repurchase of shares	**(310,222)**	(74,570)
Payment for purchase of shares for share award scheme	**(167,519)**	(103,618)
Dividend paid to the Company's shareholders	**(639,264)**	(554,604)
Dividends paid to non-controlling interests	**(66,723)**	(32,088)
Net cash flows generated from/(used in) financing activities	**4,112,146**	(397,110)
Net increase in cash and cash equivalents	**4,416,442**	2,976,460
Cash and cash equivalents at beginning of the year	**6,043,696**	3,067,928
Exchange losses on cash and cash equivalents	**(51,881)**	(692)
Cash and cash equivalents at end of the year	**10,408,257**	6,043,696

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010
(All amounts in RMB unless otherwise stated)

1 GENERAL INFORMATION

Tencent Holdings Limited (the "Company") was incorporated in the Cayman Islands. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY 1-1111, Cayman Islands. The shares of the Company have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 16 June 2004.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the "Group") are principally engaged in the provision of Internet value-added services, mobile and telecommunications value-added services and online advertising services to users in the People's Republic of China (the "PRC").

The operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited ("Tencent Computer"), a limited liability company established in the PRC by certain shareholders of the Company on 11 November 1998. Tencent Computer is legally owned by the core founders of the Company who are PRC citizens (the "Registered Shareholders").

The PRC laws and regulations limit foreign ownership of companies providing value-added telecommunications services, which include activities and services operated by Tencent Computer. In order to enable certain foreign companies to make investments into the business of the Group, the Company established a subsidiary, Tencent Technology (Shenzhen) Company Limited ("Tencent Technology"), which is a wholly foreign owned enterprise incorporated in the PRC, on 24 February 2000. The foreign investors of the Company then subscribed to additional equity interest in the Company.

Certain contractual arrangements ("Structure Contracts") have been made among the Company, Tencent Technology, Tencent Computer and the Registered Shareholders in order that the decision-making rights and operating and financing activities of Tencent Computer are ultimately controlled by the Company. The Company and Tencent Technology are also entitled to substantially all of the operating profits and residual benefits generated by Tencent Computer under these arrangements. In particular, the Registered Shareholders are required under their contractual arrangements with the Group to transfer these interests in Tencent Computer to the Group or the Group's designee upon the Group's request at a pre-agreed nominal consideration. Similar arrangements were also made with other PRC operating companies acquired or formed by the Group, namely Shiji Kaixuan Technology Company Limited ("Shiji Kaixuan"), Beijing Emark Information and Technology Company Limited, Nanjing Wang Dian Technology Company Limited ("Wang Dian"), Beijing BIZCOM Technology Company Limited ("Beijing BIZCOM"), Beijing Starsinhand Technology Company Limited ("Beijing Starsinhand"), Shenzhen Shijitianyou Technology Company Limited, Tianjin Shouzhongwanwei Network Company Limited and Guangzhou Yunxun Technology Company Limited (together with Tencent Computer, collectively known as "the PRC Operating Companies").

1 GENERAL INFORMATION (Cont'd)

As a result, Tencent Computer is accounted for as a subsidiary and the formation of the Group in 2000 was accounted for as a business combination between entities under common control under a method similar to the uniting of interests method for recording all assets and liabilities at predecessor carrying amounts. This approach was adopted because in management's belief it best reflected the substance of the formation. Similarly, all the financial statements of the PRC Operating Companies have also been consolidated by the Company (see Note 11 (a)(ii) for details).

These consolidated financial statements have been approved for issue by the Board of Directors (the "Board") on 16 March 2011.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared under the historical cost convention, as modified by available-for-sale financial assets, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

IAS 1 (Revised) prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All 'non-owner changes in equity' are required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). The Group elected to present two performance statements (the income statement and statement of comprehensive income) from 1 January 2010.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation (Cont'd)

(a) New and amended standards adopted by the Group

The following new standards and amendments to existing standards are mandatory for the first time for the financial year beginning 1 January 2010.

- IAS 27 (Revised), 'Consolidated and Separate Financial Statements'

  IAS 27 (Revised) requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. This is consistent with the Group's existing policy. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss.

  IAS 27 (Revised) contained consequential amendments to IAS 28, 'Investments in associates', and IAS 31, 'Interests in joint ventures'.

  The Group has applied this revised standard prospectively from 1 January 2010 and management has assessed that this revised standard does not have a significant impact on the Group's consolidated financial statements.

- IFRS 2 (Amendment), 'Group Cash-settled Share-based Payment Transaction'

  In addition to incorporating IFRIC 8, "Scope of IFRS 2" and IFRIC 11, "IFRS 2 - Group and treasury share transactions", the amendments expand on the guidance in IFRIC 11 to address the accounting in the separate financial statements of a subsidiary when its suppliers/employees will receive cash payments from the parent that are linked to the price of the equity instruments of an entity in the group. The parent, and not the entity, has the obligation to deliver cash. The amendments state that the entity shall account for the transaction with its suppliers/employees as equity-settled, and recognise a corresponding increase in equity as a contribution from its parent. The subsidiary shall remeasure the cost of the transaction subsequently for any changes resulting from non-market vesting conditions not being met in accordance with paragraphs 19 to 21 in IFRS 2. This differs from the measurement of the transaction as cash-settled in the consolidated financial statements of the Group.

  The Group has applied this amendment from 1 January 2010 and management has assessed that this amendment has no significant impact on the Group's consolidated financial statements.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation (Cont'd)

(a) New and amended standards adopted by the Group (Cont'd)

- IFRS 3 (Revised), 'Business Combinations'

  The revised standard continues to apply the acquisition method to business combinations but with some significant changes compared with IFRS 3. For example, all payments made to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice on an acquisition by acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed.

  In addition, in relation to an acquisition achieved in stage or a step acquisition (i.e. there is a previously held equity interest when obtaining control), the IFRS 3 (revised) requires that the previously held interest is measured to fair value at the acquisition date and a gain or loss is recognised in the income statement, which is treated as if the previously held interest has been disposed of in return, along with the other consideration transferred, for the controlling interest in the acquired subsidiary.

  The Group has applied this revised standard prospectively from 1 January 2010 and see Note 43 for further details of the business combination that occurred in 2010.

The Group also adopted the IASB's improvements to IFRS published in May 2008 and April 2009, which are relevant to the Group and effective from 1 January 2010. Such amendments have no material impact to the financial statements of the Group.

The following new and amended standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2010 but not currently relevant to the Group (although they may affect the accounting for future transactions and events).

- IAS 17 (Amendment) — Leases
- IAS 39 (Amendment) — Financial Instruments: Recognition and Measurement - Eligible Hedged Item
- IFRIC 17 — Distributions of Non-cash Assets to Owners
- IFRS 5 (Amendment) — Non-current assets held for sale and discontinued operations

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation (Cont'd)

(b) New standard which has been issued but is not effective for the financial year beginning 1 January 2010 and have not been early adopted

The following new standard has been issued and mandatory for the Group's accounting periods beginning on or after 1 January 2013 or later periods, but the Group has not yet early adopted it.

- IFRS 9, 'Financial Instrument' (effective from 1 January 2013)

  Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

  An entity shall classify all financial liabilities as subsequently measured at amortised cost using the effective interest method, except for financial liabilities at fair value through profit or loss; financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies; financial guarantee contracts and commitments to provide a loan at a below-market interest rate.

  An instrument is subsequently measured at amortised cost only if it is a debt instrument, and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.

  All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than the income statement. There is to be no recycling of fair value gains and losses to the income statement. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in the income statement, as long as they represent a return on investment.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.1 Basis of preparation (Cont'd)

(b) New standard which has been issued but is not effective for the financial year beginning 1 January 2010 and have not been early adopted (Cont'd)

This standard is effective for annual periods beginning on or after 1 January 2013 and to be applied retrospectively. However, if adopted before 1 January 2012, comparative periods do not need to be restated. In addition, entities adopting this standard before 1 January 2011 are allowed to designate any date between then and the date of issuance of IFRS 9, as the date of initial application that will be the date upon which the classification of financial assets will be determined. The Group has not yet determined when to apply this standard at current stage.

(c) New standards, amendments and interpretations have been issued but are not effective and not relevant for the Group's operation.

The following new standards, amendments and interpretations have been issued and are mandatory for the Group's accounting periods beginning on or after 1 January 2011 or later periods, but not relevant for the Group's operation.

- IAS 32 (Amendment) — Classification of Rights Issue (effective from 1 February 2010)
- IFRIC 19 — Extinguishing Financial Liabilities with Equity Instruments (effective from 1 July 2010)
- IAS 24 (Revised) — Related Party Disclosures (effective from 1 January 2011)
- Amendment to IFRIC 14 — Prepayments of A Minimum Funding Requirement (effective from 1 January 2011)
- IAS 12 (Amendment) — Deferred Tax: Recovery of underlying assets (effective from 1 January 2012)

(d) IASB's improvement to IFRS published in May 2010

In May 2010, IASB published its third annual improvements project, which made some amendments to IFRSs to clarify some accounting treatments/disclosure requirements under new/revised IFRSs and eliminate inconsistency. Management do not expect these amendments have a material impact on the Group's financial statements.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31 December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are de-consolidated from the date that control ceases.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the consolidated income statement (Note 2.8).

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(a) Subsidiaries (Cont'd)

In the Company's statement of financial position, the investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments. Cost also includes direct attributable costs of investment. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable. In addition, the contribution to the Company's share award scheme, a controlled special purpose entity, is stated at cost in "Contribution to Share Scheme Trust" first, and then will be transferred to the "Shares held for share award scheme" under equity when the contribution is used for the acquisition for the shares of the Company.

(b) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchase from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposal to non-controlling interests are also recorded in equity.

(c) Associates

Associates are all entities over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of loss in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(c) Associates (Cont'd)

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) Jointly controlled entities

The Group's interests in jointly controlled entities are accounted for by the equity method. The Group's share of its jointly controlled entities' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of loss in a jointly controlled entity equals or exceeds its interest in the jointly controlled entity, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity.

(e) Business combination achieved in stages

For a business combination achieved in stages, it applies acquisition method at the acquisition date. The previously held interest is remeasured to fair value at the acquisition date and a gain or loss is recognised in the consolidated income statement. Goodwill is calculated by deducting the fair value of identifiable net assets from the fair value of the previously held interest, the consideration and non-controlling interest.

The cost of an associate/a jointly controlled entity acquired in stages is measured as the sum of the fair value of the interest previously held plus the fair value of any additional consideration transferred as of the date when the associate/jointly controlled entity became an associate/a jointly controlled entity. A gain or loss on re-measurement of the previously held interest is taken to the income statement. Any other comprehensive income recognised in prior periods in relation to the previously held interest is also taken to the income statement. Any acquisition-related costs are expensed in the period in which the costs are incurred.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.2 Consolidation (Cont'd)

(f) Partial disposals

When the group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the income statement.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to the income statement where appropriate.

2.3 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments and making strategic decisions. The chief operating decision-makers mainly include the executive directors.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in RMB, which is both the functional currency of the Company and presentation currency of the Group.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale financial assets are analysed between translation differences resulting from changes in the amortised cost of the securities, and other changes in the carrying amount of the securities. Translation differences related to changes in the amortised cost and interest income are recognised in the income statement, and other changes in carrying amount are recognised in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in the income statement as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.4 Foreign currency translation (Cont'd)

(c) Group companies

The results and financial position of all group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency of RMB are translated into the presentation currency as follows:

(i) assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.5 Fixed assets

All fixed assets are stated at historical costs less accumulated depreciation and accumulated impairment charge. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.5 Fixed assets (Cont'd)

Depreciation is calculated on the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	20 - 50 years
Computer equipment	3 - 5 years
Furniture and office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	the shorter of their useful lives and the lease terms

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Construction in progress represents buildings under construction, which is stated at actual construction cost less any impairment loss. Construction in progress is transferred to fixed assets when completed and ready for use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.10).

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised within "Other gains/(losses), net" in the income statement.

2.6 Investment properties

Investment properties are held for long-term rental yields and are not occupied by the Group. Investment properties are carried at historical costs less accumulated depreciation and accumulated impairment charges. Historical costs include expenditures that are directly attributable to the acquisition of the items.

Depreciations are calculated on the straight-line method to allocate their costs to their residual values over their estimated useful lives of 50 years.

Investment properties' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Investment properties' carrying amounts are written down immediately to their recoverable amount if its carrying amounts are greater than their estimated recoverable amounts.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.7 Land use rights

Land use rights are up-front payments to acquire long-term interest in land. These payments are stated at cost and charged to the income statement on a straight-line basis over the remaining period of the lease or capitalised in construction in progress upon completion of construction.

2.8 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and is tested for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units ("CGU") for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose identified according to operating segment.

(b) Other intangible assets

Other intangible assets mainly include licence, computer software and technology and non-compete agreements. They are initially recognised and measured at cost or estimated fair value of intangible assets acquired through business combinations.

Other intangible assets are being amortised over their estimated useful lives (generally three to seven years).

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.9 Shares held for share award scheme

Where the Tencent Share Award Scheme ("Share Scheme Trust") purchases the Company's shares from the market, the consideration paid, including any directly attributable incremental cost, is presented as "Shares held for share award scheme" and deducted from total equity.

When the Share Scheme Trust transfers the Company's shares to the awardees upon vesting, the related costs of the awarded shares vested are credited to "Shares held for share award scheme", with a corresponding adjustment to the share premium.

2.10 Impairment of non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

Impairment testing of the investments in subsidiaries or associates is required upon receiving dividends from these investments if the dividend exceeds the total comprehensive income of the subsidiary or associate in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee's net assets including goodwill.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.11 Financial assets

(a) Classification

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired, management's intentions and whether the assets are quoted in an active market. Management determines the classification of its financial assets at initial recognition.

(i) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the end of the reporting period which are classified as non-current assets. Loans and receivables are classified as "Accounts receivable", "Other receivables", "Term deposits with initial term of over three months", "Restricted cash" and "Cash and cash equivalents" in the statement of financial position.

(iii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the end of the reporting period which are classified as current assets.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.11 Financial assets (Cont'd)

(a) Classification (Cont'd)

(iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other category. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the end of the reporting period.

(b) Recognition and measurement

Regular way purchases and sales of investments are recognised on trade-date the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the "Financial assets at fair value through profit or loss" category are presented in the income statement within "Other gains/(losses), net" in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement as part of other income when the Group's right to receive payments is established.

Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognised in other comprehensive income.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the income statement as gains and losses from investment securities.

Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.12 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liabilities simultaneously.

2.13 Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the group, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becomes probable that the borrower will enter into bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot be identified with the individual financial assets in the portfolio, including:
  - (i) adverse changes in the payment status of borrowers in the portfolio; and
  - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.13 Impairment of financial assets (Cont'd)

(a) Assets carried at amortised cost (Cont'd)

The Group first assesses whether objective evidence of impairment exists.

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the consolidated income statement.

(b) Assets classified as available for sale

The Group assesses at the end of the reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the securities below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement - is removed from other comprehensive income and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.14 Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

During the year ended 31 December 2010, the Group did not hold any derivative instruments designated as a hedging instrument but held certain derivative instruments which did not qualify for hedge accounting. The derivative instruments, which do not qualify for hedge accounting, are accounted for at fair value through profit or loss. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement within "Other gains/(losses), net".

2.15 Accounts receivable

Accounts receivable is amounts due from customers or agents for merchandise sold or services performed in the ordinary course of business. If collection of accounts receivable and other receivables is expected in one year or less, they are classified as current assets. Otherwise, they are presented as non-current assets.

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

2.16 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with initial maturities of three months or less.

2.17 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or share options are shown in equity as a deduction from the proceeds.

Where any group company purchases the Company's equity share capital (treasury share), the considerations paid, including any directly attributable incremental costs, is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received (net of any directly attributable incremental transaction costs) is included in equity attributable to the Company's equity holders.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.18 Accounts payable

Accounts payable is obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable is classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Accounts payable is recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.19 Put option liabilities

Put option is the financial instrument granted by the Group that the counterparty may have the right to request the Group to purchase its own equity instruments for cash or other financial assets when certain conditions are met. If the Group does not have the unconditional right to avoid delivering cash or another financial assets under the put option, it has to recognise a financial liability at the present value of the estimated future cash outflows under the put option. The financial liability is initially debited to equity at fair value. Subsequently, if the Group revises its estimates of payments, the Group will adjust the carrying amount of the financial liability to reflect actual and revised estimated cash outflows. The Group will recalculate the carrying amount by computing the present value of revised estimated future cash outflows at the financial instrument's original effective interest rate and the adjustments will be recognised as income or expenses in the income statement. If the put option expires without delivery, the carrying amount of the liability is reclassified as equity.

The put option liabilities are current liabilities unless the put option can only be exercised 12 months after the end of the reporting period.

2.20 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost with any difference between proceeds (net of transaction costs) and the redemption value recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.21 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company's subsidiaries and jointly controlled entities operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction neither accounting nor taxable profit or loss is affected. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.22 Employee benefits

(a) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the end of the reporting period. Employee entitlements to sick and maternity leave are not recognised until the time of leave.

(b) Pension obligations

The Group contributes on a monthly basis to various defined contribution benefit plans organised by the relevant governmental authorities. The Group's liability in respect of these plans is limited to the contributions payable in each period. Contributions to these plans are expensed as incurred. Assets of the plans are held and managed by government authorities and are separate from those of the Group.

(c) Share-based compensation benefits

The Group adopted four share option schemes and a share award scheme (see Note 23). The fair value of the employee services received in exchange for the grant of options and awarded shares is recognised as an expense and credited to share-based compensation reserve under equity. For grant of share options, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted by using an option-pricing model - Black-Scholes valuation model (the "BS Model"), excluding the impact of any service condition and non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become vested. For grant of award shares, the total amount to be expensed over the vesting period is determined by reference to the market price of the Company's shares at the grant date.

From the perspective of the Company, the Company grants the share options/shares to its subsidiaries' employees to exchange for their service provided to the subsidiaries. Accordingly, in the Company's statement of financial position, the share-based compensation expenses, which are recognised in the consolidated financial statement, are treated as part of the "Investment in subsidiaries".

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.22 Employee benefits (Cont'd)

(c) Share-based compensation benefits (Cont'd)

At each end of the reporting period, the Group and the Company revise its estimates of the number of options and awarded shares that are expected to ultimately vest. It recognises the impact of the revision of original estimates, if any, in the income statement of the Group and in the "Investment in subsidiaries" of the Company, and a corresponding adjustment to equity over the remaining vesting period.

When the options are exercised, the proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium.

2.23 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for further operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.24 Revenue recognition

The Group principally derives revenues from provision of Internet value-added services, mobile and telecommunications value-added services and online advertising services in the PRC.

(a) Internet value-added services and mobile and telecommunications value-added services

Revenues from Internet value-added services are derived principally from the provision of community and online gaming services across various Internet platforms.

Mobile and telecommunications value-added services revenues are derived principally from providing users with mobile instant messaging services, mobile chat services, and other mobile value-added services such as mobile interactive voice response services, ringback tone services, music and image/picture downloads, mobile news and information content services and mobile game services.

Internet value-added services and mobile and telecommunications value-added services are either billed on a monthly subscription basis or on a per transaction/message basis. Certain of these services are delivered to the Group's customers through the platforms of various subsidiaries of telecommunication operators in the PRC, namely China Mobile Communications Corporation ("China Mobile"), China United Communications Corporation ("China Unicom") and China Telecommunications Corporation ("China Telecom"), and these operators also collect certain service fees (the "Internet and Mobile Service Fees") on behalf of the Group.

In collecting the Internet and Mobile Service Fees on behalf of the Group, these telecommunication operators are entitled to a fixed commission, which is calculated based on agreed percentages of the Internet and Mobile Service Fees received/receivable by them, plus, in certain cases, a fixed per-message adjustment for the excess of messages sent over messages received between the platforms of the Group and these operators (collectively defined as "Mobile and Telecom Charges"). The Mobile and Telecom Charges are withheld and deducted from the gross Internet and Mobile Service Fees collected by the operators from the users, with the net amounts remitted to the Group.

The Internet and Mobile Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by these operators to the Group on a monthly basis. The Group recognises the Internet and Mobile Service Fees as revenue on a gross basis and treats the Mobile and Telecom Charges as cost of revenues.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.24 Revenue recognition (Cont'd)

(a) Internet value-added services and mobile and telecommunications value-added services (Cont'd)

For the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on the historical data. The historical data used in estimating revenues includes the most recent three-month history of the Internet and Mobile Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between the network gateways of the Group and the mobile operators. Adjustments are made in subsequent periods in the event that the actual revenue amounts are different from the original estimates.

In addition, the Internet value-added services can also be paid by way of prepaid cards and tokens (represented a specific amount of payment unit) sold by the Group through non-mobile channels such as sales agents appointed by the Group, telecommunication operators, broadband service providers, Internet cafes and banks. The end users can register the prepaid cards and tokens to their user accounts in the Group's platforms and then access the Group's online products or relevant services. Receipts from the sales of prepaid cards and tokens are deferred and recorded as "Deferred revenue" in the statement of financial position (see Note 29). The amounts are then recognised as revenue based on the actual utilisation of the payment unit: (i) when the payment unit is used to purchase services, the revenue is recognised when the related services are rendered; (ii) when the payment unit is used to purchase virtual products/items in the Group's Internet platform, the revenue is recognised over the estimated lifespan of the respective virtual products/items.

(b) Online advertising

Online advertising revenues are mainly derived from fees for selling advertising space on the Group's websites, instant messaging client and game portal in the forms such as banners, links and logos, and delivery of search-based advertising by various means throughout the community created by the Group. Commissions payable to advertising agencies are recognised as a component of the cost of revenues.

For advertising contracts based on the actual time period that the advertisements appear on the Group's websites, instant messaging client or game portal, the revenues are recognised ratably over the period in which the advertisements are displayed.

2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

2.24 Revenue recognition (Cont'd)

(c) Interest income

Interest income is recognised on a time proportion basis, taking into account of the principal outstanding and the effective interest rate over the period to maturity, when it is determined that such income will accrue to the Group.

(d) Dividend income

Dividend income is recognised when the right to receive payment is established.

2.25 Government grants/subsidies

Grants/subsidies from government are recognised at their fair value where there is a reasonable assurance that the grants/subsidies will be received and the Group will comply with all attached conditions.

Under these circumstances, the grants/subsidies are recognised as income or matched with the associated costs which the grants/subsidies are intended to compensate.

2.26 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by lessors are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

2.27 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group and Company's financial statements in the period in which the dividend is approved by the Company's shareholders.

2.28 Research and development expenses

Research expenditure is recognised as an expense as incurred.

Costs incurred on development projects (relating to the design and testing of new or improved products) are capitalised as intangible assets when recognition criteria are fulfilled and tests for impairment are performed annually. Other development expenditures that do not meet those criteria are recognised as expenses as incurred. Development costs previously recognised as expenses are not recognised as an assets insubsequent periods. Capitalised development costs are amortised from the point at which the assets are ready for use on a straight-line basis over their useful lives, not exceeding five years.

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group is subject to a variety of financial risks: market risk (including foreign exchange risk, price risk and interest rate risk) and credit risk. The Group's overall risk management strategy seeks to minimise the potential adverse effects on the financial performance of the Group. Risk management is carried out by the senior management of the Group, including the executive directors of the Group.

(a) Market risk

i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government. Therefore, to maintain the flexibility in the Company's activities including payment of dividends, share repurchases and offshore investments, the Group holds some monetary assets denominated in USD or HKD subject to certain thresholds stated in its treasury mandate, and borrows some bank loans denominated in USD from time to time. This exposes the Group to foreign exchange risk.

There is no other written policy to manage the foreign exchange risk in relation to USD and HKD as management considers that such risk could not be effectively reduced in a low-cost way. However, the Group had entered into certain foreign exchange forward contracts arrangements for managing our foreign exchange risk in relation to banks loans denominated in USD. Details are disclosed in Note 26.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

i) Foreign exchange risk (Cont'd)

As at 31 December 2010, the Group and the Company's non-RMB monetary assets and liabilities are listed below.

