

Giant Interactive Group Inc.  
Form 20-F  
April 29, 2014  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549.**

**FORM 20-F**

(Mark One)

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

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2013**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report**

**Commission file number: 001-33759**

**Giant Interactive Group Inc.**

**(Exact name of Registrant as specified in its charter)**

**Not applicable**

**(Translation of Registrant's name into English)**

**Cayman Islands**

**(Jurisdiction of incorporation or organization)**

**11/F, No. 3 Building, 700 Yishan Road**

**Shanghai, 200233, People's Republic of China**

**(Address of principal executive offices)**

**Jazy Zhang Chief Financial Officer**

**12/F, No. 3 Building, 700 Yishan Road**

**Shanghai, 200233,**

**People's Republic of China**

**Telephone: (86 21) 3397 9999**

**Facsimile: (86 21) 3397 9948**

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

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

**Title of each class  
American Depositary Shares, each representing one  
ordinary share, par value US\$0.0000002 per share**

**Name of each exchange on which registered  
New York Stock Exchange**

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

**None**

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

**None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 240,499,872 ordinary shares, par value US\$0.0000002 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

If this report is an annual or transaction report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

U.S. GAAP  International Financial Reporting Standards as issued  Other   
by the International Accounting Standards Board

If  Other has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow.  Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No



Table of Contents**GIANT INTERACTIVE GROUP INC.****TABLE OF CONTENTS**

	<b>Page</b>
<u>INTRODUCTION</u>	1
<u>FORWARD-LOOKING STATEMENTS</u>	3
<u>PART I.</u>	
ITEM 1. <u>IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>	4
ITEM 2. <u>OFFER STATISTICS AND EXPECTED TIMETABLE</u>	4
ITEM 3. <u>KEY INFORMATION</u>	4
ITEM 4. <u>INFORMATION ON THE COMPANY</u>	35
ITEM 4A. <u>UNRESOLVED STAFF COMMENTS</u>	62
ITEM 5. <u>OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	62
ITEM 6. <u>DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	78
ITEM 7. <u>MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	86
ITEM 8. <u>FINANCIAL INFORMATION</u>	88
ITEM 9. <u>THE OFFER AND LISTING</u>	90
ITEM 10. <u>ADDITIONAL INFORMATION</u>	90
ITEM 11. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	98
ITEM 12. <u>DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	99
<u>PART II.</u>	
ITEM 13. <u>DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	100
ITEM 14. <u>MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	100
ITEM 15. <u>CONTROLS AND PROCEDURES</u>	100
ITEM 16A. <u>AUDIT COMMITTEE FINANCIAL EXPERT</u>	102
ITEM 16B. <u>CODE OF ETHICS</u>	102
ITEM 16C. <u>PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	102
ITEM 16D. <u>EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES</u>	102
ITEM 16E. <u>PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	102
ITEM 16F. <u>CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT</u>	102

ITEM 16G.	<u>CORPORATE GOVERNANCE</u>	103
ITEM 16H.	<u>MINE SAFETY DISCLOSURE</u>	103
<u>PART III.</u>		
ITEM 17.	<u>FINANCIAL STATEMENTS</u>	104
ITEM 18.	<u>FINANCIAL STATEMENTS</u>	104
ITEM 19.	<u>EXHIBITS</u>	104
<u>INDEX TO CONSOLIDATED FINANCIAL STATEMENTS</u>		F-1

**Table of Contents**

**INTRODUCTION**

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

we, us, our company, and our refer to Giant Interactive Group Inc., and, unless the context requires otherwise, its predecessor entities and subsidiaries, and its consolidated affiliated entities;

Eddia International refers to Eddia International Group Limited;

Giant HK refers to Giant Interactive (HK) Limited;

Giant Network refers to Shanghai Giant Network Technology Co., Ltd.;

PRC subsidiaries refers to subsidiaries of our Company that are organized and existing under the laws of PRC, consisting of:

Beijing Giant Zhengtu Network Technology Co., Ltd., or Beijing Giant Zhengtu,

Hangzhou Snow Wolf Software Co., Ltd., or Snow Wolf Software,

Shanghai Juhuan Network Technology Co., Ltd., or Juhuan Network,

Shanghai Juhuo Network Technology Co., Ltd., or Juhuo Network,

Shanghai Jujia Network Technology Co., Ltd., or Jujia Network,

Shanghai Jujia Network Technology Co., Ltd. (II), or Jujia Network II,

Shanghai Jumao Culture Creativity Co., Ltd., or Jumao Culture,

Shanghai Juquan Network Technology Co., Ltd., or Juquan Network,

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Shanghai Juxiao Real Estate Co, Ltd., or Juxiao Real Estate (formerly known as Giant Jiante (Shanghai) Real Estate Co., Ltd., or Jiante Real Estate),

Shanghai Juyan Network Technology Co., Ltd., or Juyan Network,

Shanghai Zhengduo Information Technology Co., Ltd., or Zhengduo Information,

Shanghai Zhengju Information Technology Co., Ltd., or Zhengju Information,

Shanghai Zhengtu Information Technology Co., Ltd., or Zhengtu Information, and

Zhuhai Zhengtu Information Technology Co., Ltd., or Zhuhai Zhengtu;

PRC entities refers to PRC subsidiaries, and Giant Network and its subsidiaries, as defined hereinafter;

Giant Network and its subsidiaries refers to Giant Network and its subsidiaries, consisting of:

Beijing Haishen Network Technology Co., Ltd., or Haishen Network,

Beijing Julun Network Information Technology Co., Ltd., or Julun Network,

Giant Mobile Technology Co., Ltd., or Giant Mobile,

Shanghai Juhe Network Technology Co., Ltd., or Juhe Network,

Shanghai Jujia Network Technology Co., Ltd. (III), or Jujia Network III,

Shanghai Juxin Network Technology Co., Ltd., or Juxin Network, and

Shanghai Juzi Information Technology Co., Ltd., or Juzi Information;

China or PRC refers to the People's Republic of China, excluding, for purposes of this annual report only, Taiwan and the Special Administrative Regions of Hong Kong and Macau;



## Edgar Filing: Giant Interactive Group Inc. - Form 20-F

monthly average concurrent users, or monthly ACU, of any of our games is determined as follows: we first determine the number of users logged onto the game at five-minute intervals, and average that data over the course of a day to derive the daily average. The daily average data are then averaged over the monthly period to derive the monthly average concurrent users;

quarterly active paying accounts, or APA, is the aggregate number of accounts for our games that have been charged at least once during the quarterly period;

quarterly average concurrent users, or quarterly ACU, of any of our games is the average of monthly average concurrent users, as defined above, of such game during the quarterly period;

**Table of Contents**

quarterly average revenues per user, or ARPU, is our online game net revenues during the quarterly period divided by the quarterly active paying accounts of these games during the quarterly period; our definition of ARPU may not be comparable to similarly titled measures presented by other online game companies;

quarterly peak concurrent users, or PCU, of any of our games is the peak concurrent users of such game during the quarterly period;

a shard is, with respect to an online game, one of multiple independent copies of the game world. In a sharded game, such as Zheng Tu Online, or ZT Online, or Giant Online, players may only interact with other players in one shard at one time;

all references to Renminbi or RMB are to the legal currency of China, all references to US dollars, dollars or US\$ are to the legal currency of the United States, and all references to HK\$ are to the legal currency of the Hong Kong Special Administrative Region of China;

ordinary shares refers to our ordinary shares, par value US\$0.0000002 per share;

ADSs refers to our American depositary shares, each of which represents one ordinary share;

ADRs refers to American depositary receipts, which, if issued, evidence our ADSs;

PRC GAAP refers to accounting principles and the relevant financial regulations applicable to PRC enterprises;

US GAAP refers to generally accepted accounting principles in the United States;

virtual currency refers to a form of online platform currency which is made available for purchase through game operator's platform, website or prepaid cards and which may be exchanged for virtual coins within different games but which has no real value and may not be converted or exchanged for any real world goods, real world services or hard currency. By way of example and clarification, game points are virtual currency in our game platform; and

virtual coins refer to our in-game currency which exists in each specific game, upon redemption of game points by players at a fixed exchange rate determined by the Company, and can be used to purchase in-game virtual items and services within the game.

This annual report on Form 20-F includes our audited consolidated balance sheets as of December 31, 2012 and 2013, and the related consolidated statements of operation and comprehensive income, cash flows and changes in shareholders' equity of each of the years ended December 31, 2011, 2012 and 2013.

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

We and certain of our shareholders completed the initial public offering of 65,777,036 ADSs, each representing one ordinary share, on November 6, 2007. Our ADSs are listed on the New York Stock Exchange under the symbol GA.

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This annual report on Form 20-F contains forward-looking statements that relate to our current expectations and views of future events. The forward-looking statements are contained principally in the items entitled Risk Factors, Information on the Company, and Operating and Financial Review and Prospects. Our forward-looking statements relate to events that involve known and unknown risks, uncertainties and other factors, including those listed under Risk Factors, which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, these forward-looking statements can be identified by words or phrases such as may, will, expect, anticipate, aim, estimate, intend, plan, believe, potential, continue, is/are likely to or other similar expressions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements include, among other things, statements relating to:

our expectations with respect to our future revenues, including continued growth of our MMORPG revenue, continued reliance on the ZT Online franchise and the growth of our licensing revenue;

our expectations with respect to growth strategies, including our expansion into webgames and mobile games;

our expectations with respect to the impact of our studio reorganization;

our expectations with respect to the future mix of direct and indirect sales of our game cards and game points;

our ability to license our online games to third party operators and to expand our distribution channels;

competition from other online game developers and operators, including the increase of foreign games licensed for operation in China;

our expectations regarding future capital expenditures and other costs, including compensation expenses, research and development expenses and co-location and internet access fees;

our intentions regarding management of our employees, including future increases or decreases in the number of our employees;

our expectations regarding the expansion of our business through strategic acquisitions; and

our expectations with respect to the completion of our proposed going private transaction.

If any one or more of the assumptions underlying these forward-looking statements turns out to be incorrect, actual results may differ from the results suggested by the forward-looking statements based on these assumptions. You should not place undue reliance on these forward-looking statements.

The forward-looking statements in this annual report relate only to events or information as of the date of this annual report. Except as required by law, we undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this annual report. You should read this annual report, and the documents that we reference in this annual report, with the understanding that our actual future results may be materially different from the results we currently expect to achieve as described in our forward-looking statements.

**Table of Contents**

**PART I.**

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**

**A. Selected Financial Data**

The selected consolidated statement of comprehensive income data for each of the three years in the period ended December 31, 2013, and the selected consolidated balance sheet data as of December 31, 2012 and 2013, were derived from our consolidated financial statements, which have been audited by Ernst & Young Hua Ming LLP, an independent registered public accounting firm. The report of Ernst & Young Hua Ming LLP, as well as our audited consolidated financial statements for the years ended December 31, 2011, 2012 and 2013, are included elsewhere in this annual report. The selected consolidated statements of comprehensive income data for the years ended December 31, 2009 and 2010, and our consolidated balance sheets data as of December 31, 2009, 2010 and 2011, have been derived from our audited consolidated financial statements that are not included in this annual report.

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

**Table of Contents****Consolidated Statement of Comprehensive Income Data:**

	Year Ended December 31,					
	2009	2010	2011	2012	2013	US\$
	RMB	RMB	RMB	RMB	RMB	
	(In thousands, except per share and per ADS data)					
<b>Net revenue:</b>						
Online games	1,293,018	1,289,481	1,701,343	2,074,950	2,309,281	381,466
Licensing revenues	10,687	42,667	54,538	52,186	41,902	6,922
Other revenue, net	130	668	36,336	24,758	4,288	708
<b>Total net revenue</b>	<b>1,303,835</b>	<b>1,332,816</b>	<b>1,792,217</b>	<b>2,151,894</b>	<b>2,355,471</b>	<b>389,096</b>
Cost of services	(204,070)	(199,122)	(257,246)	(288,361)	(298,660)	(49,335)
<b>Gross profit</b>	<b>1,099,765</b>	<b>1,133,694</b>	<b>1,534,971</b>	<b>1,863,533</b>	<b>2,056,811</b>	<b>339,761</b>
<b>Operating (expenses) income:</b>						
Research and product development	(113,354)	(186,037)	(230,209)	(326,793)	(320,981)	(53,022)
Sales and marketing	(119,600)	(143,006)	(169,982)	(146,452)	(175,769)	(29,035)
General and administrative	(121,446)	(119,447)	(103,727)	(148,708)	(135,748)	(22,424)
Government financial incentives	88,460	57,386	47,746	63,644	44,766	7,395
Impairment of intangible assets		(46,558)				
<b>Total operating expenses</b>	<b>(265,940)</b>	<b>(437,662)</b>	<b>(456,172)</b>	<b>(558,309)</b>	<b>(587,732)</b>	<b>(97,086)</b>
<b>Income from operations</b>						
Interest income	833,825	696,032	1,078,799	1,305,224	1,469,079	242,675
Investment income	102,200	136,098	141,587	105,833	128,619	21,246
(loss)	(5,971)		3,048	(243,627)	8,231	1,360
Other income, net	14,025	65,466	43,558	34,844	32,861	5,428
<b>Income before income tax expenses</b>	<b>944,079</b>	<b>897,596</b>	<b>1,266,992</b>	<b>1,202,274</b>	<b>1,638,790</b>	<b>270,709</b>
Income tax expenses	(85,060)	(89,322)	(352,378)	(124,204)	(296,622)	(48,999)
Share of losses of equity investees		(648)	(8,218)	(6,117)	(6,389)	(1,055)
<b>Net income</b>	<b>859,019</b>	<b>807,626</b>	<b>906,396</b>	<b>1,071,953</b>	<b>1,335,779</b>	<b>220,655</b>
	295	3,563	(26,429)	(78,234)	(82,812)	(13,679)

Net income (loss) attributable to noncontrolling interests						
<b>Net income attributable to the Company's shareholders</b>	859,314	811,189	879,967	993,719	1,252,967	206,976
<b>Other comprehensive income (loss), net of tax</b>						
Foreign currency translation	(12,769)	(73,194)	(84,728)	2,735	(2,927)	(483)
Reclassification adjustment	(1,814)					
Unrealized holding gains (losses)	(30,951)	(14,540)	(15,998)	29,771	(1,615)	(267)
<b>Total other comprehensive income (loss), net of tax</b>	(45,534)	(87,734)	(100,726)	32,506	(4,542)	(750)
<b>Comprehensive income</b>	813,780	723,455	779,241	1,026,225	1,248,425	206,226
<b>Net earnings per ordinary shares, basic</b>	3.80	3.57	3.79	4.20	5.23	0.86
<b>Net earnings per ordinary shares, diluted</b>	3.67	3.47	3.79	4.13	5.08	0.84
Net earnings per ADS <sup>(1)</sup> , basic	3.80	3.57	3.79	4.20	5.23	0.86
Net earnings per ADS, diluted	3.67	3.47	3.79	4.13	5.08	0.84
Shares used in computation, basic	226,278,227	227,308,854	232,004,879	236,796,818	239,652,597	239,652,597
Shares used in computation, diluted	233,960,556	233,928,400	232,004,879	240,821,127	246,835,259	246,835,259