Group

	Currency	**As at 31 December**	
	denomination	**2010**	2009
		RMB'000	RMB'000
Monetary assets			
Non-current assets			
Held-to-maturity investments	USD	**–**	341,410
Current assets			
Term deposits with initial term of over three months	USD	**15,664**	187,483
Term deposits with initial term of over three months	HKD	**34,054**	–
Cash and cash equivalents	USD	**2,528,206**	358,586
Cash and cash equivalents	HKD	**231,608**	202,224
Monetary liabilities			
Non-current liabilities			
Long-term payables	USD	**–**	25,606
Current liabilities			
Accounts payable	USD	**502,427**	50,657
Short-term bank borrowings	USD	**3,973,620**	–

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

i) Foreign exchange risk (Cont'd)

Company

	Currency denomination	**As at 31 December**	
		2010	2009
		RMB'000	RMB'000
Monetary assets			
Current assets			
Term deposits with initial term of over three months	USD	**635**	–
Cash and cash equivalents	USD	**35,281**	3,123
Cash and cash equivalents	HKD	**202,244**	98,913

During the year ended 31 December 2010, the Group reported exchange gains of approximately RMB34,189,000 (2009: exchange loss of RMB1,953,000) as a result of RMB appreciation against USD. The gains were recorded in finance costs, net in the consolidated income statement for the year ended 31 December 2010.

At 31 December 2010, if USD and HKD had strengthened/weakened by 5% (2009: 5%) against RMB with all other variables held constant, the profit for the year would have been approximately RMB83,326,000 lower/higher (2009: RMB50,672,000 higher/lower) , mainly as a result of foreign exchange gains/losses on translation of monetary assets and liabilities denominated in USD and HKD.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

ii) Price risk

The Group is exposed to price risk because of investments held by the Group, which are classified as available-for-sale financial assets. The Group is not exposed to commodity price risk. To manage its price risk arising from the investments, the Group diversifies its portfolio. The investment made by the Group is either for the purpose of improving investment yield and maintaining high liquidity level simultaneously, or for strategic purpose. Each investment is managed by senior management, including the executive directors, on a case-by-case basis.

The available-for-sale financial assets are held for strategic rather than trading purposes. The Group does not actively trade these investments.

The sensitivity analysis is determined based on the exposure to equity price risks of available-for-sale financial assets at the end of the reporting period. If equity prices of the respective instruments held by the Group had been 5% (2009: 5%) higher/lower as at 31 December 2010, the other comprehensive income would have been approximately RMB206,344,000 (2009: RMB7,673,000) higher/lower.

iii) Interest rate risk

The Group has interest-bearing assets including term deposits with initial term of over three months and cash and cash equivalents, details of which have been disclosed in Notes 19 and 20.

The Group's interest rate risk arises from borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the group to fair value interest rate risk. There is no other written policy on managing the interest rate risk and management is to minimise its impact on the income statement.

As mentioned in foreign exchange risk above, the Group had extended bank loans denominated in USD having fixed interest rate as at 31 December 2010. Concurrently upon the draw-down of these loans, the Group entered into forward foreign exchange contracts to buy USD by selling RMB at designated future periods which substantially coincide with the respective loan maturity dates (see Note 28 for details).

Other financial assets and liabilities do not have material interest rate risk.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

iii) Interest rate risk (Cont'd)

For the year ended 31 December 2010, if the average interest rate on term deposits with initial term of over three months, cash and cash equivalents and short-term bank borrowings had been 5% (2009: 5%) higher/lower with all other variables held constant, the profit for the year would have been approximately RMB11,045,000 (2009: RMB6,801,000) higher/lower as a result of higher/lower interest income.

The Company only had interest-bearing assets (term deposits with initial term of over three months and cash and cash equivalents) but no interest-bearing liabilities as at 31 December 2010 (2009: same).

(b) Credit risk

The Group is exposed to credit risk in relation to its cash and deposits (including restricted cash) placed with banks and financial institutions, financial assets held for trading, and other investments, as well as accounts and other receivables.

The carrying amount of each class of the above financial assets represents the Group's maximum exposure to credit risk in relation to the corresponding class of financial assets.

To manage this risk, deposits are mainly placed with state-owned financial institutions in the PRC and reputable international financial institutions outside of the PRC. There has been no recent history of default in relation to these financial institutions.

For accounts receivable, as mentioned in Note 2.24(a), a large portion of Internet and Mobile Service Fees is derived from the co-operative arrangements with China Mobile, China Unicom and China Telecom. If the strategic relationship with the telecommunications operators is terminated or scaled-back; or if the telecommunications operators alter the co-operative arrangements; or if they experience financial difficulties in paying us, the Group's mobile and telecommunications value-added services and Internet value-added services might be adversely affected in terms of recoverability of receivables.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(b) Credit risk (Cont'd)

To manage this risk, the Group maintains frequent communications with the telecommunication operators to ensure the relevant co-operation is running effectively and smoothly. In view of our history of co-operation with the telecommunication operators and the sound collection history of the receivables due from them, management believes that the credit risk inherent in the Group's outstanding accounts receivable balances from these telecommunications operators is low (see Note 17 for details).

For accounts receivable from advertising customers, which are mainly advertising agencies, the credit quality of each customer is assessed, which takes into account its financial position, past experience and other factors. Normally, prepayments representing a certain percentage of the total service fees for each advertising service are required.

(c) Liquidity risk

The Group aims to maintain sufficient cash and cash equivalents and marketable securities. Due to the dynamic nature of the underlying businesses, the Group's finance department maintains flexibility in funding by maintaining adequate cash and cash equivalent.

The table below analyses the Group's and the Company's financial liabilities and net-settled derivative financial liabilities by relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(c) Liquidity risk (Cont'd)

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
Group					
At 31 December 2010					
Short-term bank borrowings	**5,298,947**	**–**	**–**	**–**	**5,298,947**
Derivative financial instruments	**17,964**	**–**	**–**	**–**	**17,964**
Accounts payable, other payables and accruals (excluding prepayments received from customers)	**4,303,649**	**–**	**–**	**–**	**4,303,649**
Total	**9,620,560**	**–**	**–**	**–**	**9,620,560**
At 31 December 2009					
Short-term bank borrowings	202,322	–	–	–	202,322
Long-term payables	–	111,747	174,892	–	286,639
Accounts payable, other payables and accruals (excluding prepayment received from customers)	2,250,626	–	–	–	2,250,626
Total	2,452,948	111,747	174,892	–	2,739,587

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(c) Liquidity risk (Cont'd)

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
Company					
At 31 December 2010					
Amounts due to subsidiaries	**1,833,802**	**–**	**–**	**–**	**1,833,802**
Other payables and accruals	**56,279**	**–**	**–**	**–**	**56,279**
Total	**1,890,081**	**–**	**–**	**–**	**1,890,081**
At 31 December 2009					
Amounts due to subsidiaries	1,107,184	–	–	–	1,107,184
Other payables and accruals	24,517	–	–	–	24,517
Total	1,131,701	–	–	–	1,131,701

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to enhance shareholders' value in the long term.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or redeem the Company's shares.

The Group monitors capital by regularly reviewing the gearing ratio. The gearing ratio is calculated as total liabilities divided by total assets. The total capital is the "total equity" of the Group as shown in the consolidation statement of financial position, which is also equal to total assets less total liabilities.

The gearing ratios as at 31 December 2010 and 2009 were as follows:

	2010	2009
	RMB'000	RMB'000
Total liabilities	**13,989,256**	5,207,112
Total assets	**35,830,114**	17,505,765
Gearing ratio	**39%**	30%

The increase in gearing ratio as at 31 December 2010 was mainly due to the increase in bank borrowings.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.3 Fair value estimation

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table presents the Group's assets and liabilities that are measured as at fair value at 31 December 2010.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Available-for-sale financial assets				
– equity securities	**3,869,033**	**–**	**257,845**	**4,126,878**
Total	**3,869,033**	**–**	**257,845**	**4,126,878**
Liabilities				
Financial liabilities				
at fair value through profit or loss				
– derivative financial instruments	**–**	**17,964**	**–**	**17,964**
Total	**–**	**17,964**	**–**	**17,964**

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.3 Fair value estimation (Cont'd)

The following table presents the Group's assets that are measured as at fair value at 31 December 2009.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Available-for-sale financial assets				
– equity securities	–	–	153,462	153,462
Total	–	–	153,462	153,462

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- Dealer quotes for similar instruments.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the end of the reporting period, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for financial instruments.

There were no transfers of financial assets between level 1 and level 2 fair value hierarchy classifications.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.3 Fair value estimation (Cont'd)

The following table presents the changes in level 3 instruments for the year ended 31 December 2010:

	Available-for-sale financial assets RMB'000
Opening balance	**153,462**
Additions	**131,192**
Transfer to investment in associates	**(26,809)**
Closing balance	**257,845**

The following table presents the changes in level 3 instruments for the year ended 31 December 2009:

	Available-for-sale financial assets RMB'000
Opening balance	86,180
Additions	67,282
Closing balance	153,462

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Recognition of Internet value-added services and mobile and telecommunications value-added services

As mentioned in Note 2.24(a), for the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the accounts receivable based on the historical data.

As at 31 December 2010, the balance of accounts receivable not yet confirmed by China Mobile, China Unicom and China Telecom and their subsidiaries was estimated to be RMB479,134,000 (2009: RMB379,698,000).

Were the actual outcome to differ by 5% (2009: 5%) from management's estimates, the Group would need to:

- reduce the revenue and accounts receivable by RMB23,957,000 (2009: RMB18,985,000) if unfavourable; or
- increase the revenue and accounts receivable by RMB23,957,000 (2009: RMB18,985,000) if favourable.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont'd)

4.1 Critical accounting estimates and assumptions (Cont'd)

(b) Recognition of share-based compensation expenses

As mentioned in Note 2.22(c), the Group has granted share options to its employees. The directors have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement on parameters, such as risk free rate, dividend yield and expected volatility, is required to be made by the directors in applying the BS Model (Note 23).

The fair value of options granted for the year ended 31 December 2010 determined using the BS Model was approximately HKD251,307,000 (2009: HKD116,915,000).

In addition, the Group has also granted awarded shares to its employees at the fair value of HKD666,732,000 during 2010 (2009: HKD849,595,000).

The Group has to estimate the expected yearly percentage of grantees of share options/awarded shares who will stay within the Group at the end of the vesting periods ("Expected Retention Rate of Grantees") to determine the amount of share-based compensation expenses charged into the income statement. As at 31 December 2010, the Expected Retention Rate of Grantees is assessed to be 91% (2009: 91%).

If the Expected Retention Rate of Grantees had been increased/decreased by 5% (2009: 5%), the amount of share-based compensation expenses would be increased/decreased by RMB32,315,000 (2009: RMB20,595,000).

(c) The estimates of the lifespan of virtual products/items provided in the Group's Internet platform

As mentioned in Note 2.24(a), the end users purchase certain virtual products/items provided in the Group's Internet platforms and the relevant revenue is recognsied based on the lifespan of the virtual products/items. The Group uses the available information, including the historical user pattern and behavior and the stipulated period of validity of the relevant virtual products/items, to estimate the lifespan of these products/items.

The Group will continue to monitor the average lifespan of the virtual products/items (provided and to be provided), which may differ from the historical period, and any change in the estimates may result in the revenue being recognised on a different basis than in prior periods.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont'd)

4.1 Critical accounting estimates and assumptions (Cont'd)

(d) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact current income tax and deferred income tax liabilities in the period in which such determination is made.

Were the actual final outcome (on the judgement areas) to differ by 5% from management's estimates, the group would need to:

- Increase the income tax liabilities by RMB17,055,000 and the deferred tax liabilities by RMB48,361,000 , if unfavourable; or
- Decrease the income tax liabilities by RMB17,055,000 and the deferred tax liabilities by RMB48,361,000, if favourable.

4.2 Critical judgments in applying the Group's accounting policies

Recognition of deferred tax assets

Certain intra-group software and technology sales have been transacted within the Group. The self-developed software and technology purchased by two subsidiary companies, Tencent Computer and Shiji Kaixuan, from other group companies have been initially recorded at the purchase prices as costs and then amortised over their contracted useful lives (the "Amortisation") in their local statutory financial statements, while these transactions were eliminated at the group level.

The Amortisation has been treated as a deductible expense in ascertaining the assessable profits of Tencent Computer and Shiji Kaixuan for tax reporting purposes while the costs of purchase of these assets were eliminated in preparation of the consolidated financial statements of the Group. As a result, deferred tax assets have been recognised, based on temporary differences arising from the accounting base (at the group level, which is zero) and the tax base of the software and technology involved in these intragroup transactions, at the respective enacted corporate income tax rates of Tencent Computer and Shiji Kaixuan.

As at 31 December 2010, the relevant deferred tax assets were approximately RMB219,019,000 (2009: RMB301,016,000) (Note 30), which are expected to be recovered by the tax profits to be generated from Tencent Computer and Shiji Kaixuan in future.

5 SEGMENT INFORMATION

The chief operating decision-makers mainly include executive directors of the Company. They review the Group's internal reporting in order to assess performance and allocate resources, and determine the operating segments based on these reports.

The Group has following reportable segments for the years ended 31 December 2010 and 2009:

– Internet value-added services;

– Mobile and telecommunications value-added services;

– Online advertising; and

– Others.

Other segments of the Group are mainly comprised of the provision of online payments services and trademark licensing.

The chief operating decision-makers assess the performance of the operating segments based on segment revenue and gross profit/(loss) of each operating segment. The selling and marketing expenses and general and administrative expenses are common costs incurred for the operating segments as a whole and therefore, they are not included in the measure of the segments' profit that is used by the chief operating decision-makers as a basis for the purpose of resource allocation and assessment of segment performance. Interest income, other gains/(losses), net, finance costs, net and income tax expense are also not allocated to individual operating segments.

There were no inter-segment sales during the year ended 31 December 2010 and 2009. The revenues from external customers reported to the executive directors are measured in a manner consistent with that in the consolidated income statement.

Other information, together with segment information, provided to the chief operating decision-makers, is measured in a manner consistent with that in the annual report. There were no segment assets and segment liabilities information provided to the chief operating decision-makers.

5 SEGMENT INFORMATION (Cont'd)

The segment information provided to the chief operating decision-makers for the reportable segments for the years ended 31 December 2010 and 2009 is as follows:

Year ended 31 December 2010	**Internet value-added services RMB'000**	**Mobile and telecom-munications value-added services RMB'000**	**Online advertising RMB'000**	**Others RMB'000**	**Total RMB'000**
Segment revenues (revenues from external customers)	**15,482,301**	**2,715,931**	**1,372,522**	**75,277**	**19,646,031**
Gross profit/(loss)	**10,719,866**	**1,705,073**	**931,220**	**(30,328)**	**13,325,831**
Depreciation	**374,991**	**35,264**	**21,884**	**13,923**	**446,062**
Amortisation	**37,033**	**–**	**–**	**–**	**37,033**
Share of profit of associates	**67,563**	**4,796**	**–**	**–**	**72,359**

Year ended 31 December 2009	Internet value-added services RMB'000	Mobile and telecom-munications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Segment revenues (revenues from external customers)	9,530,711	1,905,599	962,171	41,479	12,439,960
Gross profit/(loss)	6,741,486	1,177,852	664,563	(33,409)	8,550,492
Depreciation	141,427	17,956	7,063	7,114	173,560
Amortisation	73,772	–	–	–	73,772
Share of profit of associates	15,957	6,249	–	–	22,206

The reconciliation of operating profit to profit before tax is shown in the consolidated income statement.

5 SEGMENT INFORMATION (Cont'd)

The Company is domiciled in the Cayman Islands while the Group mainly operates its businesses in the PRC. For the year ended 31 December 2010, revenues from external customers in the PRC (excluding Hong Kong) were RMB19,632,117,000 (2009: RMB12,434,311,000), and revenues from external customers in other areas were RMB13,914,000 (2009: RMB5,649,000).

The Group also held financial instruments as investments which were traded in other territories, and the geographical information on the total assets is as follows:

	Total assets	
	2010	2009
	RMB'000	RMB'000
Operating assets		
– The PRC	**27,720,196**	15,807,881
– United States	**13,772**	7,176
Investments		
– The PRC (excluding Hong Kong)	**446,608**	90,244
– Hong Kong	**2,734,762**	564,321
– Other Asian countries	**886,024**	644,784
– United States	**159,719**	49,949
– Europe	**3,869,033**	341,410
Consolidated	**35,830,114**	17,505,765

Assets outside the PRC are mainly investments in associates, investment in a jointly controlled entity, available-for-sale financial assets, term deposits with initial term of over three months and cash and cash equivalents. As at 31 December 2010, the total of non-current assets other than financial instruments and deferred tax assets located in the PRC was RMB5,282,748,000 (2009: RMB3,007,274,000), and the total of these non-current assets located in other countries was RMB827,728,000 (2009: RMB465,355,000).

All the revenues derived from any single external customer were less than 10% of the Group's total revenues for the year ended 31 December 2010.

Turnover consists of revenues generated by the Group, which were RMB19,646,031,000 and RMB12,439,960,000 for the years ended 31 December 2010 and 2009, respectively.

6 FIXED ASSETS

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
At 1 January 2009						
Cost	170,410	1,402,087	43,171	7,049	117,826	1,740,543
Accumulated depreciation and impairment	(8,102)	(472,929)	(15,676)	(4,489)	(74,299)	(575,495)
Net book amount	162,308	929,158	27,495	2,560	43,527	1,165,048
Year ended 31 December 2009						
Opening net book amount	162,308	929,158	27,495	2,560	43,527	1,165,048
Additions	1,128,661	595,703	30,998	1,069	4,662	1,761,093
Disposals	–	(552)	(634)	–	(2,452)	(3,638)
Depreciation	(38,734)	(353,488)	(9,557)	(1,109)	(2,413)	(405,301)
Closing net book amount	1,252,235	1,170,821	48,302	2,520	43,324	2,517,202
At 31 December 2009						
Cost	1,299,071	1,955,282	68,837	8,118	90,368	3,421,676
Accumulated depreciation and impairment	(46,836)	(784,461)	(20,535)	(5,598)	(47,044)	(904,474)
Net book amount	1,252,235	1,170,821	48,302	2,520	43,324	2,517,202

6 FIXED ASSETS (Cont'd)

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
Year ended 31 December 2010						
Opening net book amount	1,252,235	1,170,821	48,302	2,520	43,324	2,517,202
Business combinations	–	2,174	316	–	–	2,490
Additions	68,761	1,273,450	57,135	575	42,486	1,442,407
Disposals	–	(338)	(23)	(75)	(255)	(691)
Depreciation	(59,458)	(574,870)	(17,072)	(1,065)	(16,115)	(668,580)
Closing net book amount	1,261,538	1,871,237	88,658	1,955	69,440	3,292,828
At 31 December 2010						
Cost	1,368,462	3,185,873	125,816	7,636	130,305	4,818,092
Accumulated depreciation and impairment	(106,924)	(1,314,636)	(37,158)	(5,681)	(60,865)	(1,525,264)
Net book amount	1,261,538	1,871,237	88,658	1,955	69,440	3,292,828

For the year ended 31 December 2010, depreciation of RMB446,062,000 (2009: RMB173,560,000), RMB12,198,000 (2009: RMB5,377,000) and RMB210,320,000 (2009: RMB226,364,000) were charged in cost of revenues, selling and marketing expenses and general and administrative expenses, respectively.

7 CONSTRUCTION IN PROGRESS

	2010 RMB'000	2009 RMB'000
Opening net book amount	105,771	875,897
Additions	410,362	323,673
Transfer to fixed assets	(129,190)	(1,093,799)
Closing net book amount	386,943	105,771

As at 31 December 2010, the construction in progress mainly represented the construction costs and other direct development costs of properties under construction located in Tianjin, the PRC.

8 INVESTMENT PROPERTIES

	2010	2009
	RMB'000	RMB'000
Opening net book amount	**68,025**	64,981
Additions	**247**	68,183
Transfer to fixed assets	**(29,763)**	(64,564)
Depreciation	**(1,280)**	(575)
Closing net book amount	**37,229**	68,025

The following amounts have been recognised in the consolidated income statement:

	2010	2009
	RMB'000	RMB'000
Rental income	**2,166**	3,060
Direct operating expenses arising from investment properties that generates rental income	**(1,267)**	(729)

The investment properties as at 31 December 2010 mainly represented certain units in office buildings in Chengdu, the PRC.

The fair value of the investment properties was estimated to be approximately RMB53,492,000 (2009: RMB80,425,000) as at 31 December 2010, which was based on current prices in an active market for similar buildings in the same district.

The period of leases whereby the Group leases its investment properties under operating leases is within 3 years.

8 INVESTMENT PROPERTIES (Cont'd)

The future aggregate minimum rentals receivable under non-cancellable operating leases are as follows:

	2010	2009
	RMB'000	RMB'000
Not later than one year	**1,107**	4,500
Later than one year and no later than five years	**2,400**	10,400
	3,507	14,900

9 LAND USE RIGHTS

	2010	2009
	RMB'000	RMB'000
Opening net book amount	**35,296**	36,046
Additions	**198,318**	–
Amortisation		
– capitalised in construction in progress	**–**	(284)
– charge to income statement	**(3,724)**	(466)
Closing net book amount	**229,890**	35,296

The land use rights all relate to land in the PRC with a lease period of 50 years. For the year ended 31 December 2010, RMB3,724,000 (2009: RMB466,000) of the amortisation were charged to general and administrative expenses.

10 INTANGIBLE ASSETS

	Goodwill RMB'000	Computer software and technology RMB'000	Licences RMB'000	Others RMB'000	Total RMB'000
At 1 January 2009					
Cost	62,234	231,075	196,206	111,286	600,801
Accumulated amortisation and impairment	–	(58,417)	(65,927)	(106,143)	(230,487)
Net book amount	62,234	172,658	130,279	5,143	370,314
Year ended 31 December 2009					
Opening net book amount	62,234	172,658	130,279	5,143	370,314
Additions	–	30,172	600	1,178	31,950
Disposals	–	(1,654)	–	–	(1,654)
Amortisation charge	–	(51,109)	(79,213)	(1,575)	(131,897)
Closing net book amount	62,234	150,067	51,666	4,746	268,713
At 31 December 2009					
Cost	62,234	257,817	196,806	14,497	531,354
Accumulated amortisation and impairment	–	(107,750)	(145,140)	(9,751)	(262,641)
Net book amount	62,234	150,067	51,666	4,746	268,713

10 INTANGIBLE ASSETS (Cont'd)

	Goodwill RMB'000	Computer software and technology RMB'000	Licences RMB'000	Others RMB'000	Total RMB'000
Year ended 31 December 2010					
Opening net book amount	62,234	150,067	51,666	4,746	268,713
Business combinations	240,467	32,134	324	26,116	299,041
Additions	–	87,887	25,000	1,751	114,638
Amortisation charge	–	(39,091)	(62,975)	(7,345)	(109,411)
Closing net book amount	302,701	230,997	14,015	25,268	572,981
At 31 December 2010					
Cost	302,701	377,838	222,130	42,364	945,033
Accumulated amortisation and impairment	–	(146,841)	(208,115)	(17,096)	(372,052)
Net book amount	302,701	230,997	14,015	25,268	572,981

Amortisation of RMB72,378,000 (2009: RMB58,125,000) and RMB37,033,000 (2009: RMB73,772,000) were charged to general and administrative expenses and cost of revenues respectively for the year ended 31 December 2010.

10 INTANGIBLE ASSETS (Cont'd)

Impairment tests for goodwill

Goodwill is allocated to the Group's CGUs identified according to operating segments. Most of the goodwill is related to the operating segment of Internet value-added services.

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rate stated below. The growth rate does not exceed the long-term average growth rate for the Internet value-added services business in which the CGU operates.

The key assumptions used for value-in-use calculations in 2010 for the goodwill arising from the business combination mentioned in Note 43 are as follows:

Gross margin	60%
Growth rate	3%
Discount rate	17%

Based on the assessment made by management, no impairment on goodwill was required as at 31 December 2010.