(1) Each ADS represents one ordinary share



**Table of Contents****Selected Consolidated Balance Sheets Data:**

	Year Ended December 31					
	2009 (RMB)	2010 (RMB)	2011 (RMB) (in thousands)	2012 (RMB)	2013 (RMB)	(US\$)
<b>Assets</b>						
Cash and cash equivalents <sup>(1)</sup>	1,097,155	2,776,936	950,321	1,943,062	1,021,372	168,719
Short-term investments <sup>(1)</sup>	3,802,050	3,253,362	919,775	739,315	2,799,686	462,475
<b>Total current assets<sup>(1)</sup></b>	<b>5,102,972</b>	<b>6,304,005</b>	<b>2,179,246</b>	<b>3,096,518</b>	<b>4,280,015</b>	<b>707,008</b>
Property and equipment, net	178,670	143,286	349,668	340,242	355,801	58,774
Long-term investments <sup>(2)</sup>		55,621	380,895	426,088	437,637	72,292
Available-for-sale security <sup>(3)(4)</sup>	450,967	423,303	386,851	78,741	74,773	12,352
<b>Total non-current assets</b>	<b>1,349,690</b>	<b>804,138</b>	<b>1,371,985</b>	<b>1,225,711</b>	<b>1,085,289</b>	<b>179,277</b>
<b>Total assets</b>	<b>6,452,662</b>	<b>7,108,143</b>	<b>3,551,231</b>	<b>4,322,229</b>	<b>5,365,304</b>	<b>886,285</b>
Deferred revenue	321,291	442,795	529,204	486,025	365,784	60,423
<b>Total current liabilities</b>	<b>547,448</b>	<b>700,314</b>	<b>1,014,916</b>	<b>1,026,670</b>	<b>1,712,984</b>	<b>282,965</b>
<b>Total liabilities</b>	<b>547,869</b>	<b>700,500</b>	<b>1,029,798</b>	<b>1,058,982</b>	<b>1,715,913</b>	<b>283,449</b>
<b>Total Giant Interactive Group</b>						
<b>Inc. s equity</b>	<b>5,897,185</b>	<b>6,392,860</b>	<b>2,495,648</b>	<b>3,217,728</b>	<b>3,585,387</b>	<b>592,264</b>
<b>Noncontrolling interests</b>	<b>7,608</b>	<b>14,783</b>	<b>25,785</b>	<b>45,519</b>	<b>64,004</b>	<b>10,572</b>
<b>Total liabilities and shareholders equity</b>	<b>6,452,662</b>	<b>7,108,143</b>	<b>3,551,231</b>	<b>4,322,229</b>	<b>5,365,304</b>	<b>886,285</b>

- (1) In the third quarter of 2011, we declared and paid out a special dividend of US\$3.00 per share to our ADS and ordinary share shareholders, out of which the payout was financed partially through the declaration and payout of dividends to the Company by one of its PRC subsidiaries. As such, the dividends were subject to a 10% withholding tax and, therefore, we accrued an one-time withholding income tax in the amount of RMB259.4 million associated with the repatriation of cash for the special dividend paid during the third quarter 2011.
- (2) In September 2011, we invested US\$50.0 million in the Yunfeng E-Commerce Funds for the purpose of purchasing shares of the Alibaba Group, a leading Chinese e-commerce company. In February 2014, we entered into an agreement to sell all of our limited partnership interest in Yunfeng E-Commerce Fund A, L.P. and Yunfeng E-Commerce Fund B, L.P. (which collectively known as Yunfeng E-Commerce Funds and collectively hold all of our interest in the ordinary shares of Alibaba Group Holding Limited) to Tiger Global Mauritius Fund for approximately US\$199.1 million. The sale was completed on February 12, 2014.
- (3) During the fourth quarter of 2012, we recorded an impairment charge of RMB240.7 million, which related to our 2008 investment in Five One Network Development Co. Ltd., or 51.com, as the decline in the fair value of this investment was determined to be other-than-temporary. 51.com was formerly a China-based social networking

company which transitioned into an online game developer and operator in recent years. This investment loss resulted from 51.com's lower than expected core business revenue and operating cash flow, and delay in its research and development activities and planned promotion campaigns of its newly launched games.

- (4) In May 2012, the Company recharacterized its RMB27.3 million investment in Mobile Embedded Technology Inc. from available-for-sale securities to a cost-method investment.

**Exchange Rate Information**

Our business is conducted in China and substantially all of our net revenues are denominated in Renminbi. This annual report contains translations of Renminbi amounts into U.S. dollars at specific rates solely for the convenience of the reader. Conversions of Renminbi into U.S. dollars in this annual report are based on the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York. Unless otherwise noted, all translations from Renminbi to U.S. dollars and from U.S. dollars to Renminbi in this annual report were made at a rate of RMB6.0537 to US\$1.00, the noon buying rate in effect as of December 31, 2013. We make no representation that any Renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rates stated below, or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade. On April 25, 2014, the noon buying rate was RMB6.2534 to US\$1.00.

**Table of Contents**

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

Period	Period End	Noon Buying Rate		
		Average <sup>(1)</sup>	High	Low
		(RMB per US\$1.00)		
2009	6.8259	6.8307	6.8176	6.8470
2010	6.6000	6.7696	6.6000	6.8330
2011	6.2939	6.4475	6.2939	6.6364
2012	6.2301	6.2990	6.2221	6.3879
2013	6.0537	6.1412	6.0537	6.2438
October 2013	6.0943	6.1032	6.0815	6.1209
November 2013	6.0922	6.0929	6.0903	6.0993
December 2013	6.0537	6.0738	6.0537	6.0927
2014				
January 2014	6.0590	6.0509	6.0402	6.0600
February 2014	6.1448	6.0816	6.0591	6.1448
March 2014	6.2164	6.1730	6.1183	6.2273
April 2014 (through April 25, 2014)	6.2534	6.2196	6.1966	6.2534

(1) Annual averages are calculated by using the average of the exchange rates on the end of each month during the year. Monthly averages are calculated by using the average of the daily rates during the relevant month.

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

**D. Risk Factors****Risks Relating to Our Business and Industry**

*The ZT Online franchise of massively multiplayer online role playing games, or MMORPGs, have historically accounted for the substantial majority of our net revenues. Any decrease in the popularity of these games would materially and adversely affect our results of operations.*

The ZT Online franchise, which consists of the ZT Online 1 Series and ZT Online 2, accounted for 89%, 89% and 79% of our net revenue in 2011, 2012 and 2013, respectively. In 2006 we commercially launched ZT Online, which together with ZT Online Classic Edition, and ZT Online Green Edition, constitutes the ZT Online 1 Series. In 2011 we commercially launched ZT Online 2, which is part of the ZT Online franchise but differs from the ZT Online 1 Series games in a number of ways, including its story, gameplay, graphics, maps, quests, and characters. The most significant change in ZT Online 2 is its in-game economy. ZT Online 2's next generation in-game economy, the transaction-based revenue model which allows players to purchase in-game items from other players that have earned

such items by leveling up their in-game characters and accomplishing in-game objectives, is designed to target lower spending and non-spending users as compared to that of ZT Online 1 Series, in which revenue is generated from the players' consumption of game points to purchase items sold by the in-game store. Although we currently operate fifteen games, eleven of which are not part of the ZT Online franchise, we expect that we will continue to derive the substantial majority of our net revenues from the ZT Online franchise in the near term. Our business prospects, financial condition and results of operations would therefore be materially and adversely affected by any factor that contributes to a decline in revenue from the ZT Online franchise, including:

any reduction in purchases of virtual items or services by players of the ZT Online franchise games;

any decrease in the popularity of the ZT Online 1 Series or ZT Online 2 due to competition or otherwise;

failure to improve, update or enhance the ZT Online franchise games in a timely or effective manner; or

any lasting or prolonged server interruption due to network failures or other factors.

## **Table of Contents**

As with other online games, the ZT Online franchise games have finite commercial lifespans. Although our ongoing release of new version of the ZT Online franchise games helps to extend the commercial life of the games, to ensure the continued popularity of the ZT Online 1 Series and ZT Online 2, we will need to expend considerable resources to improve and update the games on a timely basis with new content and features that appeal to our players. Any decline in the popularity of the ZT Online franchise games, whether as a result of the failure to provide timely and popular updates or otherwise, would materially and adversely affect our business prospects, financial condition and results of operation.

***If we are unable to successfully develop and license new popular online games, our business and revenues may be adversely affected.***

In order to maintain our long-term profitability and financial and operational success, we must continually develop or license new online games that are attractive to our players. While many new online game products are regularly introduced to the market, only a small number of hit titles account for a significant portion of total revenue in our industry. As the online game market is limited in size, if our newly developed games are not widely accepted by the players, or if successful hit products are launched by our competitors, our market share may be adversely affected and revenues generated by our products may fall below our expectations.

The success of our internally developed games will largely depend on our ability to anticipate and effectively respond to changing tastes and preferences of our players and to continually make technical advances to our platform. Developing games internally requires substantial initial investment prior to commercial launch of the games as well as a significant commitment of future resources. In addition, identifying new third party developed online games with strong market potential, and obtaining license to those online games on commercially reasonable terms, requires a significant degree of effort. If we are not able to successfully develop or license new hit online games that attract large numbers of players and result in substantial online game revenues, our business, financial condition and results of operations may be materially and adversely affected.

***We are substantially dependent upon the MMORPG segment of China's online game industry. Any decline in the size of the MMORPG market segment, due to competition from other video game products, other entertainment products or otherwise, would adversely affect our revenues.***

The MMORPG segment of China's online game industry, from which we derive substantially all of our revenues, is both rapidly evolving and subject to competition from other forms of video games and other entertainment products. The future prospects for the MMORPG market segment in China will depend on a number of factors beyond our control, including:

the growth of personal computer, internet and broadband users and their penetration in China;

whether the MMORPG segment of China's online game industry continues to grow and the rate of any such growth;

the availability and popularity of other forms of video game products, such as social networking games, mobile games, and console games playable on game consoles;

the availability and popularity of other forms of online and offline entertainment, such as movies, television programs and other video content;

changes in consumer demographics and consumer tastes and preferences; and

general economic conditions, particularly economic conditions adversely affecting discretionary consumer spending.

Although MMORPGs are currently popular in China, there is no assurance that they will continue to be popular in China or elsewhere. A decline in the popularity of online games in general, or the MMORPG market segment in particular, will materially and adversely affect our business prospects, financial condition and results of operations.

***We face significant competition, which could reduce our market share and adversely affect our business and net revenues.***

The online game market in China is highly competitive. In recent years, numerous competitors have entered the online game market in China, and we expect more companies to enter the market and a wider range of online games to be introduced to the market. Our principal competitors include China-based online game companies such as Tencent Holdings, Ltd., Changyou.com Limited, Perfect World Co., Ltd., Shanda Games Limited and NetEase.com. In addition, we expect international game developers to continue to license more of their games for operation in China.

## **Table of Contents**

Many of our competitors have longer operating histories, greater brand name recognition, larger player bases and significantly greater game development, technical, financial and marketing resources than we have. Furthermore, any of our competitors may be acquired by, receive investments from or enter into other cooperative relationships with larger, more well-financed companies and therefore obtain greater financial, marketing and development and licensing resources than we have. This may allow them to devote greater resources than we can to the development and promotion of new online games and technologies similar to or better than our own. These competitors may engage in more extensive research and development, undertake more far-reaching marketing campaigns, adopt more aggressive pricing policies and make more attractive offers of employment to our existing and potential employees than we can. In addition, our international competitors may establish cooperative relationships with our local competitors, which may significantly enhance their competitiveness in the online game market in China.

New and increased competition may result in larger discounts demanded by our distributors, or price reductions in our virtual items and services, any of which could adversely affect our net revenues. In addition, the increased competition in the online game market in China could make it difficult for us to retain and expand our existing player base, which could reduce the number of dedicated players and players with high disposable incomes that play our games and from whom we derive most of our net revenues. If we are unable to compete effectively in the online game market in China, our business, financial condition and results of operations would be materially and adversely affected.

***Our games are currently accessed primarily through personal computers. As devices other than personal computers are increasingly used to access the internet, successful development of games for such devices will be imperative if we are to maintain or increase our revenues, and our inability to do so may result in lower growth of or a decline in revenues.***

Devices other than personal computers, such as mobile phones and tablets, are used increasingly in China and in overseas markets to access the internet. We believe that for our business to be successful we will need to develop versions of our existing games, our pipeline games and any future games that work well with such devices. The games that we develop for such devices may not function as smoothly as our existing games, and may not be attractive to game players in other ways. In addition, manufacturers of such devices may establish restrictive conditions for developers of applications to be used on such devices, and as a result our games may not work well, or at all, on such devices. As new devices are released or updated, we may encounter problems in developing versions of our games for use on such devices and we may need to devote significant resources to the creation, support, and maintenance of games for such devices. If we are unable to successfully expand the types of devices on which our existing and future games are available, or if the versions of our games that we create for such devices do not function well or are not attractive to game players, our revenues may fail to grow and may decline.

***Our operating results fluctuate from period to period, making them difficult to predict.***

We have experienced significant fluctuations in our operating results from period to period due to a variety of factors, many of which are beyond our control. Significant fluctuations in our operating results could be caused by any of the following factors, among others:

our ability to retain existing users of our games and attract new users;

the introduction of new games or expansion packs by us or our competitors;

changes in our game features and the corresponding impact on player behavior and purchasing patterns;

the adoption of new, or changes in existing government regulations;

the quality, variety, popularity and mix of virtual items and services available for purchase in our free-to-play games and related in-game promotional efforts;

game development costs for our self-developed games, and license costs and royalty payments for licensed games;

the amount of overseas licensing net revenues generated through our licensing arrangements with operators of our games;

the mix of sales through our distributors (who purchase prepaid game cards at a discount to their face value) and direct sales of game points to players through our website;

the success of our advertising and promotional efforts;

seasonality effect during holidays in the first quarter and fourth quarter, when fewer of our targeted players play our games; and

economic conditions in general and specifically with respect to the online game industry in China.

For example, our net revenues declined 18% in 2009, which we believe was primarily due to new regulations promulgated by the PRC government in connection with certain game features, and corresponding changes to our in-game monetization features. However, our net revenues increased 2.2%, 34.5%, 20.0% and 9.5%, in 2010, 2011, 2012 and 2013, respectively.



## **Table of Contents**

As a result, our operating results may vary from period to period, be difficult to predict for any given period, be adversely affected from period to period, and not be indicative of our future performance. In the event that our operating results do not meet our expectations or those of the public market analysts and investors, the price of our ADSs may decline.

***We may not be able to successfully implement our growth strategies, which would materially and adversely affect our revenue, profitability and competitiveness.***

We are pursuing a number of growth strategies, including broadening our user base by diversifying our game portfolio, expanding our distribution channels by leveraging our strong relationships with internet platform partners, acquiring additional licenses to operate third party developed overseas games in China, pursuing additional licensing opportunities for operating our games overseas, and expanding into non-MMORPG market segments by developing web games, and games for operation on mobile and tablet devices.

For example, in order to expand our user base, in September 2012 we released the micro-client version of ZT Online 2 on Qihoo 360's platform. In 2012, we also licensed several of our new games, including Genesis of the Empire, Marine Tycoon, The Sky and World of Xianxia, to overseas partners for operations outside of China. In addition, we are expanding into web games and mobile games, and in 2013 we launched several web games on partner platforms in China including Genesis of the Empire, The Sky and the Supreme Tai Chi. In 2013, we also expanded our portfolio of licensed games by entering into an agreement to operate in China Cang Tian 2, a 3D MMORPG developed by WeMade Entertainment.

Our experience with our various new growth strategies is limited. Accordingly, we cannot assure you whether all or any of these strategies will be successful. If we are unable to implement our growth strategies, our revenue and profitability may not grow as we expect, and our competitiveness may be materially and adversely affected.