11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY

(a) Investments in subsidiaries

The amount represents investments in equity interests in subsidiaries of the Company. Details are as follows:

	2010	2009
	RMB'000	RMB'000
Investments in subsidiaries:		
– investments in equity interests - at cost, unlisted	**52**	48
– deemed investments arising from share-based compensation (Note i)	**1,199,663**	703,563
– advance to subsidiaries (Note iv)	**1,635,137**	1,278,125
	2,834,852	1,981,736

11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(a) Investments in subsidiaries (Cont'd)

The following is a list of principal subsidiaries of the Company as at 31 December 2010:

Name	Place and date of establishment and nature of legal entity	Particulars of issued/ paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2010		2009		
			Direct	Indirect	Direct	Indirect	
Tencent Computer	Established on 11 November 1998 in the PRC, private limited liability company	RMB20,000,000	–	100% (Note ii)	–	100% (Note ii)	Provision of Internet and mobile and telecommunications value-added services, and Internet advertisement services
Tencent Technology	Established on 24 February 2000 in the PRC, wholly foreign owned enterprise	USD2,000,000	–	100%	–	100%	Development of computer software and provision of information service
Shiji Kaixuan	Established on 13 January 2004 in the PRC, private limited liability company	RMB11,000,000	–	100% (Note ii)	–	100% (Note ii)	Provision of Internet advertisement service
Tencent Cyber (Tianjin) Company Limited ("Cyber Tianjin")	Established on 8 February 2004 in the PRC, wholly foreign owned enterprise	USD80,000,000	–	100%	–	100%	Development of computer software and provision of information technology services
Tencent Asset Management Limited	Established on 7 July 2004 in BVI, private limited liability company	USD100	100%	–	100%	–	Asset management
Tencent Technology (Beijing) Company Limited ("Tencent Beijing")	Established on 30 March 2005 in the PRC, wholly foreign owned enterprise	USD1,000,000	–	100%	–	100%	Development of computer software and provision of information techonology services
Wang Dian	Established on 5 January 2000 in the PRC, private limited liability company	RMB10,290,000	–	100% (Note ii)	–	100% (Note ii)	Provision of mobile and telecommunications value-added services

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010
(All amounts in RMB unless otherwise stated)

11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(a) Investments in subsidiaries (Cont'd)

The following is a list of principal subsidiaries of the Company as at 31 December 2010: (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/ paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2010		2009		
			Direct	Indirect	Direct	Indirect	
Beijing BIZCOM	Established on 11 June 2002 in the PRC, private limited liability company	RMB16,500,000	–	100% (Note ii)	–	100% (Note ii)	Provision of mobile and telecommunications value-added services
Beijing Starsinhand	Established on 13 July 2005 in the PRC, private limited liability company	RMB10,000,000	–	100% (Note ii)	–	100% (Note ii)	Provision of mobile and telecommunications value-added services
Beijing Yonghang Technology Company Limited ("Beijing Yonghang")	Established on 21 January 2005 in the PRC, private limited liability company	RMB15,000,000	–	63.9% (Note iii)	–	63.9% (Note iii)	Development of online games
Shenzhen Domain Computer Network Company Limited ("Shenzhen Domain")	Established on 28 April 1997 in the PRC, private limited liability company	RMB10,000,000	–	100% (Note iii)	–	60.2% (Note iii)	Development and provision of online games
Tencent Cyber (Shenzhen) Company Limited ("Cyber Shenzhen")	Established on 17 January 2007 in the PRC, wholly foreign owned enterprise	USD30,000,000	–	100%	–	100%	Development of computer software
Tencent Technology (Shanghai) Company Limited ("Tencent Shanghai")	Established on 23 July 2008 in the PRC, wholly foreign owned enterprise	USD5,000,000	–	100%	–	100%	Development of computer software and provision of Internet information services

11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(a) Investments in subsidiaries (Cont'd)

The following is a list of principal subsidiaries of the Company as at 31 December 2010: (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/ paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2010		2009		
			Direct	Indirect	Direct	Indirect	
Tencent Technology (Chengdu) Company Limited ("Tencent Chengdu")	Established on 10 July 2008 in the PRC, wholly foreign owned enterprise	USD30,000,000	–	100%	–	100%	Development of computer software and provision of information technology services

Notes:

(i) The amount represents share-based compensation expenses arising from grant of share options and awarded shares of the Company to employees of subsidiaries in exchange for their services provided to the subsidiaries, which were deemed to be investment made by the Company into these subsidiaries.

(ii) As described in Note 1, the Company does not have legal ownership in equity of these subsidiaries. Nevertheless, under certain contractual agreements entered into with the registered owners of these subsidiaries, the Company and its other legally owned subsidiaries control these companies by way of controlling the voting rights, governing their financial and operating policies, appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. In addition, such contractual agreements also transfer the risks and rewards of these companies to the Company and/or its legally owned subsidiaries. As a result, they are presented as consolidating subsidiaries of the Company.

(iii) These equity interests are directly owned by Tencent Computer or Shiji Kaixuan or Beijing BIZCOM, in which the Company has indirect beneficial interests through the contractual arrangements described in Note (ii) above.

(iv) These mainly represent loans from equity owners extended to Cyber Tianjin, Tencent Chengdu and investment in associates. All these balances are unsecured and interest-free and their repayments are neither planned nor likely to occur in the foreseeable future.

11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

(b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries as at 31 December 2010 represented current account balances maintained by the Company with certain subsidiaries. All balances are unsecured and interest-free and the balances are repayable on demand. The non-current portion of the amounts due from subsidiaries as at 31 December 2009 represented an advance made to Tencent Asset Management Limited for financing its acquisition of a held-to-maturity financial instrument, which will mature in 2013. During the year ended 31 December 2010, the Group had early redeemed the instrument and the advance was fully settled by Tencent Asset Management Limited.

As at 31 December 2010, the amounts due from subsidiaries were neither past due nor impaired.

(c) Consolidation of a special purpose entity

In connection with the implementation of the share award scheme of the Group mentioned in Note 23(b), the Company has set up a special purpose entity, and its particulars are as follows:

Special purpose entity	Principal activities
Share Scheme Trust	Administering and holding the Company's shares acquired for a share award scheme which is set up for the benefits of eligible employees of the Group

As the Company has the power to govern the financial and operating policies of the Share Scheme Trust and can derive benefits from the contributions of the employees who are awarded with the shares by the scheme through their continued employment with the Group, the directors of the Company consider that it is appropriate to consolidate the Share Scheme Trust in accordance with the requirements of IFRS SIC 12 - Consolidation - Special Purpose Entities.

For the year ended 31 December 2010, the Company contributed approximately RMB163,395,000 (2009: RMB103,669,000) to the Share Scheme Trust for financing its acquisition of the Company's shares. RMB167,519,000 (2009: RMB103,618,000) was paid as the consideration for acquiring 1,184,883 ordinary shares (2009: 1,013,100 shares) of the Company, which have been treated as "Shares held for share award scheme" (see Note 23(b)).

12 INVESTMENT IN ASSOCIATES

	2010	2009
	RMB'000	RMB'000
Beginning of the year	477,622	302,712
Additional investments in associates	97,087	143,836
Acquisitions of associates	412,094	8,868
Transfer from available-for-sale financial assets	26,809	–
Share of profit of associates	72,359	22,206
Dividends received from associates	(15,338)	–
End of the year	1,070,633	477,622

During the year ended 31 December 2010, the Group acquired equity interests in seven associates ranging from 10% to 49.0%. They are principally engaged in online games development and operations and advertising business. They are based in the PRC, Southeast Asia, East Asia and the United States.

For the associate which the Group only holds 10% equity interest, the Group has representation on its board of directors in order to facilitate the Group to exercise its significant influence in the company through participation in the financial and operating policy decisions of the company. In addition, the Group also acquired additional equity interests in two then existing investee companies reported as available-for-sale investments during 2010. As a result, they became associates of the Group. These two companies are principally engaged in online games operations and mobile games operations in the United States and the PRC, respectively.

Apart from the investments described above, as at 31 December 2010, the Group's investment in associates also included 30.02% (2009: 30.02%) equity interest in a Southeast Asia online game company, 27.25% (2009: 25%) equity interest in a venture capital fund in East Asia (excluding the PRC), as well as equity interests in several mobile game developers in the PRC.

Investment in associates at 31 December 2010 included goodwill of RMB324,024,000 (2009: RMB201,603,000) arising from acquisitions.

As at 31 December 2010 and 2009, there were certain call options embedded in investments in associates. The directors consider the fair value of such call options was insignificant and accordingly, the Group did not separately recognise these call options in the financial statements.

12 INVESTMENT IN ASSOCIATES (Cont'd)

The Group's share of the results of its associates, all of which are unlisted, and its aggregated assets (including goodwill) and liabilities, are shown in aggregate as follows:

	Assets RMB'000	**Liabilities RMB'000**	**Revenues RMB'000**	**Profit RMB'000**
2010				
A Southeast Asia based online game company, 30.02% equity interest	**471,650**	**22,879**	**191,261**	**34,684**
A United States based online game company, 22.34% equity interest	**124,472**	**13,223**	**31,072**	**7,729**
A PRC advertising media company, 10% equity interest	**148,250**	**17,950**	**–**	**–**
A PRC based online game company, 50% equity interest	**98,272**	**3,465**	**20,794**	**7,681**
Other associates (Note)	**318,079**	**32,573**	**96,386**	**22,265**
	1,160,723	**90,090**	**339,513**	**72,359**

	Assets RMB'000	Liabilities RMB'000	Revenues RMB'000	Profit RMB'000
2009				
An Southeast Asia based online game company, 30.02% equity interest	436,290	22,203	152,934	15,957
Other associates (Note)	65,933	2,398	18,353	6,249
	502,223	24,601	171,287	22,206

Note:

The carrying amount of each individual associate as at 31 December 2010 was below RMB80,000,000 (2009: Below RMB50,000,000).

13 INVESTMENT IN A JOINTLY CONTROLLED ENTITY

	2010	2009
	RMB'000	RMB'000
Beginning of the year	**–**	–
Additions	**71,143**	–
Share of profit of a jointly controlled entity	**3,399**	–
End of the year	**74,542**	–

In August 2010, the Group acquired 49.92% equity interest of an Internet service company in Thailand with a total consideration of USD10,501,000 (approximately RMB71,143,000). The vendor is a wholly-owned subsidiary of Naspers Limited, the holding company of MIH China (BVI) Limited, which is the substantial shareholder of the Company. Accordingly, the transaction was regarded as related parties transaction.

The Group's share of the results of its jointly controlled entity, which is unlisted, and its assets (including goodwill) and liabilities, are shown as follows:

	Assets	**Liabilities**	**Revenues**	**Profit**
	RMB'000	**RMB'000**	**RMB'000**	**RMB'000**
2010				
A jointly controlled entity	**235,827**	**161,285**	**10,329**	**3,399**

14 FINANCIAL INSTRUMENTS BY CATEGORY

The Group

	Loans and receivables RMB'000	Available-for-sale financial assets RMB'000	Held-to-maturity investments RMB'000	Total RMB'000
Assets				
At 31 December 2010				
Available-for-sale financial assets (Note 16)	**–**	**4,126,878**	**–**	**4,126,878**
Accounts receivable (Note 17)	**1,715,412**	**–**	**–**	**1,715,412**
Deposits and other receivables	**281,126**	**–**	**–**	**281,126**
Term deposits with initial term of over three months (Note 19)	**11,725,743**	**–**	**–**	**11,725,743**
Restricted cash (Note 28)	**1,036,457**	**–**	**–**	**1,036,457**
Cash and cash equivalents (Note 20)	**10,408,257**	**–**	**–**	**10,408,257**
Total	**25,166,995**	**4,126,878**	**–**	**29,293,873**
At 31 December 2009				
Available-for-sale financial assets (Note 16)	–	153,462	–	153,462
Accounts receivable (Note 17)	1,229,436	–	–	1,229,436
Deposits and other receivables	223,618	–	–	223,618
Held-to-maturity investments (Note 15)	–	–	341,410	341,410
Term deposits with initial term of over three months (Note 19)	5,310,168	–	–	5,310,168
Restricted cash (Note 28)	200,000	–	–	200,000
Cash and cash equivalents (Note 20)	6,043,696	–	–	6,043,696
Total	13,006,918	153,462	341,410	13,501,790

14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

The Group (Cont'd)

	Liabilities at fair value through the profit or loss RMB'000	Other financial liabilities at amortised cost RMB'000	Total RMB'000
Liabilities			
At 31 December 2010			
Accounts payable (Note 24)	**–**	**1,380,464**	**1,380,464**
Other payables and accruals (excluded prepayment received from customers)	**–**	**2,923,185**	**2,923,185**
Short-term bank borrowings (Note 28)	**–**	**5,298,947**	**5,298,947**
Derivative financial instruments	**17,964**	**–**	**17,964**
Total	**17,964**	**9,602,596**	**9,620,560**
At 31 December 2009			
Accounts payable (Note 24)	–	696,511	696,511
Other payables and accruals (excluded prepayment received from customers)	–	1,554,115	1,554,115
Long-term payables (Note 27)	–	274,050	274,050
Short-term bank borrowings (Note 28)	–	202,322	202,322
Total	–	2,726,998	2,726,998

14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

The Company

	Loans and receivables RMB'000	Available-for-sale financial assets RMB'000	Total RMB'000
Assets			
At 31 December 2010			
Amounts due from subsidiaries (Note 11(b))	**708,074**	**–**	**708,074**
Deposits and other receivables	**3,721**	**–**	**3,721**
Term deposits with initial term of over three months (Note 19)	**635**	**–**	**635**
Cash and cash equivalents (Note 20)	**237,525**	**–**	**237,525**
Total	**949,955**	**–**	**949,955**
At 31 December 2009			
Available-for-sale financial assets	–	14,758	14,758
Amounts due from subsidiaries (Note 11(b))	1,402,232	–	1,402,232
Deposits and other receivables	7,522	–	7,522
Cash and cash equivalents (Note 20)	102,081	–	102,081
Total	1,511,835	14,758	1,526,593

14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

The Company (Cont'd)

	Other financial liabilities at amortised cost RMB'000
Liabilities	
At 31 December 2010	
Amounts due to subsidiaries	**1,833,802**
Other payables and accruals	**56,279**
Total	**1,890,081**
At 31 December 2009	
Amounts due to subsidiaries	1,107,184
Other payables and accruals	24,517
Total	1,131,701

15 HELD-TO-MATURITY INVESTMENTS

As at 31 December 2009, the held-to-maturity investments represented a USD principal protected note with a principal amount of USD50,000,000. The note was interest bearing at a fixed annual rate and would mature in 2013. During the year ended 31 December 2010, the Group had early redeemed this investment.

16 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2010	2009
	RMB'000	RMB'000
Beginning of the year	153,462	86,180
Additions	2,179,096	67,282
Transfer to investment in associates	(26,809)	–
Net gains recognised in other comprehensive income (Note 22)	1,821,129	–
End of the year	4,126,878	153,462
Non-current portion	4,126,878	153,462

Available-for-sale financial assets include the following:

	2010	2009
Listed equity interests:		
7.56% (2009: Nil) economic interest in Mail.ru Group Limited	3,869,033	–
Unlisted equity interests:		
8.30% (2009: Nil) equity interest in an online game company in Korea	68,263	–
14.56% (2009: 14.56%) equity interest in an online game company in the PRC	40,000	40,000
13.99% (2009: 13.99%) equity interest in an online game company in Korea	37,017	37,017
10% (2009: 6%) equity interest in an Internet company in India	33,198	14,758
19.71 % (2009: 10.90%) equity interest in an online game company in Korea	26,207	8,118
10.70% (2009: 10.70%) equity interest in an Internet search engine service company in the PRC	20,477	20,477
Others	32,683	33,092
	4,126,878	153,462
Market value of listed securities	3,869,033	–

16 AVAILABLE-FOR-SALE FINANCIAL ASSETS (Cont'd)

On 12 April 2010, the Group and Digital Sky Technology Limited ("DST"), a company incorporated in BVI and one of the largest Internet companies in the Russian-speaking and Eastern European markets, entered into a share subscription agreement pursuant to which the Group subscribed for an aggregate of 8,114 ordinary shares of DST for a total cash consideration at USD300,002,000 (approximately RMB2,047,904,000). After completion of the transaction, the Group held approximately 10.3% economic interest in DST and 0.5% of the total voting rights of DST.

DST then changed its name to Mail.ru Group Limited ("Mail.ru") and completed its Initial Public Offering ("IPO") in November 2010. The global depositary receipts ("GDRs") of Mail.ru (each GDR representing one ordinary share) commenced their unconditional trading in the London Stock Exchange on 11 November 2010. After the IPO, the Group held 16,228,000 ordinary shares in Mail.ru, representing approximately 7.56% economic interest in the company on a fully diluted basis. The Group's interest in Mail.ru is subject to a 180-day lock-up period.

At 31 December 2010, the carrying amount of the interest in Mail.ru held by the Company exceeded 10% of total assets of the Company and the Group.

As at 31 December 2010 and 2009, there were certain call options embedded in available-for-sale financial assets. The directors considered that the fair value of such call options was insignificant and accordingly, the Group did not separately recognise these call options in the financial statements.

17 ACCOUNTS RECEIVABLE

	2010	2009
	RMB'000	RMB'000
0 - 30 days	**931,438**	690,858
31 - 60 days	**331,922**	173,331
61 - 90 days	**143,785**	112,752
Over 90 days but less than a year	**308,267**	252,495
	1,715,412	1,229,436

All accounts receivable are denominated in RMB.

17 ACCOUNTS RECEIVABLE (Cont'd)

The carrying amounts of accounts receivable of the Group's major agents/customers are as follows:

	2010	2009
	RMB'000	RMB'000
Telecommunications operators	**1,030,549**	796,802
Online advertising customers	**613,427**	421,328
Others	**71,436**	11,306
	1,715,412	1,229,436

While there are no contractual requirements for telecommunication operators to pay amounts owed to the Group within a specified period of time, these customers usually settle the amounts due by them within a period of 30 to 120 days. Online advertising customers, which are mainly advertising agencies, are usually granted a credit period of 90 days after full execution of the contracted advertisement orders.

As at 31 December 2010, insignificant amounts of accounts receivable were past due. No impairment provision was considered necessary after management had performed assessment on their credit quality with reference to historical counterparty default rates.

The directors considered that the carrying value of the receivable balance approximated its fair value as at 31 December 2010.

18 PREPAYMENTS, DEPOSITS AND OTHER ASSETS

	2010	2009
	RMB'000	RMB'000
Included in non-current assets:		
Prepayment for land use rights (Note (a))	**258,237**	–
Prepayment for online game licences	**187,193**	–
Loan to a related party (Note (b))	**–**	54,700
Non-current portion of running royalty fees for online games	**–**	25,606
	445,430	80,306
Included in current assets:		
Current portion of running royalty fees for online games	**85,755**	35,460
Prepaid expenses	**120,991**	95,404
Advances to suppliers	**–**	73,860
Rental deposits and other deposits	**46,466**	14,448
Interests receivable	**89,435**	53,450
Refundable value added tax ("VAT")	**45,764**	57,052
Others	**99,461**	43,968
	487,872	373,642
	933,302	453,948

Notes:

(a) During the year ended 31 December 2010, the Group entered into an agreement to purchase land use rights associated with pieces of land located in Beijing, the PRC for construction of office buildings. The total cash consideration was approximately RMB430,395,000, of which RMB258,237,000 was paid before 31 December 2010 in accordance with the payment terms of the agreement.

(b) The amount represented the outstanding balance of a loan due by Shenzhen Shijiaqi Investment Company Limited ("Shijiaqi"), a limited liability company incorporated in the PRC and wholly owned by Mr Zhang Yan, a director of Shenzhen Domain, a non-wholly owned subsidiary of the Company as at 31 December 2009. Such loan had been fully settled as at 31 December 2010.

As at 31 December 2010, the carrying amounts of the prepayments, deposits and other assets approximated their fair values.

Deposits and other receivables (excluding prepayment for land use rights, prepaid expenses, prepayment for online game licences and running royalty fees for online games) were neither past due nor impaired. Their recoverability was assessed with reference made to the credit status of the recipients.

19 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

The effective interest rate for the term deposits of the Group with initial term of over three months for the year ended 31 December 2010 was 2.15% (2009: 2.17%).

An analysis of the Group and the Company's term deposits denominated in USD and HKD with initial term of over three months as at 31 December 2010 was presented in Note 3.1(a).

The directors considered that the carrying value of the term deposits with initial term of over three months approximated their fair value as at 31 December 2010. Term deposits with initial term of over three months were neither past due nor impaired.

As at 31 December 2010, approximately 94% (2009: 91%) of these term deposits were placed in the Bank of China, Agricultural Bank of China, China Construction Bank, China Merchants Bank, Industrial and Commercial Bank of China and Morgan Stanley Bank International (China) Limited.

20 CASH AND CASH EQUIVALENTS

	Group		**Company**	
	2010	2009	**2010**	2009
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cash in bank and on hand	**5,688,087**	1,898,166	**237,525**	101,426
Term deposits with initial term within three months	**4,720,170**	4,145,530	**–**	655
	10,408,257	6,043,696	**237,525**	102,081
Maximum exposure to credit risk	**10,407,767**	6,043,069	**237,525**	101,842

The effective interest rates of the term deposits of the Group with initial term within three months for the year ended 31 December 2010 and 2009 were 1.62% and 1.48%, respectively.

20 CASH AND CASH EQUIVALENTS (Cont'd)

Details of the balances denominated in USD and HKD maintained by the Group and the Company as at 31 December 2010 are presented in Note 3.1(a). Approximately RMB7,648,272,000 (2009: RMB5,482,886,000) of the total balance of the Group was denominated in RMB and it was deposited with banks in the PRC. The Company had no material cash balance denominated in RMB.

As at 31 December 2010, cash at bank and term deposits with initial term within three months were neither past due nor impaired. In addition, approximately 88% (2009: approximately 92%) of cash and cash equivalents of the Group were placed in Standard Chartered Bank, The Hongkong and Shanghai Banking Corporation, Bank of China, Agricultural Bank of China, China Construction Bank, China Merchants Bank and Industrial and Commercial Bank of China.

21 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE

The total authorised share capital of the Company comprises 10,000,000,000 ordinary shares (2009: same) with par value of HKD0.0001 per share (2009: HKD0.0001 per share).

As at 31 December 2010, 1,835,730,235 ordinary shares (2009: 1,818,890,059 ordinary shares) were issued and allotted. They were all fully paid up.

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Total RMB'000
At 1 January 2009	1,796,513,053	195	1,155,209	(21,809)	381,439	1,515,034
Employee share option schemes:						
- value of employee services	–	–	–	–	167,178	167,178
- number of shares issued and proceeds received	16,249,906	2	165,446	–	–	165,448
Employee share award scheme:						
- value of employee services	–	–	–	–	154,946	154,946
- shares purchased for share award scheme	–	–	–	(103,618)	–	(103,618)
- shares allotted for share award scheme	8,181,180	–	–	–	–	–
- cancellation of shares pursuant to share award scheme	(132,080)	–	–	–	–	–
- shares vested from share award scheme and transferred to grantee	–	–	(1,660)	1,660	–	–
Repurchase and cancellation of shares	(1,922,000)	–	(74,570)	–	–	(74,570)
At 31 December 2009	1,818,890,059	197	1,244,425	(123,767)	703,563	1,824,418

21 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Total RMB'000
At 1 January 2010	**1,818,890,059**	**197**	**1,244,425**	**(123,767)**	**703,563**	**1,824,418**
Employee share option schemes:						
- value of employee services	–	–	–	–	139,621	139,621
- number of shares issued and proceeds received (Note (i))	15,801,201	1	199,248	–	–	199,249
Employee share award scheme:						
- value of employee services	–	–	–	–	356,479	356,479
- shares purchased for share award scheme (Note (ii))	–	–	–	(167,519)	–	(167,519)
- shares allotted for share award scheme (Note (iv))	3,662,975	–	–	–	–	–
- shares vested from share award scheme and transferred to the grantees	–	–	(33,149)	33,149	–	–
Repurchase and cancellation of shares	(2,624,000)	–	(310,222)	–	–	(310,222)
At 31 December 2010	**1,835,730,235**	**198**	**1,100,302**	**(258,137)**	**1,199,663**	**2,042,026**

As at 31 December 2010, the total number of issued ordinary shares of the Company was 1,835,730,235 shares (2009: 1,818,890,059 shares) which included 13,562,814 shares (2009: 10,411,434 shares) held under the share award scheme (Note 23(b)).