***We may not sustain our historical profitability levels.***

Historically we have achieved a relatively high gross profit margin and net income margin. Our gross profit margin was 85.6%, 86.6% and 87.3% in 2011, 2012, and 2013, respectively, and our net income attributable to the company's shareholders as a percentage of net revenue was 49.1%, 46.2% and 53.2% in 2011, 2012 and 2013, respectively. Our relatively high gross profit margin and net income margin are attributable to a number of factors, including the success of our online games, the fact that our leading games are self-developed rather than licensed from third parties and our historic ability to effectively control costs. We might not, however, be able to sustain our historical profitability levels in future periods due to a number of different factors, including, among others, economic factors out of our control, competitiveness in the online game industry, in which market share can be quickly acquired or lost, the need to increase our research and product development expenses in order to develop new and successful games, the potential need to expend greater amounts in order to license or acquire new games, changes in regulations or other factors that result in a decline of our net revenue, our inability to prevent our other costs and operating expenses from increasing, and an increase in net income attributable to non-controlling interests as a result of the success of games supported by our 51% owned game development studios. Accordingly, you should not rely on the results of any prior period as an indication of our future operating performance.

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

A substantial number of players access our game through internet cafés. Due to limited storage space on the computer hard drives for client side game software, internet cafés generally only feature a select number of games on their

computers. We thus compete with a growing number of other online game operators to ensure that our games are featured on these computers.

To help ensure that our games are featured in a sufficient number of internet cafés, we enter into advertising distribution agreements with companies that operate and distribute internet café management software, which most internet cafés in China install. These management software distributors both display advertisements for our games on PCs that use their software, and help to ensure that the client side software for our games are installed on the PCs that use their software.

Our agreements with the internet café management software companies are not on an exclusive basis, and therefore these firms can and do advertise for other game companies and ensure that the client side software for other companies games are pre-loaded on many of the PCs that use their software. If we fail to renew our advertising distribution agreements with the internet café management software companies, or if the terms including cost for such arrangement materially deteriorate, our business, financial condition and operating results may be materially and adversely affected.

**Table of Contents**

***The limited use of personal computers in China and the relatively high cost of internet access with respect to per capita gross domestic product may limit the development of the internet in China and impede our growth.***

Although the use of personal computers in China has increased in recent years, the penetration rate for personal computers in China is much lower than in the United States. In addition, despite a decrease in the cost of internet access in China due to a decrease in the cost of personal computers and the introduction and expansion of broadband access, the cost of personal internet access remains relatively high in comparison to the average per capita income in China. The PRC government has also promulgated a number of regulations to curb the growth of internet cafés. The limited use of personal computers in China, the relatively high cost of personal internet access and increased restrictions on internet cafés may limit the growth of our business. Furthermore, any internet access or telecommunications fee increase could reduce the number of players that play our online games and materially and adversely affect our business, financial condition and results of operations.

***We rely on our nationwide distribution network for a significant portion of our net revenues. Failure to maintain good relationships with our distributors, or failure of our distributors to comply with the terms of our distribution agreements, could materially disrupt our business and harm our net revenues.***

Online payment systems in China are still in a relatively early stage of development and are not as widely used by customers in China as in the United States. Although online purchase of game points through our official game website has become more popular in recent years, our business is still dependent on the performance of our regional distributors, who are composed of independent third parties. In 2013, 45.7% of our sales proceeds were generated through sales of prepaid game cards to our distributors, compared to 55.4% in 2012. Our largest distributor accounted for 2.8% of our sales proceeds in 2013. Maintaining relationships with existing distributors may be difficult and time-consuming. Although we typically enter into annual contracts with our distributors, our distribution agreements are not exclusive and do not prohibit our distributors from selling our competitors' game cards. Failure to maintain good relationships with our distributors could restrict our sales channels or encourage our distributors to seek to distribute our competitors' products, each of which could materially and adversely disrupt our business and harm our net revenues.

In addition, our distributors and internet cafés and other outlets in which they sell our prepaid game cards may violate our distribution agreements. Examples of violations include:

failure to meet minimum sales targets or penetration targets, or failure to maintain minimum price levels for our prepaid game cards;

failure to properly promote our online games in local internet cafés and other important outlets, or failure to cooperate with our sales and marketing team's efforts in their designated territories; and

selling our prepaid game cards outside their designated territories, possibly in violation of the exclusive distribution rights that we have granted to other distributors.

Some of our distributors have committed these types of violations in the past, which resulted in us terminating their existing distribution agreements. If we decide to fine, suspend or terminate our distributors for acting in violation of our distribution agreements, or if the distributors fail to address material violations committed by any of their retail outlets, our ability to effectively sell our prepaid game cards in any given territory could be negatively impacted. We

may also be liable in China for legal or regulatory violations by any of our distributors.

***We could be liable for breaches of security of our website and third-party online payment system, which may have a material adverse effect on our reputation and business.***

In 2013, 54.3% of our sales proceeds were generated by players purchasing our game points directly through our official game website, and the remaining 45.7% from purchasing physical or virtual game cards through our distributors. The direct game point purchasing through our official game website is processed by a variety of third-party online payment service providers, including Alipay.com Co., Ltd, Shanghai China UnionPay E-Payment Service Co., Ltd, 99Bill Corporation, China Payment and Remittance Service Co., Ltd. and several major commercial banks. In such transactions, secure transmission of our players' confidential billing information over public networks, including our official game website, is essential for maintaining consumer confidence. We currently provide password protection for all of our player accounts. In addition to the general password protection, we also sell a dynamic password generator, which can be used for multiple accounts under a player's name, to better ensure the security of our players' accounts. While we have not experienced any breach of our security measures to date, current security measures may be inadequate. We must therefore be prepared to increase our security measures and efforts so that our customers have confidence in the reliability of the online payment systems we use.

---

**Table of Contents**

In addition, we do not have control over the security measures of our third-party online payment service providers, and those security measures may not be adequate at present or may not be adequate with the expected increased usage of online payment systems. For example, hackers have in the past used viruses to corrupt the computers of online shoppers using Taobao, a leading e-commerce website in China that allows shoppers to purchase goods from different vendors online. In addition, through a process known as phishing, hackers have created fake webpages on Taobao that appear to be selling legitimate goods online. In both situations, when an unsuspecting online shopper attempts to submit a purchase order and payment to a third party vendor on Taobao, that purchase order and payment is redirected to our website and changed into a legitimate purchase order and payment for our game points on behalf of the hacker and not the unsuspecting online shopper. Accordingly, our systems are then misled into accepting such payment and unintentionally issuing the corresponding game points to the hacker, who then uses these game points to purchase virtual items in our games with the intention of later exchanging the virtual items for cash on offline third party trading platforms. In a few instances, online shoppers on Taobao that were misled by hackers have resorted to litigation against us in order to recover their losses. Although the amount of damages we paid in connection with this litigation was immaterial, and we have implemented stricter security measures and cooperated with local authorities to apprehend the hackers, we could be exposed to further litigation and possible liability if we fail to detect fraudulent transactions, which could harm our reputation, ability to attract customers and ability to encourage players to purchase our game points.

***Unexpected network interruptions, security breaches or computer virus attacks could have a material adverse effect on our business and reduce player satisfaction.***

Any failure to maintain satisfactory performance, reliability, security and availability of our network infrastructure, including issues arising from the internet infrastructure in China, security breaches caused by hacking and transmission of computer viruses, and natural disasters such as floods and earthquakes, may cause significant harm to our reputation and our ability to retain existing and attract new game players. In addition, all of the game servers operating our games, and all of the servers handling log-in, billing and data back-up matters for us are hosted and maintained by third-party service providers. Major risks involved in such network infrastructure include any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures which may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware.

In the past, our server network has experienced unexpected outages for several hours and occasional slower performance in a number of locations in China as a result of failures by third-party service providers. Any network interruption or inadequacy that causes interruptions in the availability of our games or deterioration in the quality of access to our games could reduce our game players' satisfaction and ultimately harm our business, financial condition and results of operations. In addition, any security breach caused by hacking, which involve 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. We do not maintain insurance policies covering losses relating to our systems and we do not have business interruption insurance.

***Changes in our lifespan estimates for the virtual items sold within our games may have a negative impact on our net revenue and results of operations.***

We generally recognize revenues from virtual items sold to players of our free-to-play online games over the estimated lifespan of the relevant virtual items as determined by historical player usage patterns and playing behavior. We are committed to continually monitoring each of our games' actual operational statistics and usage patterns, comparing these actual statistics with our original estimates and refining our estimates and assumptions when they are

materially differ from the actual statistics. Any adjustment in the estimated lifespan of these virtual items may cause our revenues to be recognized over a significantly different time period, which may have a negative impact on our net revenue and results of operations.

***Undetected programming errors or defects in our games and the proliferation of cheating programs could adversely affect our business reputation and result in a decline in our active paying accounts.***

Our online games may contain undetected programming errors or other defects. In addition, parties unrelated to us have in the past, and may again in the future, develop internet cheating programs that enable users to acquire superior features for their game characters for which they would otherwise be required to pay or otherwise earn through game play. In addition, certain cheating programs could cause the loss of a character's superior features acquired by a player. The occurrence of undetected errors or defects in our games, and our failure to discover and disable cheating programs affecting the fairness of our game environment, could damage our reputation and result in a decline in our active paying accounts. This could materially and adversely affect our business, financial condition and results of operations.

---

**Table of Contents**

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

Our future success is heavily dependent upon the continued service of our key executive officers and other key employees. In particular, we rely on the expertise, experience and leadership of Mr. Yuzhu Shi, our founder and chairman, Ms. Wei Liu, our chief executive officer, and Mr. Xuefeng Ji, our president, in connection with our business operations and game development. We also rely on their personal relationships with our employees, the relevant regulatory authorities, and our distributors. In addition, we are dependent on a number of key technology officers and staff for the development and operation of our online games. Furthermore, we need to continue to attract and retain skilled and experienced online game development personnel to maintain our competitiveness.

If one or more of our key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all and may incur additional expenses to recruit and train new personnel. These difficulties may disrupt our business, and our financial condition and results of operations could be materially and adversely affected. We do not maintain key-person life insurance for any of our key personnel. In addition, if any of our executive officers or key employees joins a competitor or forms a competing company, we may lose know-how, trade secrets, suppliers and key professionals and staff. We enter into non-compete agreements with officers, managers and senior level employees, which generally prohibit them from engaging in activities that compete with our business for two years after their employment with us provided that we satisfy certain payment obligations. Although non-compete agreements are generally enforceable under PRC laws, PRC legal practice regarding the enforceability of such provisions may not be as well-developed, and therefore we cannot assure you that a PRC court would enforce such provisions. Furthermore, since the demand and competition for talent is intense in our industry, particularly for online game development personnel and related technical personnel, we may need to offer higher compensation and other benefits in order to attract and retain key personnel in the future, which could increase our compensation expenses.

In 2008, we introduced Win@Giant, an incubation program designed to attract and retain talented employees, developers and business partners. Under Win@Giant, we have reorganized several of our game development studios by establishing various subsidiaries that are generally 51% owned by us and 49% owned by the relevant key development team members, with an aim to facilitate our development of new online games. Each reorganized studio only focuses on producing and supporting internally developed games, which we believe gives them greater incentive to make their games commercially successful. While this program is intended to supplement and not to replace our normal hiring efforts, we cannot assure you that this program will be successful or that we will be able to attract or retain qualified game developers or other key personnel that we will need to achieve our business objectives.

***The reorganization of our game development studios could materially and adversely affect our results of operations as a portion of the profits from games developed or operated by these studios will be shared with the non-controlling shareholders of these studios.***

In 2008, we introduced Win@Giant, an incubation program designed to, among other things, identify, recruit and incentivize talented individuals in the areas of game design and development. In 2009, in connection with our Win@Giant initiative, we began to reorganize our game development studios by establishing various subsidiaries that are 51% owned by us and 49% owned by the relevant development team members, which we believe provides greater incentive to the game development teams to make their games commercially successful. Following this game development studio reorganization, ZT Online 2 and World of Xianxia, two of our most successful MMORPGs, are supported by Jujia Network and Juhuo Network, respectively, each of which is 51% owned by us and 49% owned by the relevant development team members. For additional information regarding this reorganization, see Item 4. Information on the Company Business Overview Game Development and Sourcing Game Development.

As a result of our game development studio reorganization, a portion of the net income generated by games developed or supported by these game development studios will be attributable to the non-controlling shareholders of the studios. The company consolidates its financial results with those of the reorganized studios, and then presents the net income or loss attributable to the non-controlling shareholders as a separate non-controlling interest line item under the heading net income or loss attributable to non-controlling interests . The company s consolidated income attributable to its shareholders is arrived at after deducting this non-controlling interest. Total non-controlling interest related to our reorganized studios increased 5.9% from RMB78.2 million in 2012 to RMB82.8 million (US\$13.7 million) in 2013, primarily due to an increase in revenue generated by games developed and supported by reorganized studios. If our games developed and/or supported by these studios become more popular and profitable in the future, this non-controlling interest amount will increase, which may result in a lower net income attributable to company s shareholders and may materially and adversely affect our results of operations.



**Table of Contents**

***Future acquisitions may have an adverse effect on our ability to manage our business.***

We intend to continue expanding our business through selective acquisitions in the future. We do not, however, have significant experience in completing acquisitions or integrating new companies into our existing operations. In the event that we pursue acquisition opportunities in the future, we will face a number of risks that could materially and adversely affect our business and results of operations, including overpaying for the acquisitions, an inability to realize the synergies contemplated at the time of executing the transactions, difficulties in integrating the acquired companies, the diversion of management resources from other strategic and operational issues, the inability to retain the key employees of the acquired companies, and unknown or unforeseen assumed liabilities.

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

We regard our copyrights, trademarks, trade secrets and other intellectual property as critical to our success. Unauthorized use of our intellectual property may adversely affect our business and reputation.

We have historically relied on a combination of trademark and copyright law, trade secret protection, internal security measures and restrictions on disclosure to protect our intellectual property rights. Although we enter into confidentiality agreements with all of our employees, and our standard employment agreements include an invention assignment clause, we cannot assure you that these confidentiality agreements will not be breached, that we will have adequate remedies for any breach, or that our proprietary technology will not otherwise become known to, or be independently developed by, third parties.

As of December 31, 2013, we own a total of 769 registered trademarks in China and overseas and are in the process of applying for the registration of 304 trademarks in China and 28 trademarks overseas. We cannot assure you that any of these trademark applications will ultimately be successful or will provide adequate protection for our business. Some of our pending applications or registrations may also be successfully challenged or invalidated by others. If our trademark applications or registrations are not successful, we may have to use different marks or otherwise enter into arrangements with third parties.

In addition, China's online game market often faces challenges from pirate servers, which are game servers operating unauthorized copies of online games that enable players to play those games without purchasing prepaid game cards or game points from the authorized operators. We mitigate the risk of pirate servers by maintaining stringent security controls over our server side software at our offices and insisting upon high security standards at the various internet data centers where our servers are housed. In addition, once pirate servers are identified, we work with local government authorities to shut the servers down. If pirate game servers continue to operate any of our games, our business, financial condition and results of operations may be materially and adversely affected.

Implementation of intellectual property laws in China has historically been lacking, primarily because of difficulties in enforcement. Accordingly, intellectual property right protection in China may not be as effective as in the United States or other developed countries. Policing unauthorized use of our proprietary technology, trademarks and other intellectual property is difficult and expensive, and litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our resources, and could disrupt our business, as well as have a material adverse effect on our financial condition and results of operations.