21 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

Notes:

(i) During the year ended 31 December 2010, 14,499,326 Post-IPO options with exercise prices ranging from HKD3.6650 to HKD90.3000; and 1,301,875 Pre-IPO options with exercise prices ranging from USD0.0497 to USD0.4396 were exercised.

(ii) During the year ended 31 December 2010, the Share Scheme Trust (as described in Note 23(b)) acquired 1,184,883 ordinary shares of the Company in the open market for the purpose of the share award scheme. The total amount paid was HKD191,447,000 (equivalent to approximately RMB167,519,000) and had been deducted from shareholders' equity.

(iii) During the year ended 31 December 2010, the Share Scheme Trust transferred 1,696,478 ordinary shares of the Company (2009: 132,376 shares) to the share awardees upon vesting of the awarded shares.

(iv) During the year ended 31 December 2010, the Company allotted 3,662,975 ordinary shares (2009: 8,181,180 shares) to the Share Scheme Trust for the purpose of granting awarded shares under the share award scheme.

(v) As at 31 December 2010, included in "Shares held for share award scheme", 80 shares (2009: 10 shares) held by the Share Scheme Trust had not yet been granted to employees (Note 23(b)). They represented "treasury shares" of the Group as at that date.

22 OTHER RESERVES

				PRC statutory reserves		
	Capital reserve (Note i) RMB'000	Revaluation reserve RMB'000	Other reserves RMB'000	Statutory surplus reserve fund (Note ii) RMB'000	Reserve fund (Note ii) RMB'000	Total RMB'000
Balance at 1 January 2009	20,000	(6,174)	(515,000)	55,731	12,405	(433,038)
Exercise of put options granted to non-controlling interest owners	–	–	281	–	–	281
Reversal of the liabilities in respect of put options granted to non-controlling interest owners	–	–	264,200	–	–	264,200
Profit appropriations to statutory reserves	–	–	–	2,193	–	2,193
Balance at 31 December 2009	20,000	(6,174)	(250,519)	57,924	12,405	(166,364)
Balance at 1 January 2010	**20,000**	**(6,174)**	**(250,519)**	**57,924**	**12,405**	**(166,364)**
Reversal of the liabilities in respect of the put options granted to non-controlling interest owners (Note 27)	**–**	**–**	**94,246**	**–**	**–**	**94,246**
Acquisition of additional interests in a subsidiary (Note 44)	**–**	**–**	**154,198**	**–**	**–**	**154,198**
Profit appropriations to statutory reserves	**–**	**–**	**–**	**8,237**	**–**	**8,237**
Appreciation of available-for-sale financial assets (Note 16)	**–**	**–**	**1,821,129**	**–**	**–**	**1,821,129**
Transfer to retained earnings	**–**	**6,174**	**2,075**	**–**	**–**	**8,249**
Balance at 31 December 2010	**20,000**	**–**	**1,821,129**	**66,161**	**12,405**	**1,919,695**

22 OTHER RESERVES (Cont'd)

Notes:

(i) The capital reserve arises upon elimination of the registered capital balance of Tencent Computer upon formation of the Group.

(ii) In accordance with the Companies Laws of the PRC and the stipulated provisions of the articles of association of subsidiaries with limited liabilities in the PRC, appropriation of net profits (after offsetting accumulated losses from prior years) should be made by these companies to their respective Statutory Surplus Reserve Funds and the Discretionary Reserve Funds before distributions are made to the owners. The percentage of appropriation to Statutory Surplus Reserve Fund is 10%. The amount to be transferred to the Discretionary Reserve Fund is determined by the equity owners of these companies. When the balance of the Statutory Surplus Reserve Fund reaches 50% of the registered capital, such transfer needs not to be made. Both the Statutory Surplus Reserve Fund and Discretionary Reserves Fund can be capitalised as capital of an enterprise, provided that the remaining Statutory Surplus Reserve Fund shall not be less than 25% of the registered capital.

In addition, in accordance with the Law of the PRC on Enterprises with Foreign Investments and the stipulated provisions of the articles of association of wholly owned foreign subsidiaries in the PRC, appropriation from net profits (after offsetting accumulated losses brought forward from prior years) should be made by these companies to their respective Reserve Funds. The percentage of net profit to be appropriated to the Reserve Fund is not less than 10% of the net profit. When the balance of the Reserve Fund reaches 50% of the registered capital, such transfer needs not be made.

With approvals obtained from their respective boards of directors of these companies, the Reserve Fund can be used to offset accumulated deficit or to increase capital.

23 SHARE OPTION AND SHARE AWARD SCHEMES

(a) Share option schemes

The Company has adopted several share option schemes for the purpose of providing incentives and rewards to its directors, executives or officers, employees, consultants and other eligible persons:

(i) Pre-IPO Share Option Scheme (the "Pre-IPO Option Scheme")

On 27 July 2001, the Company adopted the Pre-IPO Option Scheme. As at the listing date of the Company on 16 June 2004, all options under the Pre-IPO Option Scheme had been granted.

(ii) Post-IPO Share Option Scheme I (the "Post-IPO Option Scheme I")

On 24 March 2004, the Company adopted the Post-IPO Option Scheme I in which the Board may, at its discretion, invite any employee, consultant or director of any company in the Group to take up options to subscribe for shares in the Company at a price determined by it pursuant to the terms of the scheme. The Post-IPO Option Scheme I will remain in force for a period of ten years, commencing on the adoption date.

The Post-IPO Option Scheme I was terminated upon the adoption of the Post-IPO Share Option Scheme II (the "Post-IPO Option Scheme II") as mentioned below.

(iii) Post-IPO Option Scheme II

On 16 May 2007, the Company adopted the Post-IPO Option Scheme II. Pursuant to the Post-IPO Option Scheme II, the Board may, at its discretion, grant options to any eligible person to subscribe for shares in the Company. The Post-IPO Option Scheme II shall be valid and effective for a period of ten years commencing on its date of adoption.

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme II shall not exceed 88,903,654 shares, 5% of the issued shares as at the date of shareholders' approval of the Post-IPO Option Scheme II (the "Scheme Mandate Limit A"). Options lapsed in accordance with the terms of the Post-IPO Option Scheme II shall not be counted for the purpose of calculating the 5% limit. The Company may refresh the Scheme Mandate Limit A by an ordinary resolution of the shareholders passed in a general meeting, provided that the Scheme Mandate Limit A so refreshed shall not exceed 5% of the issued shares as at the date the shareholders approve the refreshing of such Scheme Mandate Limit A. Options previously granted under any existing schemes (including options outstanding, cancelled, or lapsed in accordance with the relevant scheme rules or exercised options) shall not be counted for the purpose of calculating the limit as refreshed. Options granted under the Post-IPO Option Scheme II will expire no later than the last day of the seven-year period after the date of grant of options (subject to early termination as set out in the terms of the Post-IPO Option Scheme II).

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(a) Share option schemes (Cont'd)

(iv) Post-IPO Share Option Scheme III (the "Post-IPO Option Scheme III")

On 13 May 2009, the Company adopted the Post-IPO Option Scheme III. Pursuant to the Post-IPO Option Scheme III, the Board may, at its discretion, grant options to any eligible person (any senior executive or senior officer, director of any member of the Group or any invested entity and any consultant, advisor or agent of any member of the Board) to subscribe for shares in the Company. The Post-IPO Option Scheme III shall be valid and effective for a period of ten years commencing on its date of adoption.

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme III shall not exceed 36,018,666 shares, 2% of the issued shares as at the date of shareholders' approval of this scheme (the "Scheme Mandate Limit B"). Options lapsed in accordance with the terms of the Post-IPO Option Scheme III shall not be counted for the purpose of calculating the 2% limit. The Company may refresh the Scheme Mandate Limit B by an ordinary resolution of the shareholders passed in a general meeting, provided that the Scheme Mandate Limit B so refreshed shall not exceed 2% of the issued shares as at the date the shareholders approve the refreshing of such Scheme Mandate Limit B. Options previously granted under any existing schemes (including options outstanding, cancelled, or lapsed in accordance with the relevant scheme rules or exercised options) shall not be counted for the purpose of calculating the limit as refreshed. Options granted under the Post-IPO Option Scheme III will expire after the last day of the ten-year period after the date of grant of options (subject to early termination as set out in the terms of the Post-IPO Option Scheme III).

The maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Post-IPO Option Scheme II, the Post-IPO Option Scheme III and any other share option schemes of the Company must not in aggregate exceed 30% of issued shares from time to time.

The maximum number of shares (issued and to be issued) in respect of which options may be granted under the Post-IPO Option Scheme II, the Post-IPO Option Scheme III and any other share option schemes of the Company (whether exercised, cancelled or outstanding) to any eligible person in any 12-month period shall not exceed 1% of the issued shares from time to time unless such grant has been duly approved by an ordinary resolution of the shareholders in a general meeting at which the relevant eligible person and his associates are abstained from voting. In calculating the aforesaid limit of 1%, options that have lapsed shall not be counted.

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(a) Share option schemes (Cont'd)

(1) Movements in share options

Movements in the number of options outstanding and their related weighted average exercise prices are as follows:

	Pre-IPO Option Scheme		Post-IPO Option Scheme I		Post-IPO Option Scheme II		Post-IPO Option Scheme III		Total
	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	No. of options
At 1 January 2009	USD0.0964	4,124,083	HKD10.4762	37,615,536	HKD41.2330	28,715,506	–	–	70,455,125
Granted	–	–	–	–	HKD89.8122	2,952,150	–	–	2,952,150
Exercised	USD0.1164	(2,004,895)	HKD8.4108	(12,249,167)	HKD54.2627	(1,995,844)	–	–	(16,249,906)
Lapsed	USD0.0498	(254,120)	HKD9.6262	(424,451)	HKD45.7985	(680,393)	–	–	(1,358,964)
At 31 December 2009	USD0.0812	1,865,068	HKD11.5050	24,941,918	HKD45.1756	28,991,419	–	–	55,798,405
Currently exercisable as at 31 December 2009	USD0.0812	1,865,068	HKD9.6579	18,037,478	HKD41.5573	3,057,144	–	–	22,959,690
At 1 January 2010	**USD0.0812**	**1,865,068**	**HKD11.5050**	**24,941,918**	**HKD45.1756**	**28,991,419**	**–**	**–**	**55,798,405**
Granted	**–**	**–**	**–**	**–**	**HKD138.3689**	**2,708,350**	**HKD158.5000**	**1,000,000**	**3,708,350**
Exercised	**USD0.0759**	**(1,301,875)**	**HKD9.9387**	**(11,925,949)**	**HKD32.3254**	**(2,573,377)**	**–**	**–**	**(15,801,201)**
Lapsed	**–**	**–**	**HKD17.9512**	**(210,206)**	**HKD58.2388**	**(331,224)**	**–**	**–**	**(541,430)**
At 31 December 2010	**USD0.0935**	**563,193**	**HKD12.8579**	**12,805,763**	**HKD54.9391**	**28,795,168**	**HKD158.5000**	**1,000,000**	**43,164,124**
Currently exercisable as at 31 December 2010	**USD0.0935**	**563,193**	**HKD11.2750**	**11,069,343**	**HKD41.4494**	**6,210,804**	**–**	**–**	**17,843,340**

During the year ended 31 December 2010, 1,000,000 share options (2009: Nil) were granted to an executive director of the Company.

As a result of options exercised during the year ended 31 December 2010, 15,801,201 (2009: 16,249,906) ordinary shares were issued by the Company (Note 21). The weighted average price of the shares at the time these options were exercised was HKD161.12 (equivalent to approximately RMB140.40) per share (2009: HKD90.56 per share).

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(a) Share option schemes (Cont'd)

(2) Outstanding share options

Details of the expiry dates, exercise prices and the respective numbers of share options which remained outstanding as at 31 December 2010 and 2009 are as follows:

Expiry Date	Range of exercise price	Number of options 2010	Number of options 2009
31 December 2011	USD0.0497	**482,700**	1,660,300
(Pre-IPO Option Scheme)	USD0.1967-USD0.4396	**80,493**	204,768
		563,193	1,865,068
10 years commencing from the			
adoption date of 24 March 2004	HKD3.6650-HKD8.3500	**5,553,585**	13,237,120
(Post-IPO Option Scheme I)	HKD11.5500-HKD25.2600	**7,252,178**	11,704,798
		12,805,763	24,941,918
7 years commencing from date of			
grant of options (Post-IPO	HKD31.7500-HKD43.5000	**14,186,579**	15,589,627
Option Scheme II)	HKD45.5000-HKD90.3000	**11,660,539**	13,137,092
	HKD128.4000-HKD158.5000	**2,948,050**	264,700
		28,795,168	28,991,419
10 years commencing from date of grant			
of options (Post-IPO Option Scheme III)	HKD158.5000	**1,000,000**	–
		43,164,124	55,798,405

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(a) Share option schemes (Cont'd)

(3) Fair value of options

The directors have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement on parameters, such as risk free rate, dividend yield and expected volatility, is required to be made by the directors in applying the BS Model.

The fair value of the options granted to employees, together with the parameters used, during the period from 1 January 2009 to 31 December 2010 are as follows:

Date of grant	Fair value of options	No. of options granted	Exercise price	Closing share price at date of grant	Risk free rate (Note (i))	Dividend yield (Note (ii))	Expected volatility (Note (iii))	Exercisable date
17/2/2009	HKD6,613,000	380,000	HKD48.01	HKD45.75	1.45%	0.71%	54.0%	Based on grant date (Note (iv))
10/7/2009	HKD92,727,000	2,307,450	HKD90.30	HKD90.30	2.14%	0.71%	53.4%	Based on grant date: 393,950 options (Note (iv)), 1,162,250 options (Note (v)) and 751,250 options (Note (vi))
24/9/2009	HKD748,000	14,700	HKD128.40	HKD128.40	2.21%	0.71%	53.0%	Based on grant date (Note (iv))
24/11/2009	HKD16,827,000	250,000	HKD146.58	HKD145.10	1.92%	0.71%	52.7%	Based on grant date (Note (vi))
24/3/2010	HKD55,365,000	750,000	HKD158.50	HKD158.30	2.35%	0.63%	52.1%	Based on grant date: 25,000 options (Note (v)), 500,000 options (Note (vii)) and 225,000 options (Note (viii))
24/3/2010	HKD83,898,000	1,000,000	HKD158.50	HKD158.30	2.73%	0.63%	52.1%	Based on grant date (Note (ix))
5/7/2010	HKD110,630,000	1,933,350	HKD130.40	HKD130.40	2.06%	0.63%	51.5%	Based on grant date : 163,300 options (Note (iv)), 1,067,550 options (Note (v)) and 702,500 options (Note (x)
13/8/2010	HKD1,414,000	25,000	HKD 150.70	HKD144.80	1.72%	0.63%	51.1%	Based on grant date: 12,500 options (Note (iv)) and 12,500 options (Note (v))

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(a) Share option schemes (Cont'd)

(3) Fair value of options (Cont'd)

Notes:

(i) The risk free rate was determined based on the yield to maturity of Hong Kong Government Bonds with maturity in December 2015, June 2016 or December 2016, June 2017, December 2017, or December 2019 as at the date of valuation.

(ii) Dividend yield was estimated based on the Company's historical dividend yield.

(iii) Volatility, measured as the standard deviation of expected share price returns, was determined based on the average daily trading price volatility of the shares of the Company.

(iv) The first 20% of the option can be exercised one year after the grant date, and then each 20% of the total options will become exercisable in each subsequent year.

(v) The first 20% of the option can be exercised two years after the grant date, and then each 20% of the total options will become exercisable in each subsequent year.

(vi) The first 20% of the option can be exercised three years after the grant date, and then each 20% of the total options will become exercisable in each subsequent year, except the last 20% of the total options which will become exercisable in the eleventh month after the fourth 20% of the total options become exercisable.

(vii) The first 50% of the option can be exercised four years after the grant date, and then the remaining 50% of the total options will become exercisable in the subsequent year.

(viii) The first one-third of the option can be exercised four years after the grant date, and then each one-third of the total options will become exercisable in each subsequent year.

(ix) The first 25% of the option can be exercised five years after the grant date, and then each 25% of the total options will become exercisable in each subsequent year.

(x) The first 20% of the option can be exercised three years after the grant date, and then each 20% of the total options will become exercisable in each subsequent year. The last 20% of the total option will become exercisable in the eleventh month of the seventh year.

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme

On 13 December 2007, the Company adopted a share award scheme (the "Share Scheme"), which was subsequently amended on 31 January 2008 and 13 May 2009, respectively. The Board may, at its absolute discretion, select any eligible persons (the "Awarded Persons") to participate in the Share Scheme.

Pursuant to the Share Scheme, ordinary shares of the Company are acquired by an independent trustee (the "Trustee") at the cost of the Company or shares are allotted to the Trustee under general mandates granted or to be granted by shareholders of the Company at general meetings from time to time. These shares are/will be held in trust for the Awarded Persons by the Trustee until the end of each vesting period. Vested shares are/will be transferred at no cost to the Awarded Persons. The Awarded Persons are not entitled to the dividends on the awarded shares not yet transferred to them.

Unless it is early terminated by the Board, the Share Scheme shall be valid and effective for a term of fifteen years commencing on the adoption date according to the amendment on 13 May 2009.

The number of shares to be awarded under the Share Scheme throughout its duration shall not exceed 2% of the issued share capital of the Company as at the adoption date. The maximum number of shares which may be awarded to an Awarded Person under the Share Scheme shall not exceed 1% of the issued share capital of the Company as at the adoption date.

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme (Cont'd)

(1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares

Movements in the number of shares held for the Share Scheme and awarded shares for the years ended 31 December 2010 and 2009 are as follows:

	Shares held for the Share Scheme	Awarded shares
At 1 January 2009	132,160	1,349,450
Purchased	1,013,100	–
Allotted to Share Scheme	8,181,180	–
Granted to the employee	(9,194,350)	9,194,350
Cancelled	(132,080)	–
Vested	–	(132,376)
At 31 December 2009	10	10,411,424
Currently exercisable as at 31 December 2009		339,056
At 1 January 2010	**10**	**10,411,424**
Purchased (Note 21(ii))	**1,184,883**	**–**
Allotted to Share Scheme	**3,662,975**	**–**
Granted to the employee	**(4,847,788)**	**4,847,788**
Vested	**–**	**(1,696,478)**
At 31 December 2010	**80**	**13,562,734**
Currently exercisable as at 31 December 2010		**101,337**

During the year ended 31 December 2010, no awarded shares (2009: Nil) had been granted to any director of the Company.

The fair value of the awarded shares was calculated based on market prices of the Company's shares as at the respective grant dates. The expected dividends during the vesting periods have been taken into account when assessing the fair value of these awarded shares.

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme (Cont'd)

(1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

The fair value of the awarded shares and their vesting dates during the period from 1 January 2009 to 31 December 2010 are as follows:

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
23/1/2009	HKD5,341,000	120,700	HKD44.25	Based on grant date: 60,700 shares (Note (ii)), 35,000 shares (Note (iv)) and 25,000 shares (Note (v))
17/2/2009	HKD1,144,000	25,000	HKD45.75	Based on grant date (Note (ii))
10/7/2009	HKD772,599,000	8,555,910	HKD90.30	Based on grant date: 4,746,045 shares (Note (ii)), 3,456,575 shares (Note (iii)), 41,600 shares (Note (iv)), 196,690 shares (Note (vii)), 15,000 shares (Note (viii)), 35,000 shares (Note (ix)), 35,000 shares (Note (x)) and 30,000 shares (Note (xi))
22/9/2009	HKD23,916,000	186,840	HKD128.00	Based on grant date: 144,420 shares (Note (ii)), 40,820 shares (Note (iii)) and 1,600 shares (Note(iv))
24/11/2009	HKD24,725,000	170,400	HKD145.10	Based on grant date: 38,650 shares (Note (ii)), 23,750 shares (Note (iii)), 8,000 shares (Note (v)) and 100,000 shares (Note (vii))

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme (Cont'd)

(1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
15/12/2009	HKD21,870,000	135,500	HKD161.40	Based on grant date: 116,500 shares (Note (ii)), 16,500 shares (Note (iii)) and 2,500 shares (Note (vii))
8/1/2010	HKD7,656,000	45,600	HKD167.90	Based on grant date: 36,850 shares (Note (ii)) and 8,750 shares (Note (iii))
24/3/2010	HKD29,618,000	187,100	HKD158.30	Based on grant date: 15,100 shares (Note (v)), 70,500 shares (Note (ii)), 11,500 shares (Note (iii)) and 90,000 shares (Note (vi))
9/4/2010	HKD56,668,000	351,100	HKD161.40	Based on grant date: 115,500 shares (Note (xii)), 229,800 shares (Note (ii)) and 5,800 shares (Note (iii))
13/5/2010	HKD27,965,000	175,993	HKD158.90	Based on grant date: 25,000 shares (Note (xiii)), 10,500 shares (Note (iv)), 100,000 (Note (viii)), 37,993 (Note (ii)) and 2,500 shares (Note (iii))

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme (Cont'd)

(1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
2/6/2010	HKD6,452,000	42,500	HKD151.80	Based on grant date: 10,000 shares (Note (iv)), 29,000 shares (Note (ii)) and 3,500 shares (Note (iii))
5/7/2010	HKD486,691,000	3,732,295	HKD130.40	Based on grant date: 52,725 shares (Note (v)), 1,814,715 shares (Note (ii)), 1,417,330 shares (Note (iii)), 397,525 shares (Note (vii)) and 50,000 shares (Note (xiv))
7/7/2010	HKD1,088,000	8,000	HKD136.00	Based on grant date: 4,000 shares (Note (ii)) and 4,000 shares (Note (iii))
13/8/2010	HKD4,185,000	28,900	HKD144.80	Based on grant date: 23,900 shares (Note (ii)) and 5,000 shares (Note (iii))
3/9/2010	HKD5,518,000	38,000	HKD145.20	Based on grant date: 29,000 shares (Note (ii)) and 9,000 shares (Note (iii))
27/9/2010	HKD4,369,000	25,900	HKD168.70	Based on grant date: 21,700 shares (Note (ii)) and 4,200 shares (Note (iii))

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme (Cont'd)

(1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
17/11/2010	HKD19,254,000	115,500	HKD166.70	Based on grant date: 85,000 shares (Note (ii))) and 30,500 shares (Note (iii))
15/12/2010	HKD17,268,000	96,900	HKD178.20	Based on grant date: 91,900 shares (Note (ii))) and 5,000 shares (Note (iii))

Notes:

(i) The awarded shares will generally be transferred to the Awarded Person on or about the relevant vesting dates.

(ii) The first 20% of these awarded shares will be vested one year after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.

(iii) The first 20% of these awarded shares will be vested two years after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.

(iv) The first one-third of these awarded shares will be vested one year after the grant date, and then each one-third of the total awarded shares will be vested in each subsequent year.

(v) The first 50% of these awarded shares will be vested one year after the grant date, and the remaining 50% of the total awarded shares will be vested in the subsequent year.

(vi) The first one-third of these awarded shares will be vested four years after the grant date, and then each one-third of the total awarded shares will be vested in each subsequent year.

(vii) The first 20% of these awarded shares will be vested three years after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.

(viii) The first 25% of these awarded shares will be vested one year after the grant date, and then each 25% of the total awarded shares will be vested in each subsequent year.

(ix) The first 50% of these awarded shares will be vested from 31 December 2009, and the remaining 50% of the total awarded shares will be vested in the subsequent year.

(x) The first 50% of these awarded shares will be vested from 31 December 2010, and the remaining 50% of the total awarded shares will be vested in the subsequent year.

23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

(b) Share award scheme (Cont'd)

Notes: (Cont'd)

(xi) The first 50% of these awarded shares will be vested from 31 December 2011, and the remaining 50% of the total awarded shares will be vested in the subsequent year.

(xii) 66,000 shares of these awarded shares will be vested 3 months after the grant date, and then the remaining of the total awarded shares will be vested 15 months after the grant date.

(xiii) The first 50% of these awarded shares will be vested 3 months after the grant date, and then the remaining 50% of the total awarded shares will be vested 15 months after the grant date.

(xiv) The first 20% of these awarded shares will be vested four years after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.

(2) Outstanding awarded shares

Details of fair value and the respective numbers of awarded shares which remained outstanding as at 31 December 2010 and 2009 are as follows:

Market price at grant date	**Number of shares**	
	2010	2009
HKD44.25 – HKD90.30	**8,361,903**	9,918,684
HKD128.00 – HKD178.20	**5,200,831**	492,740
	13,562,734	10,411,424

(c) Expected retention rate of grantees

The Group has to estimate the Expected Retention Rate of Grantees in order to determine the amount of share-based compensation expenses charged to the income statement. As at 31 December 2010, the Expected Retention Rate of Grantees was assessed to be 91% (31 December 2009: 91%).

24 ACCOUNTS PAYABLE

Accounts payable and their ageing analysis are as follows:

	2010	2009
	RMB'000	RMB'000
0 - 30 days	**975,869**	493,013
31 - 60 days	**242,547**	72,554
61 - 90 days	**68,632**	82,525
Over 90 days but less than a year	**93,416**	48,419
	1,380,464	696,511

25 OTHER PAYABLES AND ACCRUALS

	2010	2009
	RMB'000	RMB'000
Staff costs and welfare accruals	**1,337,627**	846,349
Marketing and administrative expense accruals	**533,631**	267,417
Prepayments received from customers	**74,623**	71,936
Deposits from customer-to-customer business	**766,472**	265,136
Others	**285,455**	175,213
	2,997,808	1,626,051

26 DERIVATIVE FINANCIAL INSTRUMENTS

	2010	2009
	RMB'000	RMB'000
Foreign exchange forward contracts - held for trading	**17,964**	–

During the year ended 31 December 2010, the Group entered into foreign exchange forward contracts with several banks to purchase USD600,000,000 with RMB. The contracted amount of USD to be purchased was equal to the aggregate principal amounts of USD-denominated bank borrowings (details disclosed in Note 28) expected to be repaid by the Group. These forward contracts will mature within one year, and they will be settled at the difference between the forward rates stated in the contracts and the spot rates as at the respective maturity dates, multiplied by the notional amounts of the face value of the contracts.

27 LONG-TERM PAYABLES

	2010	2009
	RMB'000	RMB'000
Non-current portion of the present value of running royalty fee	–	25,606
Present value of liabilities for the put options granted to non-controlling interest owners	–	248,444
	–	274,050

As at 31 December 2009, the long-term payables mainly represented a financial liability arising from certain put options granted to non-controlling interest owners of a 40% equity interest of Shenzhen Domain ("SZ Domain Holders"). In 2008, the Group granted put options to the SZ Domain Holders for selling their 40% equity interest (out of which 29% equity interest are held by Shijiaqi) in Shenzhen Domain to the Group, upon certain conditions were met (the "Option Equity Interest").

27 LONG-TERM PAYABLES (Cont'd)

As the Group did not have the unconditional right to avoid delivering cash under the put option agreement, the Group had previously recognised the relevant financial liability at an amount equal to the present value of the estimated future cash outflow when it would be required to acquire the Option Equity Interest. The directors of the Company also considered that the risk and reward for these equity interests would only be transferred to the Group upon the option was exercised. Accordingly, the initial recognition of the liabilities had been reflected as a debit made to equity attributable to the Company's equity holders.

At 31 December 2009, the put option liabilities recognised by the Group on the Option Equity Interest were approximately RMB248,444,000.

In April 2010, the Group entered into certain agreements to acquire the exercisable Option Equity Interest (representing approximately 32% of equity interest in Shenzhen Domain) from the holders at a total consideration of RMB154,198,000 (Note 44). As a result, the original put option agreement was terminated and the directors of the Company revised the relevant put option liabilities to RMB154,198,000. The difference was charged as a credit to equity. Such liabilities had been fully discharged as at 31 December 2010.

28 SHORT-TERM BANK BORROWINGS

	2010	2009
	RMB'000	RMB'000
Bank borrowings accounted for as RMB borrowings (Note (a))		
– secured (Note (b))	**990,887**	202,322
– unsecured	**334,440**	–
	1,325,327	202,322
USD borrowings		
– unsecured (Note (c))	**3,973,620**	–
	5,298,947	202,322

28 SHORT-TERM BANK BORROWINGS (Cont'd)

(a) These bank borrowings were denominated in USD according to the loan agreements executed with the lending banks. The aggregate principal amount was USD198,637,000 and the interest rates were fixed at 1.71% to 3.36% per annum. These borrowings will be repaid in full in USD and the term for each of these borrowings is one year. Concurrently, foreign exchange forward contracts were arranged with the same banks as at the respective initial borrowing dates in order to enable the Group to purchase the required amount of USD with RMB for settling the principal amounts of the borrowings plus related interests upon the loan due dates. The bank borrowings and the foreign exchange forward contracts are deemed as linked transactions and accordingly, the bank borrowings have effectively been accounted for as borrowings denominated in RMB.

These bank borrowings and the forward contracts were transacted on the belief that, despite the associated interest expenses to be incurred, the Group would benefit from the interest income from the restricted cash (Note (b)) and the cash increased as a result of the unsecured bank borrowings, as well as the fixed exchange gains arising from the bank borrowings (which are calculated as the difference between the forward rates stated in the contracts and the respective spot rates at the borrowing dates).

(b) These bank borrowings were secured by a pledge of bank deposits of RMB1,014,493,000 of the Group with the banks.

(c) These unsecured bank borrowings were also denominated in USD. The aggregate principal amount was USD600,000,000 and the interest rates were fixed at 1.20% to 2.32% per annum. In addition, the Group entered into foreign forward contracts to purchase the required amount of USD with RMB for settling the principal amount of the borrowings upon the due dates (Note 26). However, the Group arranged the bank loans and the forward contracts with different banks, and the Group did not adopt hedge accounting. As a result, these bank borrowings and the relevant foreign forward contracts were accounted for separately. These bank borrowings were accounted for as USD denominated bank borrowings and stated at amortised cost, while the forward contracts were accounted for as derivative financial instruments stated at fair value with their gains or losses recorded in "Other gains/(losses), net" in the consolidated income statement.

The fair value of the short-term bank borrowings approximated to their carrying amounts as at 31 December 2010.

29 DEFERRED REVENUE

Deferred revenue mainly represents service fees prepaid by customers for certain Internet value-added services in the form of pre-paid tokens or cards, of which the related services had not been rendered as at 31 December 2010. It also included customer loyalty incentives offered by the Group to its customers which were valued at their respective fair values.

30 DEFERRED INCOME TAXES

Deferred income taxes are calculated in full on temporary differences under the liability method using the tax rates which are expected to apply at the time of reversal of the temporary differences.

There was no offsetting of deferred income tax assets and liabilities in 2010 and 2009.

	2010	2009
	RMB'000	RMB'000
Deferred income tax assets:		
– to be recovered after more than 12 months	**164,442**	244,829
– to be recovered within 12 months	**54,577**	56,187
	219,019	301,016
Deferred income tax liabilities:		
– to be recovered after more than 12 months	**(14,633)**	(13,245)
– to be recovered within 12 months	**(952,578)**	(356,738)
	(967,211)	(369,983)

The gross movements of the deferred income tax account were as follows:

	2010	2009
	RMB'000	RMB'000
At beginning of year	**(68,967)**	255,796
Business combinations	**(8,691)**	–
Debit to income statement relating to origination and reversal of temporary differences (Note 39)	**(615,639)**	(324,763)
Effect of change in tax rates recognised in income statement (Note 39)	**(54,895)**	–
At end of year	**(748,192)**	(68,967)

30 DEFERRED INCOME TAXES (Cont'd)

The movements of deferred tax assets, which are arising from intra-group software and technology sales, were as follows:

	2010	2009
	RMB'000	RMB'000
At beginning of year	**301,016**	334,164
Credit to income statement relating to origination of temporary differences	**29,709**	27,020
Effect of change in tax rates recognised in income statement	**(54,895)**	–
Charge to income statement relating to reversal of temporary differences	**(56,811)**	(60,168)
At end of year	**219,019**	301,016

The deferred tax assets recognised are mainly related to the temporary differences arising from certain intra-group software and technology transfer transactions (Note 4.2(a)). The credit to income statement represents tax impacts of originating temporary differences arising from these software and technology transfer, while the charge to income statement represents tax impacts of the reversal of the temporary differences as a result of the amortisation of the costs of these software and technology.

As at 31 December 2010, the Group did not recognise deferred income tax assets of RMB66,459,000 (2009: RMB33,902,000) in respect of cumulative tax losses amounting to RMB265,836,000 (2009: RMB135,607,000). These tax losses will expire from 2011 to 2015.

30 DEFERRED INCOME TAXES (Cont'd)

The movements of deferred tax liabilities were as follows:

Deferred tax liabilities:	**Intangible assets acquired in business combination at fair value**	**Withholding tax on the earnings anticipated to be remitted by subsidiaries**	**Total**
	RMB'000	RMB'000 (Note)	RMB'000
At 1 January 2009	(28,368)	(50,000)	(78,368)
Credit/(charge) to income statement relating to origination of temporary differences	8,385	(300,000)	(291,615)
At 31 December 2009	(19,983)	(350,000)	(369,983)
At 1 January 2010	**(19,983)**	**(350,000)**	**(369,983)**
Business combination	**(8,691)**	–	**(8,691)**
Credit/(charge) to income statement relating to origination of temporary differences	**6,625**	**(595,162)**	**(588,537)**
At 31 December 2010	**(22,049)**	**(945,162)**	**(967,211)**

Note:

According to applicable PRC tax regulations, withholding tax will be levied on the dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 (Note 39 (a)(iv)).

As at 31 December 2010, the Group recognised the relevant deferred tax liabilities of RMB945,162,000 (2009: RMB350,000,000) on the earnings anticipated to be remitted by certain PRC subsidiaries in the foreseeable future. No withholding tax had been provided for the earnings of approximately RMB3,610,269,000 (2009: RMB4,300,000,000) expected to be retained by the PRC subsidiaries and not to be remitted out of the PRC in the foreseeable future based on management's estimation of the funding requirements outside of the PRC.

31 COST OF REVENUES

Cost of revenues mainly comprises the Mobile and Telecom Charges (Note 2.24(a)), bandwidth and server custody fees, staff costs, sharing and content subscription costs incurred in deriving the revenues.

32 INTEREST INCOME

Interest income mainly represented interest income from bank deposits, including current deposit, term deposits with initial term of three months or less, term deposits with initial term of over three months and investment income from held-to-maturity investments.

33 OTHER GAINS/(LOSSES), NET

	2010	2009
	RMB'000	RMB'000
Government subsidies	**96,537**	28,339
Fair value gains on financial assets held for trading	**–**	11,929
Losses from derivative financial instruments (Note 26)	**(17,964)**	–
Donation to a charity fund established by the Group	**(70,000)**	(85,000)
Gain/(loss) on disposals of fixed assets	**883**	(3,043)
Loss on disposals of intangible assets	**–**	(1,654)
Others	**28,600**	(8,784)
	38,056	(58,213)

34 EXPENSES BY NATURE

	2010	2009
	RMB'000	RMB'000
Employee benefits expenses (Note) (Note 35)	**3,143,967**	2,133,135
Mobile and telecommunications charges and bandwidth and server custody fees	**2,089,273**	1,584,025
Content costs and agency fees	**2,797,872**	1,430,526
Promotion and advertising expenses	**557,601**	306,309
Depreciation of fixed assets (Note) (Note 6)	**668,580**	405,301
Amortisation of intangible assets (Note 10)	**109,411**	131,897
Amortisation of land use rights (Note 9)	**3,724**	466
Travelling and entertainment expenses	**124,320**	108,404
Operating lease rentals in respect of office buildings	**116,378**	89,381
Auditor's remuneration	**8,000**	5,950
Other expenses	**482,670**	301,889
Total cost of revenues, selling and marketing expenses and general and administrative expenses	**10,101,796**	6,497,283

Note:

Research and development expenses for the year ended 31 December 2010 were RMB1,685,525,000 (2009: RMB1,191,637,000) which included employee benefit expenses of RMB1,407,948,000 (2009: RMB948,309,000) and depreciation of fixed assets of RMB194,090,000 (2009: RMB215,674,000).

35 EMPLOYEE BENEFITS EXPENSES (INCLUDING DIRECTORS' EMOLUMENTS)

	2010	2009
	RMB'000	RMB'000
Wages, salaries and bonuses	**2,223,725**	1,548,049
Welfare, medical and other expenses	**207,495**	129,603
Share-based compensation expenses	**495,772**	321,422
Contributions to pension plans (Note)	**197,238**	117,774
Training expenses	**19,737**	16,287
	3,143,967	2,133,135

Note:

All local employees of the subsidiaries in the PRC participate in employee social security plans established in the PRC, which cover pension, medical and other welfare benefits. The plans are organised and administered by the governmental authorities. Except for the contribution to these social security plans, the Group has no other material commitments owing to the employees. According to the relevant regulations, the portion of premium and welfare benefit contributions that should be borne by the companies within the Group as required by the above social security plans are principally determined based on percentages of the basic salaries of employees, subject to a certain ceiling, and are paid to the respective labour and social welfare authorities. Contributions to the plans are expensed as incurred. The applicable percentages used to provide for insurance premium and welfare benefit funds are listed below.

	Percentage
Pension insurance	8 – 22%
Medical insurance	0.5 – 12%
Unemployment insurance	0 – 2.5%
Housing fund	0 – 12%

36 DIRECTORS' EMOLUMENTS

The aggregate amounts of emoluments paid/payable to directors of the Company for the year ended 31 December 2010 and 2009 are as follows:

	2010	2009
	RMB'000	RMB'000
Fees - independent non-executive directors	**2,157**	1,854
Salaries, bonuses, allowances and benefits in kind	**39,919**	33,851
Contributions to pension plans	**48**	40
Share-based compensation expenses charged to income statement	**21,796**	18,710
	63,920	54,455
Number of directors		
– with emoluments	**6**	6
– without emoluments	**2**	2
Number of directors	**8**	8

36 DIRECTORS' EMOLUMENTS (Cont'd)

The remuneration of every director for the year ended 31 December 2010 is set out below.

Name of director	Fees	Salaries, bonuses, allowances and benefits in kind	Contributions to pension plans	Share-based compensation expenses	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Ma Huateng	–	18,419	24	–	18,443
Zhang Zhidong	–	13,282	24	–	13,306
Lau Chi Ping Martin (Note)	795	8,218	–	21,523	30,536
Iain Ferguson Bruce	596	–	–	91	687
Ian Charles Stone	383	–	–	91	474
Li Dong Sheng	383	–	–	91	474
Antonie Andries Roux	–	–	–	–	–
Charles St Leger Searle	–	–	–	–	–
	2,157	39,919	48	21,796	63,920

Note:

During the year ended 31 December 2010, 1,000,000 share options (2009: Nil) were granted to Mr Lau Chi Ping, Martin. Other than that, no options/awarded shares were granted to other executive, non-executive or independent non-executive directors of the Company (2009: Nil).

36 DIRECTORS' EMOLUMENTS (Cont'd)

The remuneration of every director for the year ended 31 December 2009 is set out below.

Name of director	Fees RMB'000	Salaries, bonuses, allowances and benefits in kind RMB'000	Contributions to pension plans RMB'000	Share-based compensation expenses RMB'000	Total RMB'000
Ma Huateng	–	15,616	20	–	15,636
Zhang Zhidong	–	11,375	20	–	11,395
Lau Chi Ping Martin	820	6,860	–	18,245	25,925
Iain Ferguson Bruce	418	–	–	155	573
Ian Charles Stone	308	–	–	155	463
Li Dong Sheng	308	–	–	155	463
Antonie Andries Roux	–	–	–	–	–
Charles St Leger Searle	–	–	–	–	–
	1,854	33,851	40	18,710	54,455

No director received any emolument from the Group as an inducement to join or leave the Group or compensation for loss of office. No director waived or has agreed to waive any emoluments during the year ended 31 December 2010 (2009: Nil).

37 FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Group during the year included two (2009: three) directors whose details have been reflected in the analysis presented above (Note 36). The emoluments paid/payable to the remaining three (2009: two) individuals during the year were as follows:

	2010	2009
	RMB'000	RMB'000
Salaries, bonuses, allowances and benefits in kind	**28,832**	18,252
Share-based compensation expenses charged to income statement	**22,042**	6,338
Contributions to pension plans	**70**	39
	50,944	24,629

The emoluments of the above three individuals (2009: two) fell within the following bands:

	Number of individuals	
	2010	2009
Emolument bands		
HKD13,000,001 – HKD13,500,000 (equivalent to RMB11,320,401 – RMB11,755,800)	**–**	1
HKD15,000,001 – HKD15,500,000 (equivalent to RMB13,062,001 – RMB13,497,400)	**–**	1
HKD16,000,001 – HKD16,500,000 (equivalent to RMB13,932,801 – RMB14,368,200)	**1**	–
HKD21,000,001 – HKD21,500,000 (equivalent to RMB18,286,801 – RMB18,722,200)	**2**	–

38 FINANCE COSTS, NET

	2010	2009
	RMB'000	RMB'000
Interest expenses	**35,027**	–
Exchange (gains)/losses	**(34,189)**	1,953
	838	1,953

Interest expenses mainly arose from the USD bank borrowings mentioned in Note 28.

39 TAX EXPENSE

(a) Income tax

(i) Cayman Islands and British Virgin Islands profits tax

The Group has not been subject to any taxation in these jurisdictions for the year ended 31 December 2010 (2009: Nil).

(ii) Hong Kong profits tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising in Hong Kong for the year ended 31 December 2010 (2009: Nil).

(iii) PRC Corporate Income Tax ("CIT")

CIT is provided on the assessable income of entities within the Group incorporated in the PRC, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

Pursuant to the PRC Corporate Income Tax Law passed by the Tenth National People's Congress on 16 March 2007 ("CIT Law"), the CIT for domestic and foreign enterprises has been unified at 25%, effective 1 January 2008.

The CIT Law also provides a five-year transitional period starting from its effective date for those enterprises which were established before the promulgation of the CIT law and which were entitled to preferential income tax rates under the then effective tax laws or regulations.

On 26 December 2007, the State Council issued the "Circular to Implementation the Transitional Preferential Policies for the Corporate Income Tax". Pursuant to this circular, the transitional income tax rates for the Group's subsidiaries established in the Shenzhen Special Economic Zone or the Beijing High Technology Zone before 16 March 2007 are 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011 and 2012, respectively. Other tax preferential treatments such as reduction of 50% in income tax rate shall be based on the above transitional income tax rates for the respective years.

In 2008, six subsidiaries namely Tencent Computer, Tencent Technology, Shenzhen Domain, Cyber Shenzhen, Tencent Beijing and Cyber Tianjin, applied for and were subsequently approved as High/New Technology Enterprises, and accordingly, they were subject to a reduced preferential CIT rate of 15% according to the CIT Law. With such status, the above mentioned transitional income tax rates for the period from 2008 to 2010 were no longer applicable to them.

39 TAX EXPENSE (Cont'd)

(a) Income tax (Cont'd)

(iii) PRC Corporate Income Tax ("CIT") (Cont'd)

In April 2010, the PRC tax authorities issued a new tax circular Guoshui 2010 No. 157 to clarify that an entity is only allowed to enjoy either the preferential CIT rate of 15% as a High/New Technology Enterprise or CIT exemption for two or three years and followed by a 50% reduction for the next 3 years based on the unified CIT rate in the PRC.

According to the special tax incentives granted by the local tax authority in Beijing, Tencent Beijing is exempt from CIT for three years starting from the first year of its commercial operation, followed by a 50% reduction for the next three years. 2005 was its first year of operation and accordingly, the provision for CIT was provided at a rate of 11% for 2010 (2009: 7.5%).

As approved by the relevant tax authority, Cyber Tianjin is exempt from CIT for two years commencing from the first year of profitable operation after offsetting tax loss brought forward from prior years, followed by a 50% reduction for the next three years. 2008 was its first profit-making year and accordingly provision for CIT was made at a rate of 12.5% for 2010 (2009: Nil).

In addition, Beijing Yonghang was recognised as a newly set-up software production enterprise in 2009, and according to the tax incentives granted by the tax authority, it was exempt from CIT in 2009, followed by a 50% reduction from 2010 to 2012. As a result, the provision for CIT was made at a rate of 12.5% for 2010 (2009: Nil).

Furthermore, Tencent Chengdu was recognised as a newly set-up software production enterprise by the relevant tax authority, Tencent Chengdu is exempt from CIT for two years commencing from the first year of profitable operation after offsetting tax loss brought forward from prior years, followed by a 50% reduction for the next three years. 2010 was its first profit-making year and accordingly it was exempt from CIT in 2010 (2009: Nil).

For Tencent Technology, it was further approved as a national key software enterprise for 2010, and accordingly, its CIT rate in 2010 was further reduced to 10%.

39 TAX EXPENSE (Cont'd)

(a) Income tax (Cont'd)

(iv) PRC withholding tax

According to applicable PRC tax regulations, dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 are subject to a 10% withholding tax. If a foreign investor is incorporated in Hong Kong and meets the conditions or requirements under the double taxation arrangement entered into between the PRC and Hong Kong, the relevant withholding tax rate will be reduced to 5% from 10%.

The income tax charge of the Group for the year ended 31 December 2010 and 2009 are analysed as follows:

	2010	2009
	RMB'000	RMB'000
Current tax	**1,127,390**	494,357
Deferred income tax (Note 30)	**670,534**	324,763
	1,797,924	819,120

39 TAX EXPENSE (Cont'd)

(a) Income tax (Cont'd)

The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the tax rate of 22% for the year ended 31 December 2010 (2009: 20%), the tax rate of the major subsidiaries of the Company before preferential tax treatments. The difference is analysed as follows:

	2010	2009
	RMB'000	RMB'000
Profit before income tax	**9,913,133**	6,040,731
Less: Share of profit of associates and a jointly controlled entity	**(75,758)**	(22,206)
	9,837,375	6,018,525
Tax calculated at a tax rate of 22% (2009: 20%)	**2,164,223**	1,203,705
Effects of different tax rates available to different companies of the Group	**(575,213)**	(363,940)
Effect of tax holiday on assessable profits of subsidiaries	**(556,561)**	(429,638)
Effect of changes in tax rates	**54,895**	–
Income not subject to tax	**(29,217)**	–
Expenses not deductible for tax purposes	**110,391**	75,691
Adjustments in respect of prior year	**5,869**	(13,528)
Withholding tax on earnings expected to be remitted by PRC subsidiaries (Note 30)	**595,162**	300,000
Unrecognised deferred income tax assets	**28,375**	46,830
Income tax expense	**1,797,924**	819,120

(b) Value-added tax, business tax and related taxes

The operations of the Group are also subject to the following taxes in the PRC:

Category	**Tax rate**	**Basis of levy**
Value-added tax ("VAT")	(i) 17%	Sales value of goods sold, offsetting by VAT on purchases
	(ii) 3%	Sales value of goods sold
Business tax ("BT")	3-5%	Services fee income
City construction tax	1-7%	Net VAT and BT payable amount
Educational surcharge	3%	Net VAT and BT payable amount

40 LOSS ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE COMPANY

The loss attributable to the equity holders of the Company for the year ended 31 December 2010 is dealt with in the financial statements of the Company to the extent of RMB59,255,000 (2009: profit of RMB728,237,000).

41 EARNINGS PER SHARE

(a) Basic

Basic earnings per share ("EPS") are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2010	2009
Profit attributable to equity holders of the Company for the year (RMB'000)	**8,053,625**	5,155,646
Weighted average number of ordinary shares in issue (thousand shares)	**1,816,954**	1,801,646
Basic EPS (RMB per share)	**4.432**	2.862

41 EARNINGS PER SHARE (Cont'd)

(b) Diluted

Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options and awarded shares granted by the Company (collectively forming the denominator for computing the diluted EPS). No adjustment is made to earnings (numerator).

	2010	2009
Profit attributable to equity holders of the Company for the year (RMB'000)	**8,053,625**	5,155,646
Weighted average number of ordinary shares in issue (thousand shares)	**1,816,954**	1,801,646
Adjustments for share options (thousand shares)	**35,252**	43,566
Adjustments for awarded shares (thousand shares)	**8,777**	2,073
Weighted average number of ordinary shares for the calculation of diluted earnings per share (thousand shares)	**1,860,983**	1,847,285
Diluted EPS (RMB per share)	**4.328**	2.791

42 DIVIDEND

The dividend paid in 2010 was RMB639,264,000 (2009: RMB554,604,000), which excluded the dividend related to the shares held by the Share Scheme Trust of RMB3,717,000 (2009: RMB462,000).