***We may be subject to infringement and misappropriation claims in the future, which may cause us to incur significant expenses, pay substantial damages and be prevented from providing our services or technologies.***

Our success depends in part on our ability to carry out our business without infringing the intellectual property rights of third parties. We may be subject to litigation involving claims of patent, copyright or trademark infringement, or other violations of intellectual property rights of third parties. In particular, the patent field covering online games and related technology is rapidly evolving and surrounded by a great deal of uncertainty, and therefore we cannot assure you that our technologies, processes or methods do not infringe upon third-party patents, either now existing or to be issued in the future. Future litigation may cause us to incur significant expenses, and third-party claims, if successfully asserted against us, may cause us to pay substantial damages, seek licenses from third parties, pay ongoing royalties, redesign our services or technologies, or prevent us from providing services or technologies subject to these claims. Even if we were to prevail, any litigation would likely be costly and time-consuming and divert the attention of our management and key personnel from our business operations.

**Table of Contents**

***We have limited business insurance coverage, which may result in our incurring substantial costs and the diversion of resources.***

Insurance companies in China offer limited business insurance products. We have purchased a public liability insurance policy, which would cover certain third party personal injury or property damage incurred in connection with the operation of our business. We also understand that business interruption insurance is available to a limited extent in China, but 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 purchase for such insurance. As a result, other than the public liability insurance policy described above, we do not have any business liability, disruption or litigation insurance coverage for our operations in China. Except for the public liability insurance policy described above, property insurance for our offices and fixed assets, and legally required automobile liability insurance, we do not carry any other property or casualty insurance. 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.

***If we fail to maintain an effective system of internal control over financial reporting, our investors may lose confidence in our financial statements.***

We are subject to provisions of the Sarbanes-Oxley Act of 2002. Section 404 of the Sarbanes-Oxley Act requires that we include a report from management on the effectiveness of our internal control over financial reporting in our annual reports on Form 20-F. In addition, our independent registered public accounting firm must attest to and report on the operating effectiveness of our internal control over financial reporting. Our management has concluded that our internal control over financial reporting is effective as of December 31, 2013, and our independent registered public accounting firm concurred with our management's conclusion. However, if we fail to maintain effective internal control over financial reporting in the future, our management and our independent public accounting firm may not be able to conclude that our internal control over financial reporting is effective. This in turn could result in a loss of investor confidence in the reliability of our reporting processes, which could materially and adversely affect the trading price of our ADSs. Furthermore, we have incurred considerable costs, management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

***We are exempt from certain corporate governance requirements of the NYSE. This may afford less protection to the holders of our ADSs.***

We are exempt from certain corporate governance requirements of the NYSE by virtue of being a foreign private issuer. As a foreign private issuer, we are permitted to follow home country practice in lieu of certain corporate governance requirements of the NYSE. We are required to provide a brief description of the significant differences between the corporate governance practices of our home country, the Cayman Islands, and the corporate governance practices required to be followed by U.S. domestic companies under the NYSE rules. The standards applicable to us are considerably different than the standards applied to U.S. domestic issuers. The significantly different standards applicable to us do not require us to, among other things:

have a majority of the board be independent (other than due to the requirements for the audit committee under the United States Securities Exchange Act of 1934, as amended, or the Exchange Act); or

obtain shareholder approval for the implementation and material revisions of the terms of our equity compensation plans.

We are committed to a high standard of corporate governance and as such we endeavor to comply with most of the NYSE corporate governance practices. We do, however, intend to rely on each of the foreign private issuer exemptions noted above. As a result, you may not be provided with the benefits of certain corporate governance requirements of the NYSE.

***As an online game company, our experience with investment activities is limited.***

We explore selected investment opportunities that may have strategic value to us or that are purely financial in nature, with the primary objective of providing us with a more favorable rate of return than is customary for ordinary bank deposits.

For example, as of December 31, 2011, 2012 and 2013, we held short-term investments with a more favorable rate of return than is customary for ordinary bank deposits and long-term held-to-maturity investments in the amount of RMB700.0 million, RMB790.0 million and RMB2,559.2 million (US\$422.7 million), respectively. In May 2011, we invested RMB100.0 million in a trust arrangement with China Resources SZITIC Trust Co., Ltd., which in turn invested in certain real estate development projects in the PRC cities of Ningbo and Chengdu for a period of five years. In 2013, this investment was terminated early. In 2012, we invested RMB600.0 million in two trust arrangements with Huaneng Guicheng Trust Co., Ltd., both of these trust investments are associated with certain real estate development projects and have a term of one year. As of December 31, 2013, each of these real estate related investments had either matured or been wound-up.

---

**Table of Contents**

In addition, we have made certain other investments. For example, in 2008 we acquired a 25% equity interest in 51.com, formerly a China-based social networking company which transitioned into an online game developer and operator in recent years, for a consideration of US\$50.8 million. During the fourth quarter of 2012, we recorded an impairment charge of RMB240.7 million with respect to this investment due to lower than expected core business revenue and operating cash flow, and delays in research and development activities and planned promotion campaigns for newly launched games. In April 2011, we committed to invest RMB30.0 million in Beijing Innovation Work Investment Center (LP), or Innovation Work, an early-stage China-based internet and technology company investment fund, which is led by Mr. Kai-Fu Lee, a well-known business leader in the internet space in China, of which RMB22.5 million had been invested by December 31, 2013. Finally, in May 2013, we committed to invest US\$20 million in Yunfeng Fund II, L.P. As of March 31, 2014, we paid US\$3.29 million in total to Yunfeng Fund II, L.P. For additional information regarding our investments, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Investing Activities.

These investments are made in contemplation that the underlying businesses will achieve or sustain continued business growth, eventually go public or be acquired, which there are no guarantees of occurring. In addition, some of these investments may only provide limited exits to us and therefore our investments may be illiquid until their respective maturity, or potentially until a liquidity event occurs with respect to the underlying companies.

Although these investments may offer us potentially higher returns, these returns are not guaranteed and as such, we may not be able to achieve an adequate rate of return and may suffer losses on our investments. If we experience significant losses in connection with our investment activities, our financial condition and results of operations may be materially and adversely affected.

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

We have licensed seven of our self-developed games for operation in various foreign countries, regions and territories of Asia, Europe and North America by a variety of different operating partners. In 2013, our revenues from licensing our games to overseas third party operators was approximate RMB21.2 million (US\$3.5 million), accounting for approximately 0.9% of our total net revenues. Licensing our games for operation in overseas markets exposes us to a number of risks, including difficulties in:

identifying and maintaining good relations with game operators who are knowledgeable, and can effectively distribute and operate our games, in overseas markets;

negotiating licensing agreements with game operators on terms that are commercially acceptable to us and enforcing the provisions of those agreements;

developing games, updates and expansion packs catering to overseas markets and renewing our license agreements with game operators upon expiration;

maintaining the reputation of our company and our games, given that our games are operated by game operators in the international markets with different standards;

protecting our intellectual property rights overseas and managing the related costs;

receiving and auditing the royalties we are entitled to receive;

complying with the different commercial and legal requirements of the international markets in which our games are offered, such as game import regulatory procedures, taxes and other restrictions and expenses; and

managing our foreign currency risks.

For example, in November 2012, a newly updated version of ZT Online 2 that we licensed for operation in Vietnam included a map that indicated certain islands in the South China Sea that are claimed by both Vietnam and China belong to China. After receiving considerable pressure from the Vietnamese government and media, our local operator in Vietnam stopped operating both ZT Online and ZT Online 2. Following the operation shutdown, we terminated both game license agreements.