A final dividend in respect of the year ended 31 December 2010 of HKD0.55 per share (2009: HKD0.40 per share) was proposed pursuant to a resolution passed by the Board on 16 March 2011 and subject to the approval of the shareholders in the annual general meeting to be held on 11 May 2011. These consolidated financial statements do not reflect this dividend payable.

43 BUSINESS COMBINATION

On 20 September 2010, the Group entered into an agreement ("Acquisition Agreement") to acquire 100% equity interest in Comsez Inc. ("Comsenz"), a company incorporated in the Cayman Islands, at a consideration of approximately USD43,000,000 (equivalent to RMB292,844,000). Through its wholly-owned foreign enterprise in the PRC, Comsenz controls an operating company established in the PRC through various contractual arrangements (collectively referred to as the "Comsenz Group"). The Comsenz Group is an Internet community software and service provider in the PRC.

In addition, pursuant to the Acquisition Agreement, the Group undertakes to grant awarded shares of the Company equivalent to USD2,000,000 to the key employees of the Comsenz Group one year after the acquisition.

As a result of the acquisition, the Group is expected to increase its presence in the market where the Comsenz Group has been operating in. The goodwill of RMB240,467,000 arising from the acquisition is attributable to anticipated operating synergies, assembled workforce and economies of scale expected from combining the operations of the Group and Comsenz Group. None of the goodwill recognised is expected to be deductible for income tax purposes.

43 BUSINESS COMBINATION (Cont'd)

The following table summarises the consideration paid for the acquisition and the amounts of assets acquired and liabilities assumed recognised at the acquisition date.

	RMB'000
Considerations:	
Cash paid	270,848
Cash to be paid (included in other payables)	21,996
Total considerations	292,844
Acquisition-related costs (Note)	1,246
Recognised amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	1,996
Accounts receivable	2,264
Prepayments, deposits and other receivables	702
Fixed assets	2,490
Computer software and technology (included in intangible assets)	634
Technology platform (included in intangible assets)	31,500
Customer relationship (included in intangible assets)	6,626
Trademark (included in intangible assets)	19,490
Licences (included in intangible assets)	324
Other payables and accruals	(2,294)
Current income tax liabilities	(932)
Other tax liabilities	(1,732)
Deferred income tax liabilities (Note 30)	(8,691)
Total identifiable net assets	52,377
Goodwill	240,467
	292,844

Note:

The acquisition-related costs were included in general and administrative expenses in the consolidated income statement for the year ended 31 December 2010

43 BUSINESS COMBINATION (Cont'd)

The business conducted by the Comsenz Group contributed to the Group revenues of RMB4,757,000 and a net loss of RMB11,122,000 for the period from the acquisition date to 31 December 2010. If the above acquisition had occurred on 1 January 2010, the Group's revenues would have been increased by RMB32,549,000 and net profit would have been decreased by RMB35,418,000. These amounts have been arrived at based on the Group's accounting policies by adjusting the results of the Comsenz Group to reflect the additional amortisation that would have been charged against the identifiable intangible assets upon acquisition from 1 January 2010, together with the consequential tax effects.

44 TRANSACTIONS WITH NON-CONTROLLING INTEREST OWNERS OF A SUBSIDIARY

As mentioned in Note 27, the Group entered into agreements to acquire the exercisable Option Equity Interest in Shenzhen Domain from the SZ Domain Holders (the "Transaction") in April 2010. After the Transaction, Shenzhen Domain became a wholly owned subsidiary of the Company.

Carrying amount of the non-controlling interests acquired and the excess of the consideration paid recognised within equity as a result of the Transaction are as follows:

	2010
	RMB'000
Carrying amount of non-controlling interest acquired	**31,095**
Consideration paid/payable to non-controlling interest owners	**(154,198)**
Excess of consideration paid recognised within equity	**(123,103)**

The effect of the Transaction on equity attributable to the Company's equity holders during the year ended 31 December 2010 is summarised as follows:

	2010
	RMB'000
Total comprehensive income for the year attributable to the equity holders of the Company	**9,874,754**
Effect of the Transaction on equity	**(123,103)**
Total comprehensive income for the year attributable to the equity holders of the Company after taking consideration of the Transaction	**9,751,651**

45 CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of net profit to net cash inflow from operating activities:

	2010 RMB'000	2009 RMB'000
Profit for the year	**8,115,209**	5,221,611
Adjustments for:		
Income tax expense	**1,797,924**	819,120
Depreciation of fixed assets and investment properties	**669,860**	405,876
Amortisation of intangible assets	**109,411**	131,897
Amortisation of leasehold land and land use rights	**3,724**	466
(Gain)/loss on disposals of fixed assets	**(883)**	3,043
Loss on disposals of intangible assets	**–**	1,654
Fair value losses on derivative financial assets	**17,964**	–
Interest income	**(255,922)**	(136,014)
Share-based compensation expenses	**495,772**	321,422
Share of profit of associates	**(72,359)**	(22,206)
Share of profit of a jointly controlled entity	**(3,399)**	–
Exchange (gains)/losses	**(34,189)**	1,953
Changes in working capital:		
Inventories	**–**	5,483
Accounts receivable	**(483,712)**	(245,977)
Prepayments, deposits and other receivables	**(51,936)**	36,892
Financial assets held for trading	**–**	329,804
Long-term payables	**(179,804)**	(43,331)
Accounts payable	**478,330**	247,454
Other payables and accruals	**1,551,226**	608,788
Other tax liabilities	**9,942**	113,045
Deferred revenue	**1,024,570**	1,053,833
Cash generated from operations	**13,191,728**	8,854,813

45 CONSOLIDATED CASH FLOW STATEMENT (Cont'd)

(a) Reconciliation of net profit to net cash inflow from operating activities: (Cont'd)

In the consolidated cash flow statement, proceeds from disposals of fixed assets comprise:

	2010	2009
	RMB'000	RMB'000
Net book amount	**691**	3,638
Gain/(loss) on disposals of fixed assets	**883**	(3,043)
Proceeds from disposals of fixed assets	**1,574**	595

(b) Analysis of changes in financing during the years are as follows:

	Dividend payable	Share capital including premium	Shares held for share award scheme	Short-term bank borrowings	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2009	–	1,155,404	(21,809)	–	1,133,595
Proceeds from issue of shares and share options	–	165,448	–	–	165,448
Payments for repurchase of issued shares/purchase of shares for share award scheme	–	(74,570)	(103,618)	–	(178,188)
Vesting of awarded shares	–	(1,660)	1,660	–	–
Proposed dividend	554,604	–	–	–	554,604
Payment of dividend	(554,604)	–	–	–	(554,604)
Proceeds from short-term bank borrowings	–	–	–	202,322	202,322
At 31 December 2009	–	1,244,622	(123,767)	202,322	1,323,177

45 CONSOLIDATED CASH FLOW STATEMENT (Cont'd)

(b) Analysis of changes in financing during the years are as follows: (Cont'd)

	Dividend payable RMB'000	Share capital including premium RMB'000	Shares held for share award scheme RMB'000	Short-term bank borrowings RMB'000	Total RMB'000
At 1 January 2010	–	1,244,622	(123,767)	202,322	1,323,177
Proceeds from issue of shares and share options	–	199,249	–	–	199,249
Payments for repurchase of issued shares/purchase of shares for share award scheme	–	(310,222)	(167,519)	–	(477,741)
Vesting of awarded shares	–	(33,149)	33,149	–	–
Proposed dividend	639,264	–	–	–	639,264
Payment of dividend	(639,264)	–	–	–	(639,264)
Repayment of short-term bank borrowings	–	–	–	(202,322)	(202,322)
Proceeds from short-term bank borrowings	–	–	–	5,298,947	5,298,947
At 31 December 2010	–	1,100,500	(258,137)	5,298,947	6,141,310

(c) Major non-cash transactions

There were no other material non-cash transactions for the year ended 31 December 2010.

46 CONTINGENCIES

The Group has no material contingent liabilities outstanding as at 31 December 2010.

47 COMMITMENTS

(a) Capital commitments

Capital commitments as at 31 December 2010 and 2009 are analysed as follows:

	2010	2009
	RMB'000	RMB'000
Contracted:		
Construction of buildings	211,558	36,215
Purchase of other fixed assets	135,165	55,606
Capital investment in an investee	100,996	14,335
	447,719	106,156
Authorised but not contracted:		
Construction of buildings	373,277	247,001
Capital investment in an investee	385,000	19,802
	758,277	266,803
	1,205,996	372,959

(b) Operating lease commitments

The future aggregate minimum lease payments under non-cancellable operating leases in respect of buildings are as follows:

	2010	2009
	RMB'000	RMB'000
Contracted:		
Not later than one year	236,343	67,893
Later than one year and not later than five years	572,818	86,730
Later than five years	18,845	3,242
	828,006	157,865

47 COMMITMENTS (Cont'd)

(c) Other commitments

The future aggregate minimum payments under non-cancellable bandwidth and server custody leases and online game licensing agreements are as follows:

	2010	2009
	RMB'000	RMB'000
Contracted:		
Not later than one year	**1,064,792**	357,632
Later than one year and not later than five years	**1,981,543**	171,230
	3,046,335	528,862

48 RELATED PARTIES TRANSACTIONS

Except as disclosed in Note 13 (Investment in a jointly controlled entity), Note 23 (Share options and share award scheme) and Note 36 (Directors' emoluments) to the consolidated financial statements, the Group had no other material transactions with related parties for the year ended 31 December 2010, and no other related parties' balances as at 31 December 2010. The key management compensation has already been disclosed in Note 36 (Directors' emoluments).

49 SUBSEQUENT EVENT

Subsequent to 31 December 2010, the Group acquired a majority interest in Riot Games, Inc. ("Riot Games"), a US-based independent developer and publisher of premium online games, from the existing shareholders including the founders of Riot Games (the "Founders"), for a cash consideration of USD231,500,000 (the "Acquisition"). Immediately before the Acquisition, Riot Games was approximately 22.34% held by the Company and accounted for as an associate of the Company. Subsequent to the closing of the Acquisition, the interest of the Group and the Founders in Riot Games was approximately 92.78% and 7.22% respectively. Riot Games became a subsidiary of the Company as a result of the Acquisition.

In connection with the Acquisition, the Group will offer, among others, cash bonus, employee options and special restricted stock units of Riot Games to the Founders and certain key employees. As of the date of this report, the Group is in the process of assessing and quantifying the total consideration payable for the Acquisition arising from the above arrangements, as well as the fair value of the net identifiable assets acquired. As such, it is not in a position to complete its initial accounting because of the time constraint and the multiple components of the total consideration payable for the Acquisition.

Report on Review of Interim Financial Information

TO THE BOARD OF DIRECTORS OF
TENCENT HOLDINGS LIMITED
(Incorporated in the Cayman Islands with limited liability)

INTRODUCTION

We have reviewed the interim financial information set out on pages 22 to 59, which comprises the consolidated statement of financial position of Tencent Holdings Limited (the "Company") and its subsidiaries (together, the "Group") as at 30 June 2012 and the related consolidated income statement, the consolidated statement of comprehensive income for the three and six months then ended, the consolidated statement of changes in equity and the condensed consolidated statement of cash flows for the six months then ended, and a summary of significant accounting policies and other explanatory notes (collectively defined as the "Interim Financial Information"). The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on interim financial information to be in compliance with the relevant provisions thereof and International Accounting Standard 34 'Interim Financial Reporting'. The directors of the Company are responsible for the preparation and presentation of this interim financial information in accordance with International Accounting Standard 34 'Interim Financial Reporting'. Our responsibility is to express a conclusion on this Interim Financial Information based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

SCOPE OF REVIEW

We conducted our review in accordance with International Standard on Review Engagement 2410 'Review of interim financial information performed by the independent auditor of the entity'. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the Interim Financial Information is not properly prepared, in all material respects, in accordance with International Accounting Standard 34 'Interim Financial Reporting'.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 15 August 2012

Consolidated Statement of Financial Position

As at 30 June 2012

	Note	**Unaudited 30 June 2012 RMB'000**	Audited 31 December 2011 RMB'000
ASSETS			
Non-current assets			
Fixed assets	7	**6,201,179**	5,884,952
Construction in progress	7	**323,786**	158,656
Investment properties	7	**21,643**	21,871
Land use rights	7	**348,509**	230,915
Intangible assets	7	**4,194,417**	3,779,976
Interests in associates	8	**5,292,559**	4,338,075
Investment in jointly controlled entities		**53,908**	61,903
Deferred income tax assets	19	**184,608**	198,058
Available-for-sale financial assets	9	**5,320,869**	4,343,602
Prepayments, deposits and other assets	11	**3,877,451**	2,282,869
		25,818,929	21,300,877
Current assets			
Inventories		**202,106**	–
Accounts receivable	10	**2,500,207**	2,020,796
Prepayments, deposits and other assets	11	**3,275,968**	2,211,917
Term deposits with initial term of over three months		**17,014,730**	13,716,040
Restricted cash		**2,317,431**	4,942,595
Cash and cash equivalents		**10,602,451**	12,612,140
		35,912,893	35,503,488
Total assets		**61,731,822**	56,804,365
EQUITY			
Equity attributable to the Company's equity holders			
Share capital	12	**198**	198
Share premium	12	**2,488,779**	2,058,051
Shares held for share award scheme	12	**(609,657)**	(606,874)
Other reserves		**532,264**	302,091
Retained earnings		**31,652,090**	26,710,368
		34,063,674	28,463,834
Non-controlling interests		**650,698**	624,510
Total equity		**34,714,372**	29,088,344

Consolidated Statement of Financial Position

As at 30 June 2012

	Note	**Unaudited 30 June 2012 RMB'000**	Audited 31 December 2011 RMB'000
LIABILITIES			
Non-current liabilities			
Borrowings	17	**948,735**	–
Long-term notes payable	18	**3,751,839**	3,733,331
Deferred income tax liabilities	19	**893,822**	939,534
Long-term payables	16	**1,441,920**	1,859,808
		7,036,316	6,532,673
Current liabilities			
Accounts payable	14	**3,368,438**	2,244,114
Other payables and accruals	15	**4,872,613**	5,014,281
Derivative financial instruments		**14,680**	20,993
Borrowings	17	**3,609,323**	7,999,440
Current income tax liabilities		**998,523**	708,725
Other tax liabilities		**256,781**	179,499
Deferred revenue		**6,860,776**	5,016,296
		19,981,134	21,183,348
Total liabilities		**27,017,450**	27,716,021
Total equity and liabilities		**61,731,822**	56,804,365
Net current assets		**15,931,759**	14,320,140
Total assets less current liabilities		**41,750,688**	35,621,017

The accompanying notes on pages 29 to 59 form an integral part of this Interim Financial Information.

On behalf of the Board

Ma Huateng	**Zhang Zhidong**
Director	Director

Consolidated Income Statement

For the three and six months ended 30 June 2012

		Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
		2012	2011	**2012**	2011
	Note	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Revenues					
Internet value-added services		**7,786,625**	5,386,578	**15,168,246**	10,637,860
Mobile and telecommunications value-added services		**929,007**	793,839	**1,842,849**	1,571,631
Online advertising		**879,691**	512,312	**1,419,804**	793,206
e-Commerce transactions		**857,526**	–	**1,610,343**	–
Others		**74,395**	46,315	**133,860**	74,767
		10,527,244	6,739,044	**20,175,102**	13,077,464
Cost of revenues	21	**(4,311,379)**	(2,331,637)	**(8,147,696)**	(4,525,366)
Gross profit		**6,215,865**	4,407,407	**12,027,406**	8,552,098
Interest income		**196,806**	106,546	**363,539**	207,208
Other (losses)/gains, net	20	**(3,219)**	2,809	**(66,861)**	341,878
Selling and marketing expenses	21	**(609,672)**	(369,491)	**(1,078,872)**	(669,944)
General and administrative expenses	21	**(1,862,165)**	(1,363,372)	**(3,616,239)**	(2,260,838)
Operating profit		**3,937,615**	2,783,899	**7,628,973**	6,170,402
Finance (costs)/income, net	22	**(115,256)**	1,771	**(185,238)**	(2,098)
Share of profit/(losses) of associates	8	**5,411**	23,454	**(4,342)**	61,308
Share of losses of jointly controlled entities		**(9,375)**	(60,689)	**(7,995)**	(64,986)
Profit before income tax		**3,818,395**	2,748,435	**7,431,398**	6,164,626
Income tax expense	23	**(707,824)**	(405,163)	**(1,358,497)**	(937,146)
Profit for the period		**3,110,571**	2,343,272	**6,072,901**	5,227,480
Attributable to:					
Equity holders of the Company		**3,100,075**	2,349,246	**6,049,585**	5,219,620
Non-controlling interests		**10,496**	(5,974)	**23,316**	7,860
		3,110,571	2,343,272	**6,072,901**	5,227,480
Earnings per share for profit attributable to equity holders of the Company (expressed in RMB per share)					
– basic	24	**1.698**	1.289	**3.316**	2.863
– diluted	24	**1.665**	1.260	**3.252**	2.800

The accompanying notes on pages 29 to 59 form an integral part of this Interim Financial Information.

Consolidated Statement of Comprehensive Income

For the three and six months ended 30 June 2012

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2012	2011	**2012**	2011
	RMB'000	RMB'000	**RMB'000**	RMB'000
Profit for the period	**3,110,571**	2,343,272	**6,072,901**	5,227,480
Other comprehensive income, net of tax:				
Net (losses)/gains from changes in fair value of available-for-sale financial assets	**(530,203)**	264,280	**758,711**	(418,156)
Currency translation differences	**7,743**	(74)	**13,819**	133
	(522,460)	264,206	**772,530**	(418,023)
Total comprehensive income for the period	**2,588,111**	2,607,478	**6,845,431**	4,809,457
Attributable to:				
Equity holders of the Company	**2,576,886**	2,613,452	**6,821,375**	4,801,597
Non-controlling interests	**11,225**	(5,974)	**24,056**	7,860
	2,588,111	2,607,478	**6,845,431**	4,809,457

The accompanying notes on pages 29 to 59 form an integral part of this Interim Financial Information.

Consolidated Statement of Changes in Equity

For the six months ended 30 June 2012

	Unaudited							
	Attributable to equity holders of the Company							
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2012	198	2,058,051	(606,874)	302,091	26,710,368	28,463,834	624,510	29,088,344
Comprehensive income								
Profit for the period	–	–	–	–	6,049,585	6,049,585	23,316	6,072,901
Other comprehensive income:								
– net gains from changes in fair value of available-for-sale financial assets	–	–	–	758,711	–	758,711	–	758,711
– currency translation differences	–	–	–	13,079	–	13,079	740	13,819
Total comprehensive income for the period	–	–	–	771,790	6,049,585	6,821,375	24,056	6,845,431
Transaction with owners								
Capital injection	–	–	–	–	–	–	7,220	7,220
Employee share option schemes:								
– value of employee services	–	55,669	–	34,432	–	90,101	18,182	108,283
– proceeds from shares issued	–	113,640	–	–	–	113,640	–	113,640
Employee share award scheme:								
– value of employee services	–	295,814	–	25,792	–	321,606	4,415	326,021
– shares purchased for share award scheme	–	–	(16,946)	–	–	(16,946)	–	(16,946)
– vesting of awarded shares	–	(14,163)	14,163	–	–	–	–	–
Profit appropriations to statutory reserves	–	–	–	(26)	26	–	–	–
Repurchase and cancellation of shares	–	(20,232)	–	–	–	(20,232)	–	(20,232)
Dividend (Note 25)	–	–	–	–	(1,107,889)	(1,107,889)	(18,180)	(1,126,069)
Total contributions by and distributions to owners for the period	–	430,728	(2,783)	60,198	(1,107,863)	(619,720)	11,637	(608,083)
Non-controlling interests arising from business combinations (Note 26)	–	–	–	–	–	–	(2,455)	(2,455)
Acquisition of additional equity interests in non-wholly owned subsidiaries	–	–	–	(244,197)	–	(244,197)	(7,050)	(251,247)
Recognition of financial liabilities in respect of the put options granted to non-controlling interests	–	–	–	(357,618)	–	(357,618)	–	(357,618)
Total transactions with owners for the period	–	430,728	(2,783)	(541,617)	(1,107,863)	(1,221,535)	2,132	(1,219,403)
Balance at 30 June 2012	198	2,488,779	(609,657)	532,264	31,652,090	34,063,674	650,698	34,714,372

The accompanying notes on pages 29 to 59 form an integral part of this Interim Financial Information.

Consolidated Statement of Changes in Equity

For the six months ended 30 June 2012

	Unaudited							
	Attributable to equity holders of the Company							
	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total equity RMB'000
Balance at 1 January 2011	198	2,299,965	(258,137)	1,919,695	17,795,225	21,756,946	83,912	21,840,858
Comprehensive income								
Profit for the period	–	–	–	–	5,219,620	5,219,620	7,860	5,227,480
Other comprehensive income:								
– net losses from changes in fair value of available-for-sale financial assets	–	–	–	(418,156)	–	(418,156)	–	(418,156)
– currency translation differences	–	–	–	133	–	133	–	133
Total comprehensive income for the period	–	–	–	(418,023)	5,219,620	4,801,597	7,860	4,809,457
Transaction with owners								
Employee share option schemes:								
– value of employee services	–	93,102	–	–	–	93,102	–	93,102
– proceeds from shares issued	–	80,689	–	–	–	80,689	–	80,689
Employee share award scheme:								
– value of employee services	–	242,477	–	–	–	242,477	–	242,477
– shares purchased for share award scheme	–	–	(247,777)	–	–	(247,777)	–	(247,777)
– vesting of awarded shares	–	(29,574)	29,574	–	–	–	–	–
Repurchase and cancellation of shares	–	(97,586)	–	–	–	(97,586)	–	(97,586)
Dividends (Note 25)	–	–	–	–	(838,290)	(838,290)	(56,531)	(894,821)
Transfer to reserve	–	–	–	10,000	(10,000)	–	–	–
Total contributions by and distributions to owners for the period	–	289,108	(218,203)	10,000	(848,290)	(767,385)	(56,531)	(823,916)
Non-controlling interests arising from business combinations	–	–	–	–	–	–	187,092	187,092
Recognition of the financial liabilities in respect of the put option granted to non-controlling interests	–	–	–	(670,985)	–	(670,985)	–	(670,985)
Total transactions with owners for the period	–	289,108	(218,203)	(660,985)	(848,290)	(1,438,370)	130,561	(1,307,809)
Balance at 30 June 2011	198	2,589,073	(476,340)	840,687	22,166,555	25,120,173	222,333	25,342,506

The accompanying notes on pages 29 to 59 form an integral part of this Interim Financial Information.

Condensed Consolidated Statement of Cash Flows

For the six months ended 30 June 2012

	Unaudited Six months ended 30 June	
	2012	2011
	RMB'000	RMB'000
Net cash flows generated from operating activities	**8,945,857**	5,434,115
Net cash flows used in investing activities	**(6,455,778)**	(9,547,558)
Net cash flows (used in)/generated from financing activities	**(4,506,408)**	1,741,476
Net decrease in cash and cash equivalents	**(2,016,329)**	(2,371,967)
Cash and cash equivalents at beginning of period	**12,612,140**	10,408,257
Exchange gains/(losses) on cash and cash equivalents	**6,640**	(73,200)
Cash and cash equivalents at end of period	**10,602,451**	7,963,090
Analysis of balances of cash and cash equivalents:		
Bank balances and cash	**6,699,446**	6,381,618
Term deposits and highly liquid investments with initial term within three months	**3,903,005**	1,581,472
	10,602,451	7,963,090

The accompanying notes on pages 29 to 59 form an integral part of this Interim Financial Information.

Notes to the Interim Financial Information

1 GENERAL INFORMATION

Tencent Holdings Limited (the "Company") was incorporated in the Cayman Islands. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY 1-1111, Cayman Islands. The shares of the Company have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 16 June 2004.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the "Group") are principally engaged in the provision of Internet value-added services ("IVAS"), mobile and telecommunications value-added services ("MVAS"), online advertising services and e-Commerce transactions services to users in the People's Republic of China (the "PRC").

The consolidated statement of financial position as at 30 June 2012, the related consolidated income statement and the consolidated statement of comprehensive income for the three and six months then ended, the consolidated statement of changes in equity and the condensed consolidated statement of cash flows for the six months then ended, and a summary of significant accounting policies and other explanatory notes (collectively defined as the "Interim Financial Information") of the Group have been approved by the Board on 15 August 2012.

This Interim Financial Information has not been audited.

2 BASIS OF PREPARATION AND PRESENTATION

The Interim Financial Information is prepared in accordance with International Accounting Standards ("IAS") 34 'Interim Financial Reporting' issued by the International Accounting Standards Board.

The Interim Financial Information should be read in conjunction with the annual consolidated financial statements of the Group for the year ended 31 December 2011 as set out in the 2011 annual report of the Company dated 14 March 2012 (the "2011 Financial Statements").

3 SIGNIFICANT ACCOUNTING POLICIES

Except as described below, the accounting policies and method of computation used in the preparation of the Interim Financial Information are consistent with those used in the 2011 Financial Statements, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and derivative financial instruments.

Taxes on income for the interim period are accrued using the tax rates that would be applicable to expected total annual assessable profits.

The new or revised standards and amendments to the existing standards, which are mandatory for the financial year of the Company beginning 1 January 2012, are either not currently relevant or have no impact on the Group's Interim Financial Information.

Because of the growth in related business during the six months ended 30 June 2012, the Group disclosed the following accounting policies in this Interim Financial Information, which were not included in the principal accounting policies in the 2011 Financial Statements:

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

(a) Revenue recognition in third-party developed games/applications hosted by the developers

In 2012, the Group entered into cooperation agreements with third-party game/application developers, pursuant to which the games/applications designed, developed and hosted by third-party developers are available to the users on the Group's Internet platforms. The respective third-party game/application developers are responsible for the users' experiences. Under the terms of the cooperation agreements, the Group pays the third-party developers a stated percentage of the fees paid by and collected from end users for the virtual products/items utilised in these games/applications. The Group recognises revenue at the net amount it retains because the Group acts as an agent in the arrangement.

The Group issues prepaid cards and tokens (represent a specific amount of payment unit) through various channels to end users of the games/applications. The end users can register these prepaid cards and tokens to their user accounts on the Group's Internet platforms and then gain access to the respective games/applications hosted by the third-party developers. The users can use the Group's prepaid cards and tokens to purchase virtual products/items in the games/applications. The Group defers the related revenue over an estimated period of the respective products/items as there is an implicit obligation of the Group to maintain and allow access of the users of the games/applications through its platforms.

Revenue derived from games/applications hosted by third-party developers on the Group's Internet platforms is presented within revenues from IVAS.

(b) Revenue recognition in relation to e-Commerce transactions business

e-Commerce transactions revenues are primarily derived from sales of merchandise through the Group's Internet platforms. The Group recognises revenues from merchandise sales and related costs on a gross basis when it acts as a principal. Whether the Group acts as a principal is based on several criteria, including whether it is a primary obligor, whether it is subject to inventory risk, whether it has latitude in establishing prices and selecting suppliers, or has several but not all of these indicators, in a transaction. When the Group is not a principal and is instead acting as an agent, revenues are recognised on a net basis based on a pre-determined percentage.

For merchandise sold under e-Commerce transactions, the customers place their orders online with a commitment made at a fixed selling price. Payment for the purchased merchandise is made either before delivery or upon delivery. When the Group is acting as a principal, revenues, net of discounts and return allowances and value-added tax, are recognised when the merchandise is physically delivered to the respective customers. Return allowances, which reduce the gross amount of revenues, are estimated based on historical experience.

4 ESTIMATES

The preparation of the Interim Financial Information requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

In preparing the Interim Financial Information, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those applied to the 2011 Financial Statements.

5 FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

The Group is subject to a variety of financial risks: market risk (including foreign exchange risk, price risk and interest rate risk), credit risk and liquidity risk.

The Interim Financial Information does not include all financial risk management information and disclosures required in the annual financial statements, and should be read in conjunction with the 2011 Financial Statements.

There were no changes in any risk management policies during the six months ended 30 June 2012.

(b) Foreign exchange risk

Listed below are the Group's major non-RMB monetary assets and liabilities as at 30 June 2012, which are exposed to foreign exchange risk:

		Unaudited	Audited
	Denomination currency	**30 June 2012**	31 December 2011
		RMB'000	RMB'000
Monetary assets			
Current assets	USD	**5,245,878**	5,645,223
Current assets	HKD	**274,086**	304,835
Current assets	EUR	**259,706**	194,705
Monetary liabilities			
Non-current liabilities	USD	**5,722,494**	5,529,637
Current liabilities	USD	**3,789,364**	6,600,412
Current liabilities	HKD	**38,329**	52,086

During the three and six months ended 30 June 2012, the Group reported exchange losses of RMB45,912,000 and RMB48,316,000, respectively (for the three and six months ended 30 June 2011: exchange gains of RMB14,903,000 and RMB27,719,000, respectively) (Note 22). The losses were recorded in "Finance (costs)/ income, net" in the consolidated income statements for the three and six months ended 30 June 2012.

5 FINANCIAL RISK MANAGEMENT (continued)

(c) Capital risk management

The Group monitors capital by regularly reviewing the gearing ratio. The gearing ratio is calculated as total liabilities divided by total assets. The total capital is the "total equity" of the Group as shown in the consolidated statement of financial position, which is also equal to total assets less total liabilities.

As at 30 June 2012, the gearing ratio of the Group was 44% (31 December 2011: 49%).

(d) Fair value estimation

The Group's main financial instruments carried at fair value are available-for-sale financial assets and derivative financial instruments, and the valuation method is the same as that applied in the 2011 Financial Statements.

During the three and six months ended 30 June 2012, the Group reported a net loss (net of tax) of RMB530,203,000 and a net gain (net of tax) of RMB758,711,000 respectively, for available-for-sale financial assets in other comprehensive income, which mainly resulted from the change in fair value of available-for-sale financial assets which have quoted prices (unadjusted) in active markets.

There were no reclassifications of financial assets during the three and six months ended 30 June 2011 and 2012.

6 SEGMENT INFORMATION

The chief operating decision-makers mainly include the executive directors of the Company. They review the Group's internal reports in order to determine the operating segments, assess performance and allocate resources based on these reports.

During the three and six months ended 30 June 2012, the scale of e-Commerce transactions business of the Group increased significantly and the executive directors of the Company treated e-Commerce transactions business as a separate segment of the Group's operations. As a result, a new line of segment information has been presented since 1 January 2012. No comparative figures of the comparative quarters of 2011 is presented since the amounts involved were insignificant.

The Group has the following reportable segments for the three and six months ended 30 June 2012:

– IVAS;
– MVAS;
– Online advertising;
– e-Commerce transactions; and
– Others.

Other segments of the Group are mainly comprised of the provision of trademark licensing, software development services and software sales.

6 SEGMENT INFORMATION (continued)

The chief operating decision-makers assess the performance of the operating segments mainly based on segment revenue and gross profit/(losses) of each operating segment. The selling and marketing expenses and general and administrative expenses are common costs incurred for the operating segments as a whole and, therefore, they are not included in the measure of the segments' performance which is used by the chief operating decision-makers as a basis for the purpose of resource allocation and assessment of segment performance. Interest income, other (losses)/gains, net, finance (costs)/income, net and income tax expense are not allocated to individual operating segment either.

There were no material inter-segment sales during the three and six months ended 30 June 2012 and 2011. The revenues from external customers reported to the chief operating decision-makers are measured in a manner consistent with that applied in the consolidated income statement.

Other information, together with the segment information, provided to the chief operating decision-makers, is measured in a manner consistent with that applied in the Interim Financial Information. There were no segment assets and segment liabilities information provided to the chief operating decision-makers.

The segment information provided to the chief operating decision-makers for the reportable segments for the three and six months ended 30 June 2012 and 2011 is as follows:

	Unaudited					
	Three months ended 30 June 2012					
	IVAS RMB'000	MVAS RMB'000	Online advertising RMB'000	e-Commerce transactions RMB'000	Others RMB'000	Total RMB'000
Segment revenues	**7,786,625**	**929,007**	**879,691**	**857,526**	**74,395**	**10,527,244**
Gross profit	**5,141,251**	**570,072**	**458,403**	**21,521**	**24,618**	**6,215,865**
Depreciation	**263,625**	**26,350**	**24,899**	**1,940**	**4,397**	**321,211**
Amortisation	**48,315**	**–**	**44,756**	**–**	**–**	**93,071**
Share of profit/(losses) of associates	**7,358**	**527**	**–**	**(8,338)**	**5,864**	**5,411**
Share of losses of jointly controlled entities	**(9,375)**	**–**	**–**	**–**	**–**	**(9,375)**

6 SEGMENT INFORMATION (continued)

	IVAS	MVAS	Online advertising	Others	Total
	Unaudited Three months ended 30 June 2011				
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenues	5,386,578	793,839	512,312	46,315	6,739,044
Gross profit/(losses)	3,598,338	471,385	343,688	(6,004)	4,407,407
Depreciation	166,973	14,134	13,487	7,559	202,153
Amortisation	10,585	–	–	–	10,585
Share of profit/(losses) of associates	25,158	(1,704)	–	–	23,454
Share of losses of jointly controlled entities	(60,689)	–	–	–	(60,689)

	IVAS	**MVAS**	**Online advertising**	**e-Commerce transactions**	**Others**	**Total**
	Unaudited Six months ended 30 June 2012					
	RMB'000	**RMB'000**	**RMB'000**	**RMB'000**	**RMB'000**	**RMB'000**
Segment revenues	**15,168,246**	**1,842,849**	**1,419,804**	**1,610,343**	**133,860**	**20,175,102**
Gross profit	**10,114,049**	**1,145,075**	**682,333**	**42,287**	**43,662**	**12,027,406**
Depreciation	**511,545**	**52,124**	**48,633**	**3,697**	**8,680**	**624,679**
Amortisation	**90,206**	**–**	**85,577**	**–**	**–**	**175,783**
Share of profit/(losses) of associates	**6,698**	**(4,128)**	**–**	**(20,100)**	**13,188**	**(4,342)**
Share of losses of jointly controlled entities	**(7,995)**	**–**	**–**	**–**	**–**	**(7,995)**

6 SEGMENT INFORMATION (continued)

	Unaudited				
	Six months ended 30 June 2011				
	IVAS	MVAS	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Segment revenues	10,637,860	1,571,631	793,206	74,767	13,077,464
Gross profit/(losses)	7,107,472	951,677	506,478	(13,529)	8,552,098
Depreciation	300,905	25,312	24,106	12,008	362,331
Amortisation	13,597	–	–	–	13,597
Share of profit/(losses) of associates	62,300	(992)	–	–	61,308
Share of losses of jointly controlled entities	(64,986)	–	–	–	(64,986)

The reconciliation of gross profit to profit before tax is shown in the consolidated income statement.

The Company is domiciled in the Cayman Islands while the Group mainly operates its businesses in the PRC. Revenues derived from external customers in mainland China for the three and six months ended 30 June 2012 were RMB10,097,850,000 and RMB19,391,349,000, respectively (for the three and six months ended 30 June 2011: RMB6,706,925,000 and RMB12,996,547,000, respectively), and revenues derived from external customers in other regions were RMB429,394,000 and RMB783,753,000, respectively (for the three and six months ended 30 June 2011: RMB32,119,000 and RMB80,917,000, respectively).

As at 30 June 2012, the total non-current assets, excluding financial instruments and deferred income tax assets, located in mainland China and other regions were RMB16,738,557,000 and RMB3,574,895,000, respectively (31 December 2011: RMB13,620,472,000 and RMB3,138,745,000, respectively).

Revenues derived from any single external customer were less than 10% of the Group's total revenues for the three and six months ended 30 June 2012.

7 FIXED ASSETS, CONSTRUCTION IN PROGRESS, INVESTMENT PROPERTIES, LAND USE RIGHTS AND INTANGIBLE ASSETS

			Unaudited		
	Fixed assets RMB'000	Construction in progress RMB'000	Investment properties RMB'000	Land use rights RMB'000	Intangible assets RMB'000
Net book amount at 1 January 2011	3,292,828	386,943	37,229	229,890	572,981
Business combinations	14,781	–	–	–	2,644,502
Other additions	1,380,752	198,149	–	–	539,376
Transfers	472,126	(457,297)	(14,829)	–	–
Disposals	(317)	–	–	–	–
Depreciation/amortisation	(494,544)	–	(300)	(2,358)	(275,861)
Net book amount at 30 June 2011	4,665,626	127,795	22,100	227,532	3,480,998
Net book amount at 1 January 2012	**5,884,952**	**158,656**	**21,871**	**230,915**	**3,779,976**
Business combinations	**503**	**–**	**–**	**–**	**84,906**
Other additions	**1,041,695**	**315,119**	**–**	**120,760**	**706,834**
Transfers	**149,989**	**(149,989)**	**–**	**–**	**–**
Disposals	**(1,298)**	**–**	**–**	**–**	**–**
Depreciation/amortisation	**(868,772)**	**–**	**(228)**	**(3,166)**	**(384,574)**
Exchange difference	**(5,890)**	**–**	**–**	**–**	**7,275**
Net book amount at 30 June 2012	**6,201,179**	**323,786**	**21,643**	**348,509**	**4,194,417**

Non-financial assets that have an indefinite life are not subject to amortisation, but are tested for impairment annually at year-end (31 December) or whenever there is any indication of impairment. Non-financial assets that are subject to amortisation and depreciation are reviewed for impairment whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

There was no indication of impairment for fixed assets, construction in progress, investment properties, land use rights and intangible assets during the three and six months ended 30 June 2012.

8 INTERESTS IN ASSOCIATES

	Unaudited Six months ended 30 June	
	2012	2011
	RMB'000	RMB'000
At beginning of period	**4,338,075**	1,070,633
Additions ((a), (b) and (c))	**1,017,698**	1,789,296
Transfer from available-for-sale financial assets	**31,139**	–
Transfer out as a result of step-up business combination	**–**	(117,502)
Share of (losses)/profit of associates	**(4,342)**	61,308
Dividends received from associates	**(21,748)**	(20,000)
Disposal of an associate	**(68,263)**	–
At end of period	**5,292,559**	2,783,735

Note:

(a) On 31 January 2012, the Group acquired 619,400,000 ordinary shares of ChinaVision Media Group Limited ("ChinaVision"), representing approximately 8% of its total outstanding shares, for a cash consideration of HKD247,760,000. ChinaVision is a company listed on the Main Board of the Stock Exchange, and principally engaged in production and licensing of film and television programmes, and printed media and television advertising businesses. Since the Group has the right to nominate a director to the board of ChinaVision, the investment in ChinaVision is accounted for as an investment in associate of the Group.

(b) In April 2012, the Group acquired 3,600,000 preference shares of Kakao Corp. ("Kakao"), a company principally engaged in developing and operating mobile chat applications, representing approximately 13.84% of its issued share capital, for a cash consideration of KRW72,000,000,000. Since the Group has significant influence in Kakao through its representative of the board, the investment in Kakao is accounted for as an investment in associate of the Group.

(c) In addition to the above, the Group acquired some other associates for an aggregate consideration of RMB221,843,000 during the six months ended 30 June 2012. They are principally engaged in online community service, online game development and other Internet related businesses. The Group also made additional investments in existing investees for an aggregate consideration of RMB193,224,000 during the six months ended 30 June 2012. They are principally engaged in game development.

As at 30 June 2012 and 2011, there were certain call or conversion options embedded in interests in associates. The directors of the Company considered that the fair values of such options were insignificant and accordingly, the Group did not separately recognise these options in the Interim Financial Information.

9 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Unaudited Six months ended 30 June	
	2012	2011
	RMB'000	RMB'000
At beginning of period	**4,343,602**	4,126,878
Additions	**252,063**	953,535
Transfer to interests in associates	**(31,139)**	–
Gains/(losses) from changes in fair value	**756,343**	(424,846)
At end of period	**5,320,869**	4,655,567
Market value of listed securities	**4,075,137**	3,889,122

As at 30 June 2012, there were certain call or conversion options embedded in available-for-sale financial assets. The directors of the Company considered that the fair values of such options were insignificant and accordingly, the Group did not separately recognise these options in the Interim Financial Information.

10 ACCOUNTS RECEIVABLE

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
0 - 30 days	**1,502,110**	1,103,261
31 - 60 days	**363,831**	443,555
61 - 90 days	**324,424**	246,501
Over 90 days	**309,842**	227,479
	2,500,207	2,020,796

Accounts receivable was mainly denominated in RMB.

Receivable balances as at 30 June 2012 mainly represented amounts due from telecommunication operators, including China Mobile Communications Corporation, China United Telecommunications Co. Ltd., China Telecommunications Corporation and their respective branches, subsidiaries and affiliates, as well as online advertising customers mainly located in the PRC.

10 ACCOUNTS RECEIVABLE (continued)

While there are no contractual requirements for the telecommunication operators to pay amounts owed to the Group within a specified period of time, they usually settle the amounts due by them within a period of 30 to 120 days. Online advertising customers, which are mainly advertising agencies, are usually granted a credit period of 90 days after full execution of the contracted advertisement orders.

The directors of the Company considered that the carrying amounts of the receivable balances approximated to their fair value as at 30 June 2012.

11 PREPAYMENTS, DEPOSITS AND OTHER ASSETS

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
Included in non-current assets:		
Prepayment for interests in associates	**2,118,925**	–
Prepayment for purchase of buildings	**743,379**	510,425
Prepayment for online game licences	**423,764**	350,668
Prepayment for land use rights	**258,237**	258,237
Loans to associates and jointly controlled entities	**184,133**	111,063
Non-current portion of running royalty fees for online games	**132,103**	945,135
Prepaid expenses	**16,910**	107,341
	3,877,451	2,282,869
Included in current assets:		
Current portion of running royalty fees for online games	**1,527,516**	405,915
Prepaid expenses	**575,694**	483,592
Interest receivables	**249,858**	143,370
Refundable value-added tax	**280,322**	270,028
Rental deposits and other deposits	**117,288**	112,714
Loans to associates	**36,075**	6,052
Others	**489,215**	790,246
	3,275,968	2,211,917
	7,153,419	4,494,786

11 PREPAYMENTS, DEPOSITS AND OTHER ASSETS (continued)

The directors of the Company considered that the carrying amounts of the prepayments, deposits and other assets approximated to their fair values as at 30 June 2012.

Prepayments, deposits and other assets were neither past due nor impaired. Their recoverability was assessed with reference made to the credit status of the respective recipients.

12 SHARE CAPITAL, SHARE PREMIUM AND SHARES HELD FOR SHARE AWARD SCHEME

As at 30 June 2012, the total authorised number of ordinary shares is 10,000,000,000 shares (31 December 2011: 10,000,000,000 shares) with par value of HKD0.0001 per share (31 December 2011: HKD0.0001 per share).

As at 30 June 2012, all issued shares were fully paid.

		Unaudited			
	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Total RMB'000
At 1 January 2012	**1,839,814,008**	**198**	**2,058,051**	**(606,874)**	**1,451,375**
Employee share option schemes:					
Value of employee services	–	–	55,669	–	55,669
Number of shares issued and proceeds received	4,430,528	–	113,640	–	113,640
Employee share award scheme:					
Value of employee services	–	–	295,814	–	295,814
Shares purchased and withheld for share award scheme	–	–	–	(16,946)	(16,946)
Shares vested from share award scheme and transferred to the grantees	–	–	(14,163)	14,163	–
Repurchase and cancellation of shares	(154,400)	–	(20,232)	–	(20,232)
At 30 June 2012	**1,844,090,136**	**198**	**2,488,779**	**(609,657)**	**1,879,320**

12 SHARE CAPITAL, SHARE PREMIUM AND SHARES HELD FOR SHARE AWARD SCHEME (continued)

		Unaudited			
	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Total RMB'000
At 1 January 2011	1,835,730,235	198	2,299,965	(258,137)	2,042,026
Employee share option schemes:					
Value of employee services	–	–	93,102	–	93,102
Number of shares issued and proceeds received	3,980,713	–	80,689	–	80,689
Employee share award scheme:					
Value of employee services	–	–	242,477	–	242,477
Shares purchased and withheld for share award scheme	–	–	–	(247,777)	(247,777)
Shares vested from share award scheme and transferred to the grantees	–	–	(29,574)	29,574	–
Repurchase and cancellation of shares	(611,300)	–	(97,586)	–	(97,586)
At 30 June 2011	1,839,099,648	198	2,589,073	(476,340)	2,112,931

Note:

(a) As at 30 June 2012, the total number of issued ordinary shares of the Company was 1,844,090,136 shares (31 December 2011: 1,839,814,008 shares), which included 17,418,292 shares (31 December 2011: 17,809,839 shares) held under the Share Award Scheme (Note 13(b)).

(b) The Group merged the share-based compensation reserve related to the Company's share option schemes and share award scheme into the Company's share premium during the six months ended 30 June 2012. The comparative figures have been reclassified to conform to the presentation of the current period. Such reclassification has no impact on the Group's net profit for the comparative period, as well as on the Group's net assets as at 31 December 2011.

13 SHARE-BASED PAYMENTS

(a) Share option schemes

The Company has adopted four share option schemes, namely, the Pre-IPO Option Scheme, the Post-IPO Option Scheme I, the Post-IPO Option Scheme II and Post-IPO Option Scheme III, under which the directors may, at their discretion, grant options to any qualifying participants to subscribe for shares in the Company, subject to the terms and conditions stipulated therein. No further options will be granted under the Pre-IPO Option Scheme and the Post-IPO Option Scheme I.

In respect of Post-IPO Option Scheme II and Post-IPO Option Scheme III, the exercise price must be at least the higher of: (i) the closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; (ii) the average closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's shares. In addition, the option vesting period is determined by the Board provided that it is not later than the last day of a 7-year or 10-year period after the date of grant of option.

(i) Movements in share options

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	Pre-IPO Option Scheme		Post-IPO Option Scheme I		Post-IPO Option Scheme II		Post-IPO Option Scheme III		Total
	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	No. of options
At 1 January 2011	USD0.0935	563,193	HKD12.8579	12,805,763	HKD54.9391	28,795,168	HKD158.5000	1,000,000	43,164,124
Granted	–	–	–	–	HKD194.4000	312,550	–	–	312,550
Exercised	USD0.0709	(464,420)	HKD12.7643	(1,866,215)	HKD43.6137	(1,650,078)	–	–	(3,980,713)
Lapsed	–	–	HKD4.4850	(33)	HKD58.0532	(96,556)	–	–	(96,589)
At 30 June 2011	USD0.1998	98,773	HKD12.8739	10,939,515	HKD57.2042	27,361,084	HKD158.5000	1,000,000	39,399,372
Exercisable as at 30 June 2011	USD0.1998	98,773	HKD11.6643	9,671,095	HKD 41.1057	7,512,924	–	–	17,282,792
At 1 January 2012	**–**	**–**	**HKD12.3871**	**8,761,937**	**HKD59.9665**	**26,156,088**	**HKD158.5000**	**1,000,000**	**35,918,025**
Exercised	**–**	**–**	**HKD15.6453**	**(2,026,139)**	**HKD45.0567**	**(2,404,389)**	**–**	**–**	**(4,430,528)**
Lapsed	**–**	**–**	**HKD8.1734**	**(157)**	**HKD47.3139**	**(85,024)**	**–**	**–**	**(85,181)**
At 30 June 2012	**–**	**–**	**HKD11.4071**	**6,735,641**	**HKD61.5267**	**23,666,675**	**HKD158.5000**	**1,000,000**	**31,402,316**
Exercisable as at 30 June 2012	**–**	**–**	**HKD11.1559**	**6,615,641**	**HKD40.8706**	**9,526,152**	**–**	**–**	**16,141,793**

13 SHARE-BASED PAYMENTS (continued)

(a) Share option schemes (continued)

(i) Movements in share options (continued)

During the six months ended 30 June 2012, no share option (during the six months ended 30 June 2011: Nil) was granted to the directors of the Company.

As a result of options exercised during the six months ended 30 June 2012, 4,430,528 ordinary shares (during the six months ended 30 June 2011: 3,980,713 ordinary shares) were issued by the Company (Note 12). The weighted average price of the shares at the time these options were exercised was HKD213.57 per share (for the six months ended 30 June 2011: HKD202.01 per share).

(ii) Outstanding share options

Details of the expiry dates, exercise prices and the respective numbers of share options which remained outstanding as at 30 June 2012 and 31 December 2011 are as follows:

		Number of share options	
Expiry Date	**Range of exercise price**	**30 June 2012**	31 December 2011
10 years commencing from the adoption			
date of 24 March 2004	HKD3.66-HKD8.35	**3,509,751**	4,164,319
(Post-IPO Option Scheme I)	HKD11.55-HKD25.26	**3,225,890**	4,597,618
		6,735,641	8,761,937
7 years commencing from the date of	HKD31.75-HKD43.50	**11,689,738**	12,715,582
grant of options	HKD45.50-HKD90.30	**8,271,812**	9,733,781
(Post-IPO Option Scheme II)	HKD128.40-HKD194.40	**3,705,125**	3,706,725
		23,666,675	26,156,088
10 years commencing from the date of			
grant of options			
(Post-IPO Option Scheme III)	HKD158.50	**1,000,000**	1,000,000
		31,402,316	35,918,025

13 SHARE-BASED PAYMENTS (continued)

(b) Share award scheme

The Company has adopted a share award scheme (the "Share Award Scheme"), which is managed by an independent trustee appointed by the Group (the "Trustee"). The vesting period of the awarded share is determined by the Board.

Movements in the number of shares held for the Share Award Scheme and awarded shares for the six months ended 30 June 2012 and 2011 are as follows:

	Number of shares held for the Share Award Scheme	Number of awarded shares
At 1 January 2011	80	13,562,734
Purchased for awards	1,437,320	–
Shares to be allotted to the Share Award Scheme	535,170	–
Granted	(1,972,570)	1,972,570
Vested and exercised	–	(238,616)
At 30 June 2011	–	15,296,688
Exercisable as at 30 June 2011		72,117
At 1 January 2012	**1,970,840**	**15,838,999**
Purchased and withheld for award	**107,981**	**–**
Granted	**(759,400)**	**759,400**
Lapsed	**321,925**	**(321,925)**
Vested and exercised	**–**	**(499,528)**
At 30 June 2012	**1,641,346**	**15,776,946**
Exercisable as at 30 June 2012		**3,005**

During the six months ended 30 June 2012, no awarded share (during the six months ended 30 June 2011: 35,000) was granted to the directors of the Company.

13 SHARE-BASED PAYMENTS (continued)

(b) Share award scheme (continued)

The fair value of the awarded shares was calculated based on the market price of the Company's shares at the respective grant date. The expected dividends during the vesting period have been taken into account when assessing the fair value of these awarded shares.

The weighted average fair value of awarded shares granted during the six months ended 30 June 2012 was HKD 215.62 per share (during the six months ended 30 June 2011: HKD208.32 per share). In addition, such awarded shares are divided into one to five tranches on an equal basis. The first tranche can be exercised immediately or after a specified period ranging from three months to five years from the grant dates, and the remaining tranches will become exercisable in each subsequent year.

(c) Employee incentive scheme

In 2011, the Group established an employee incentive scheme in a form of limited liability partnership (the "EIS") for incentive purpose pursuant to a shareholders' resolution passed at the 2011 annual general meeting of the Company held on 11 May 2011. The Board may, at its absolute discretion, select any employees of the Group to participate in the EIS by subscribing for partnership interest at cash consideration. The initial total cash contribution by selected employees is limited to approximately RMB80,000,000. The participating employees are entitled to all the economic benefits generated by the EIS (if any) after a specified vesting period under the EIS, ranging from 4 to 7 years. A wholly-owned subsidiary of the Company which acts as a general partner of the EIS manages and in essence, controls it. The EIS is therefore consolidated by the Company. In addition, because certain continuous service conditions are attached to the partnership interest subscribed by the employees, the EIS is accounted for as an equity-settled share-based payment transaction.

During the six months ended 30 June 2012, there was no partnership interest of EIS granted to the employees of the Group.

(d) Share options and restricted share award schemes adopted by non-wholly owned subsidiaries

Other than the above, certain non-wholly owned subsidiaries of the Company operate their own share-based compensation plans (share option and/or restricted share award schemes). The exercise prices of the share options, as well as the vesting periods of the share options and restricted shares are determined by the board of directors of these subsidiaries at their sole discretion in accordance with the relevant plans. Similar to the share option/award schemes adopted by the Company, the share options or restricted shares of the subsidiaries so granted are normally vested in several tranches.

The directors of the Company considered that the fair value of share options/restricted shares granted under the share-based compensation plans of the non-wholly owned subsidiaries, and the relevant share-based compensation expense charged to the income statement of the Group for the three and six months ended 30 June 2012, are not significant to the Group.

13 SHARE-BASED PAYMENTS (continued)

(e) Expected retention rate of grantees

The Group has to estimate the expected yearly percentage of grantees that will stay within the Group at the end of vesting periods of the options and awarded shares (the "Expected Retention Rate") in order to determine the amount of share-based compensation expenses charged to the income statement. As at 30 June 2012, the Expected Retention Rate was assessed to be 91% (31 December 2011: 91%).

14 ACCOUNTS PAYABLE

Accounts payable and their ageing analysis are as follows:

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
0 - 30 days	**2,169,560**	1,514,155
31 - 60 days	**962,739**	351,587
61 - 90 days	**54,185**	108,337
Over 90 days	**181,954**	270,035
	3,368,438	2,244,114

15 OTHER PAYABLES AND ACCRUALS

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
Prepayments received from customers and e-Commerce business	**2,003,263**	1,840,947
Staff costs and welfare accruals	**1,504,655**	1,478,391
Marketing and administrative expense accruals	**683,071**	731,571
Purchase consideration payables for business combinations and associates	**266,489**	252,952
Current portion of running royalty fee for online games	**44,274**	315,045
Others	**370,861**	395,375
	4,872,613	5,014,281

16 LONG-TERM PAYABLES

	Unaudited 30 June 2012 RMB'000	Audited 31 December 2011 RMB'000
Present value of non-current portion of running royalty fee for online games	**132,103**	945,135
Present value of liabilities in relation to put options granted to non-controlling interests	**1,028,603**	670,985
Present value of purchase consideration payable for certain business combination	**137,344**	131,180
Others	**143,870**	112,508
	1,441,920	1,859,808

17 BORROWINGS

	Unaudited 30 June 2012 RMB'000	Audited 31 December 2011 RMB'000
Included in non-current liabilities:		
USD bank borrowing		
Unsecured (a)	**948,735**	–
Included in current liabilities:		
RMB bank borrowings		
Secured (b)	**320,375**	2,958,720
USD bank borrowings		
Unsecured (c)	**3,288,948**	4,410,630
Bonds		
Unsecured	**–**	630,090
	3,609,323	7,999,440
	4,558,058	7,999,440

17 BORROWINGS (continued)

Movement in the borrowings is analysed as follows:

	Unaudited Six months ended 30 June	
	2012	2011
	RMB'000	RMB'000
At beginning of period	**7,999,440**	5,298,947
Additions of bank borrowings	**1,893,240**	4,778,230
Issuance of bonds	**–**	657,520
Repayments of bonds	**(629,190)**	–
Repayments of bank borrowings	**(4,729,060)**	(2,493,119)
Exchange difference	**23,628**	(91,513)
At end of period	**4,558,058**	8,150,065

Note:

(a) Unsecured long-term bank borrowing of carrying amount of RMB948,735,000 as at 30 June 2012 was denominated in USD. The aggregate principal amount was USD150,000,000 with an interest rate of LIBOR plus 2.44% per annum. Such bank borrowing shall be repaid by installments.

(b) Bank borrowings of carrying amount of RMB320,375,000 were secured by pledge of bank deposits of RMB324,347,000.

(c) Unsecured bank borrowings of carrying amount of RMB3,288,948,000 as at 30 June 2012 were denominated in USD. The aggregate principal amount was USD520,000,000 with interest rates of LIBOR plus 0.85% to 1.75% per annum. In addition, the Group entered into foreign exchange forward contracts to purchase the required amount of USD with RMB for settling some of the bank borrowings with an aggregate principal amount of USD45,000,000 upon the respective borrowing due dates. As the Group did not adopt hedge accounting, these bank borrowings and the relevant foreign exchange forward contracts were accounted for separately. The bank borrowings were accounted for as USD denominated bank borrowings and stated at amortised cost, while the forward contracts were accounted for as derivative financial instruments stated at fair value with their gains or losses recorded in "Other (losses)/gains, net" in the consolidated income statement.

18 LONG-TERM NOTES PAYABLE

On 12 December 2011, the Company issued long-term notes (the "Notes") with an initial aggregate principal amount of USD600,000,000 for general corporate purposes. The Notes bear an interest at 4.625% per annum from 12 December 2011, payable semi-annually in arrears on 12 June and 12 December of each year, beginning on 12 June 2012. The Notes are listed on Singapore Exchange Securities Trading Limited and will mature on 12 December 2016.

As at 30 June 2012, the carrying amount of the Notes was RMB3,751,839,000.

19 DEFERRED INCOME TAXES

The movements of the deferred income tax assets/liabilities account were as follows:

	Deferred income tax assets RMB'000	Deferred income tax liabilities RMB'000	Deferred income tax, net RMB'000
At 1 January 2011	219,019	(967,211)	(748,192)
Charge to consolidated income statement	(28,136)	(48,775)	(76,911)
Credit to other comprehensive income	6,690	–	6,690
Temporary differences arising from a business combination	–	(269,793)	(269,793)
Withholding tax paid in relation to the remittance of dividends from the PRC to foreign investors	–	339,946	339,946
At 30 June 2011	197,573	(945,833)	(748,260)
At 1 January 2012	**198,058**	**(939,534)**	**(741,476)**
Charge to consolidated income statement	**(15,818)**	**(105,714)**	**(121,532)**
Credit to other comprehensive income	**2,368**	**–**	**2,368**
Temporary differences arising from a business combination (Note 26)	**–**	**(3,082)**	**(3,082)**
Withholding tax paid in relation to the remittance of dividends from the PRC to foreign investors	**–**	**156,968**	**156,968**
Exchange difference	**–**	**(2,460)**	**(2,460)**
At 30 June 2012	**184,608**	**(893,822)**	**(709,214)**

20 OTHER (LOSSES)/GAINS, NET

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2012	2011	**2012**	2011
	RMB'000	RMB'000	**RMB'000**	RMB'000
Gains on disposal/deemed disposal of associates	**–**	–	**11,543**	459,037
Government subsidies	**13,258**	9,699	**32,836**	14,988
Gains/(losses) from derivative financial instruments	**18**	(23,495)	**(19,842)**	(44,869)
Donation to Tencent Charity Fund	**–**	–	**(60,000)**	(100,000)
Others	**(16,495)**	16,605	**(31,398)**	12,722
	(3,219)	2,809	**(66,861)**	341,878

21 EXPENSES BY NATURE

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2012	2011	**2012**	2011
	RMB'000	RMB'000	**RMB'000**	RMB'000
Employee benefit expenses (Note)	**1,908,491**	1,249,702	**3,597,857**	2,209,952
Content costs and agency fees	**1,697,518**	1,103,048	**3,140,491**	2,236,777
Mobile and telecom charges and bandwidth and server custody fees	**817,869**	620,745	**1,593,286**	1,212,068
Cost of merchandise sold	**810,273**	–	**1,524,365**	–
Depreciation of fixed assets (Note)	**444,716**	273,999	**868,772**	494,544
Promotion and advertising expenses	**386,383**	240,817	**663,444**	447,004
Amortisation of intangible assets	**142,464**	222,651	**384,574**	275,861
Operating lease rentals in respect of office buildings	**145,827**	80,339	**288,674**	139,350
Travelling and entertainment expenses	**73,669**	48,380	**131,113**	77,549
Other expenses	**356,006**	224,819	**650,231**	363,043
	6,783,216	4,064,500	**12,842,807**	7,456,148

21 EXPENSES BY NATURE (continued)

Note:

Research and development expenses for the three and six months ended 30 June 2012 were RMB1,042,440,000 and RMB1,983,203,000, respectively (for the three and six months ended 30 June 2011: RMB671,791,000 and RMB1,184,978,000, respectively) which included employee benefit expenses of RMB842,449,000 and depreciation of fixed assets of RMB109,412,000 for the three months ended 30 June 2012 (for the three months ended 30 June 2011: RMB582,534,000 and RMB63,088,000, respectively) and employee benefit expenses of RMB1,617,522,000 and depreciation of fixed assets of RMB217,176,000 for the six months ended 30 June 2012 (for the six months ended 30 June 2011: RMB1,022,103,000 and RMB116,291,000, respectively). No research and development expenses were capitalised as at 30 June 2012.

22 FINANCE (COSTS)/INCOME, NET

	Unaudited Three months ended 30 June		**Unaudited Six months ended 30 June**	
	2012	2011	**2012**	2011
	RMB'000	RMB'000	**RMB'000**	RMB'000
Exchange (losses)/gains	**(45,912)**	14,903	**(48,316)**	27,719
Interest expenses	**(69,344)**	(13,132)	**(136,922)**	(29,817)
	(115,256)	1,771	**(185,238)**	(2,098)

Interest expenses mainly arose from the borrowings (Note 17) and long-term notes payable (Note 18).

23 TAX EXPENSE

(a) Income tax expense

(i) Cayman Islands and British Virgin Islands profits tax

The Group was not subject to any taxation in the Cayman Islands and British Virgin Islands for the three and six months ended 30 June 2012 and 2011.

(ii) Hong Kong profits tax

Hong Kong profits tax provision has been provided at the rate of 16.5% on the estimated assessable profits for the three and six months ended 30 June 2012. No such provision was provided for the three and six months ended 30 June 2011.

(iii) PRC Corporate Income Tax ("CIT")

CIT provision was made on the assessable profits of entities within the Group incorporated in the PRC, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

Pursuant to the PRC Corporate Income Tax Law passed by the Tenth National People's Congress on 16 March 2007 (the "CIT Law"), the CIT rate for domestic and foreign enterprises has been unified at 25%, effective from 1 January 2008.

The CIT Law also provides a five-year transitional period starting from its effective date for those enterprises which were established before the promulgation of the CIT Law and which were entitled to preferential income tax rates under the then effective tax laws or regulations.

On 26 December 2007, the State Council issued the "Circular to Implementation of the Transitional Preferential Policies for the Corporate Income Tax". Pursuant to this circular, the transitional CIT rates for the Group's subsidiaries established in the Shenzhen Special Economic Zone or the Beijing High Technology Zone before 16 March 2007 are 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011 and 2012, respectively. Other tax preferential treatments such as reduction of 50% in income tax rates shall be based on the above transitional income tax rates for the respective years.

In 2011, certain subsidiaries of the Company in the PRC were approved as High and New Technology Enterprise, and accordingly, they were subject to a reduced preferential CIT rate of 15% for a 3-year period from 2011 to 2013 according to the applicable CIT Law.

In addition, according to relevant tax circulars issued by the PRC tax authorities, certain subsidiaries of the Company are exempt from CIT for two years, followed by a 50% reduction in the applicable tax rates for the next three years, commencing either from the first year of commercial operation or from the first year of profitable operation after offsetting tax losses generated in prior years.

23 TAX EXPENSE (continued)

(a) Income tax expense (continued)

(iv) United States corporate income tax

United States corporate income tax provision was provided during the three and six months ended 30 June 2012 for the entities within the Group which were incorporated in the United States. No such provision was provided for the three and six months ended 30 June 2011.

(v) PRC withholding tax

According to applicable PRC tax regulations, dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 are generally subject to a 10% withholding tax. If a foreign investor is incorporated in Hong Kong and meets the conditions or requirements under the double taxation arrangement entered into between the PRC and Hong Kong, the relevant withholding tax rate will be reduced from 10% to 5%.

The income tax expense of the Group for the three and six months ended 30 June 2012 and 2011 are analysed as follows:

	Unaudited Three months ended 30 June		**Unaudited Six months ended 30 June**	
	2012	2011	**2012**	2011
	RMB'000	RMB'000	**RMB'000**	RMB'000
Current tax	**631,810**	432,561	**1,236,965**	860,235
Deferred tax	**76,014**	(27,398)	**121,532**	76,911
	707,824	405,163	**1,358,497**	937,146

23 TAX EXPENSE (continued)

(a) Income tax expense (continued)

The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the tax rate of 25% for the three and six months ended 30 June 2012 (for the three and six months ended 30 June 2011: 24%), being the tax rate of the major subsidiaries of the Company before preferential tax treatments. The difference is analysed as follows:

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2012	2011	**2012**	2011
	RMB'000	RMB'000	**RMB'000**	RMB'000
Profit before income tax	**3,818,395**	2,748,435	**7,431,398**	6,164,626
Add: Share of losses/(profit) of associates and jointly controlled entities	**3,964**	37,235	**12,337**	3,678
	3,822,359	2,785,670	**7,443,735**	6,168,304
Tax calculated at a tax rate of 25% (for the three and six months ended 30 June 2011: 24%)	**955,590**	668,561	**1,860,934**	1,480,393
Effects of different tax rates applicable to different subsidiaries	**(308,254)**	(227,458)	**(672,381)**	(533,220)
Effects of tax holiday on assessable profit of subsidiaries	**(67,650)**	(125,882)	**(135,057)**	(249,576)
Income not subject to tax	**(27,478)**	(1,900)	**(46,456)**	(11,663)
Expenses not deductible for tax purposes	**60,843**	79,318	**120,092**	113,879
Withholding tax on earnings expected to be remitted by PRC subsidiaries	**78,603**	50,000	**171,603**	141,500
Unrecognised deferred income tax assets	**29,588**	22,019	**73,180**	55,328
Adjustments in respect of CIT filing	**(13,418)**	(59,495)	**(13,418)**	(59,495)
Income tax expense	**707,824**	405,163	**1,358,497**	937,146

23 TAX EXPENSE (continued)

(b) Value-added tax, business tax and related taxes and surcharges

The operations of the Group are also subject to the following taxes and surcharges in the PRC:

Category	Tax rate	Basis of levy
Value-added tax ("VAT")	6-17%	Sales value of goods sold, offsetting by VAT on purchases
	3%	Sales value of goods sold
Business tax ("BT")	3-5%	Services fee income
City construction tax	1-7%	Net VAT and BT payable amount
Construction fee for cultural undertakings	3%	Advertising income
Educational surcharge	3-5%	Net VAT and BT payable amount

24 EARNINGS PER SHARE

(a) Basic

Basic earnings per share ("EPS") are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the period.

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2012	2011	**2012**	2011
Profit attributable to equity holders of the Company for the period (RMB'000)	**3,100,075**	2,349,246	**6,049,585**	5,219,620
Weighted average number of ordinary shares in issue (thousand shares)	**1,826,071**	1,823,051	**1,824,501**	1,822,866
Basic EPS (RMB per share)	**1.698**	1.289	**3.316**	2.863

24 EARNINGS PER SHARE (continued)

(b) Diluted

The share options and awarded shares granted by the Company have potential dilutive effect on the EPS. Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options and awarded shares granted by the Company (collectively forming the denominator for computing the diluted EPS). No adjustment is made to earnings (numerator).

In addition, the share options and restricted shares granted by the Company's non-wholly owned subsidiaries and associates should also have potential dilutive effect on the EPS. During the three and six months ended 30 June 2012, these share options and restricted shares either had anti-dilutive effect or their dilutive effect was insignificant to the Group.

	Unaudited Three months ended 30 June		**Unaudited Six months ended 30 June**	
	2012	2011	**2012**	2011
Profit attributable to equity holders of the Company for the period (RMB'000)	**3,100,075**	2,349,246	**6,049,585**	5,219,620
Weighted average number of ordinary shares in issue (thousand shares)	**1,826,071**	1,823,051	**1,824,501**	1,822,866
Adjustments for share options (thousand shares)	**23,766**	30,626	**24,406**	31,160
Adjustments for awarded shares (thousand shares)	**11,496**	10,160	**11,515**	10,061
Weighted average number of ordinary shares for the calculation of diluted EPS (thousand shares)	**1,861,333**	1,863,837	**1,860,422**	1,864,087
Diluted EPS (RMB per share)	**1.665**	1.260	**3.252**	2.800

25 DIVIDEND

A final dividend in respect of the year ended 31 December 2011 of HKD0.75 per share (2010: HKD0.55 per share) was proposed pursuant to a resolution passed by the Board on 14 March 2012 and approved by shareholders at the 2012 annual general meeting of the Company held on 16 May 2012. Such dividend, amounted to HKD1,369,117,000 (equivalent to approximately RMB1,107,889,000) (final dividend for 2010: HKD1,010,294,000 (equivalent to approximately RMB838,290,000)), had been paid as at 30 June 2012.

The Board did not propose any interim dividend for the six months ended 30 June 2012 (for the six months ended 30 June 2011: Nil).

26 BUSINESS COMBINATIONS

During the six months ended 30 June 2012, the Group acquired 51% equity interest in a company engaged in publication and online reading services and 100% equity interest in a company engaged in providing massively multi-player online game information.

The considerations and the allocation of such considerations to the fair value of the net assets acquired and goodwill recognised as at the respective dates of these acquisitions are as follows:

	RMB'000
Purchase considerations	75,846
Carrying amount of the non-controlling interests	(2,455)
	73,391
Fair value of net assets acquired	7,544
Goodwill	65,847
	73,391

The revenues and net profit contributed by these subsidiaries from their respective acquisition dates to 30 June 2012 to the Group were not material.

27 CONTINGENCIES

The Group had no material contingent liabilities outstanding as at 30 June 2012.

28 COMMITMENTS

(a) Capital commitments

Capital commitments as at 30 June 2012 and 2011 are analysed as follows:

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
Contracted:		
Construction/purchase of buildings and purchase of land use rights	**589,375**	463,046
Purchase of other fixed assets	**149,685**	132,260
Capital investment in investees	**1,075,357**	816,910
	1,814,417	1,412,216
Authorised but not contracted:		
Construction/purchase of buildings and purchase of land use rights	**1,049,033**	1,186,867
Capital investment in investees	**450,772**	651,927
	1,499,805	1,838,794
	3,314,222	3,251,010

(b) Operating lease commitments

The future aggregate minimum lease payments under non-cancellable operating leases in respect of buildings are as follows:

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
Contracted:		
Not later than one year	**505,969**	520,396
Later than one year and not later than five years	**1,301,742**	1,462,788
Later than five years	**255,295**	286,135
	2,063,006	2,269,319

28 COMMITMENTS (continued)

(c) Other commitments

The future aggregate minimum payments under non-cancellable bandwidth and server custody leases, online game licensing and contents agreements are as follows:

	Unaudited	Audited
	30 June	31 December
	2012	2011
	RMB'000	RMB'000
Contracted:		
Not later than one year	**1,024,238**	596,031
Later than one year and not later than five years	**1,333,948**	768,291
	2,358,186	1,364,322

29 RELATED PARTIES TRANSACTIONS

Save as disclosed in "Loans to associates and jointly controlled entities" in Note 11 (Prepayments, deposits and other assets) and Note 13 (Share-based payments) to this Interim Financial Information, the Group had no other material transactions with related parties for the three and six months ended 30 June 2012, and no other material related parties' balances as at 30 June 2012.

30 SUBSEQUENT EVENTS

(a) In July 2012, the Group purchased 49% issued share capital of Level Up! International Holdings Pte. Ltd. ("Level Up") from a related party (the "Level Up Acquisition"). In addition, the Group has an option to acquire, within a two-year period after closing, certain additional number of shares in Level Up that, together with the shares acquired in the Level Up Acquisition, will represent 67% of the issued share capital of Level Up as at the date when the option is fully exercised. Level Up is principally engaged in online game publishing and game magazine publication. As of the date of this report, the Group is in the process of assessing and quantifying the fair value of the net identifiable assets acquired and not in a position to complete its initial accounting because of time constraint.

(b) In May 2012, the Group entered into sales and purchase agreement, pursuant to which, the Group agreed to purchase certain equity interest of Epic Games, Inc. ("Epic"). This acquisition was completed in July 2012. Epic is principally engaged in developing game engine technology, as well as game titles for PC, consoles and mobile devices. Upon completion of the acquisition, Epic has been accounted for as an associate of the Group.

31 SEASONALITY

The Group's online advertising business is subject to seasonal fluctuations as advertisers usually reduce their advertising spending around the Chinese New Year holiday period (the first quarter of the year).