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

## **Table of Contents**

***Our reputation and trading prices of our securities may be negatively affected by adverse publicity related to our business.***

Beginning in early 2014, we were subject to negative publicity resulting from a series of reports published by an entity that holds itself out as a research firm resulting in volatility in the trading price of our ADSs. The reports contained numerous allegations with respect to, among other things, the independence of our outside directors and certain investments and transactions entered into by us. Our management and audit committee, and then our full board, evaluated the allegations and determined that they do not merit further investigation or changes to our prior year financial statement disclosure. However, such allegations and any corresponding adverse publicity related to our business, regardless of merit, could harm our reputation, cause the trading price of our ADSs to decline or fluctuate significantly and require additional responsive actions distracting our management.

## **Risks Related to the Regulation of Our Business**

PRC regulations relating to our industry are evolving. Any adverse or unanticipated regulatory changes could significantly harm our business or limit our ability to operate.

***Substantial uncertainties and restrictions exist with respect to the application and implementation of PRC laws and regulations in the online game industry. If the PRC government finds that our past or current structure for our business operations does not comply with PRC laws and regulations, we may lose control of Giant Network, resulting in its deconsolidation, and could be subject to severe penalties, including ceasing our operations.***

Various regulations in China currently restrict or prevent foreign and foreign-invested entities from engaging in value-added telecommunication services, which are defined by PRC authorities to include operating online games and providing online advertisements. Since we are a Cayman Islands exempted company and therefore are a foreign or foreign-invested enterprise under PRC law, neither we nor our PRC subsidiaries are eligible to hold the licenses required to operate online games in China. To comply with PRC laws and regulations, we operate our online games in China through Giant Network, which is beneficially owned by certain of our officers and directors and other individuals. Through a series of contractual arrangements, Zhengtu Information is able to effect control and management of Giant Network. Giant Network, which conducts business as an internet content provider, or ICP, holds a value-added telecommunications business operating license, or ICP license, issued by the Shanghai Communications Administration, a local office of the Ministry of Industry and Information Technology of the PRC, or the MIIT, which allows Giant Network to provide internet content distribution services in Shanghai. In addition, Giant Network also holds an internet culture operation license issued by the Ministry of Culture, or MOC, and an internet publishing license issued by the State Administration of Press, Publication, Radio, Film and Television or SAPPRFT, in order to operate and distribute games through the internet. These licenses are essential to the operation of our business.

Despite the lack of technical majority ownership, there exists a parent-subsidary relationship between our Cayman Islands Company and Giant Network through the irrevocable proxy granted by Giant Network to Zhengtu Information, a wholly-owned subsidiary of our Cayman Islands company, whereby the equity holders of Giant Network effectively assigned all of their voting rights underlying their equity interest to Zhengtu Information. We have entered into contractual arrangements with Giant Network pursuant to which Zhengtu Information, our wholly-owned subsidiary, provides technical support and exclusive software licenses to Giant Network. As a result of these contractual arrangements, under U.S. GAAP, we are considered the primary beneficiary of Giant Network and, accordingly, we consolidate its historical results in our financial statements. For detailed descriptions of these contractual arrangements, see Item 4. Information on the Company Organizational Structure and Item 7. Major Shareholders and Related Party Transactions Related Party Transactions.

The relevant PRC regulatory authorities have broad discretion in determining whether a particular contractual structure is in violation of the law. For example, on July 26, 2006, the MIIT publicly released the Notice on Strengthening the Administration of Foreign Investment in Operating Value-added Telecommunications Business, dated July 13, 2006, or the MIIT Notice, which reiterates certain provisions under China's Administrative Rules on Telecommunications Enterprises prohibiting a domestic company that holds an ICP license from renting, transferring or selling a telecommunications license to foreign investors in any form, or providing any resources, sites or facilities to foreign investors that intend to conduct value-added telecommunication business illegally in China. Trademarks and domain names that are used in the provision of Internet content services must be owned by the ICP license holder. There is currently no official interpretation or implementation practice under the MIIT Notice. Due to a lack of interpretative materials from the authorities, it is uncertain whether the MIIT would consider our corporate structure and the contractual arrangements as a kind of foreign investment in telecommunication services. Therefore, it is unclear what impact the MIIT Notice might have on us or the other PRC internet companies that have adopted the same or similar corporate structures and contractual arrangements as ours.



---

**Table of Contents**

In addition, on September 28, 2009, SAPPRFT, together with the National Copyright Administration, and the National Office of Combating Pornography and Illegal Publications jointly issued a Notice on Further Strengthening on the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Game (Xin Chu Lian [2009] No. 13), or the SAPPRFT Notice. The SAPPRFT Notice restates that foreign investors are not permitted to invest in online game operating businesses in China 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 contractual or technical arrangements. However, the SAPPRFT Notice does not provide any interpretation of the term foreign investors or make a distinction between foreign online game companies and companies with a corporate structure that is similar to our own, including the many internet and other companies from China with shares listed on overseas stock exchanges. If our corporate structure was deemed under the SAPPRFT Notice to be an indirect way for foreign investors to exercise control over or participate in the operation of a domestic online game business, our contractual arrangements might be challenged.

We cannot be sure that the PRC government would view our contractual arrangements to be in compliance with PRC licensing, registration or other regulatory requirements, including without limitation, the requirements described in the MIIT Notice and the SAPPRFT Notice, existing policies, or with requirements or policies that may be adopted in the future. If any of our businesses are determined not to be in compliance with the MIIT Notice or the SAPPRFT Notice, the PRC government could take a number of regulatory or enforcement actions that could be harmful to our business, including but not limited to: levying fines, confiscating our income, revoking our business and operating licenses, discontinuing or restricting our operations, blocking our website, requiring us to restructure our business, restricting our right to collect revenue or imposing additional conditions or requirements with which we cannot comply. We may also encounter difficulties in obtaining performance or enforcement of related contracts, thereby losing our control of Giant Network, resulting in its deconsolidation. Any of these actions could cause our business, financial condition and results of operations to suffer and subsequently the market price of our ADSs to decline. In addition, if our ownership structure was required to change, our ability to consolidate the financial results of Giant Network and its consolidated entities could be adversely affected.

***The contractual arrangements with Giant Network and its 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.***

We rely on contractual arrangements with Giant Network and its shareholders to operate our business. For a description of these contractual arrangements, see Item 4. Information on the Company Organizational Structure and Item 7. Major Shareholders and Related Party Transactions Related Party Transactions. These contractual arrangements may not be as effective as direct ownership in providing us with operational control over Giant Network. Direct ownership would allow us, for example, to directly exercise our rights as a shareholder to (i) effect changes in the board of directors of Giant Network, which in turn could effect changes, subject to any applicable fiduciary obligations, in the management team, and (ii) derive economic benefits from the operations of Giant Network by causing it to declare and pay dividends. Because we rely on these contractual arrangements to effect control over Giant Network, we are exposed to the risk that the shareholders of Giant Network may fail to perform their respective obligations under these contractual arrangements. In addition, the shareholders of Giant Network may potentially have a conflict of interest with us, and they may breach their contracts with us or cause such contracts to be amended in a manner contrary to the interest of our company, if they believe such action furthers their own interest, or if they otherwise act in bad faith. If any of the foregoing were to occur, we may have to incur substantial costs and expend significant resources to enforce these contractual arrangements.

In addition, all of these contractual arrangements are governed by PRC law and provide for the resolution of disputes through arbitration in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. We would have to rely for enforcement on legal remedies under PRC law, including specific performance, injunctive relief or damages, which may not be effective or possible. The legal environment in the PRC is not as developed as in jurisdictions such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. In the event we are unable to enforce these contractual arrangements, which relate to critical aspects of our operations, we may be unable to exert effective control over Giant Network and our ability to conduct our business, and our financial condition and results of operations may be negatively affected.

**Table of Contents**

***The contractual arrangements entered into among our PRC subsidiaries, Giant Network and its shareholders may be subject to audit or challenge by the PRC tax authorities; a finding that our PRC subsidiaries or Giant Network owes additional taxes could substantially reduce our net income and the value of your investment.***

Under 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 material and adverse tax consequences if the PRC tax authorities determine that the contractual arrangements among our PRC subsidiaries Zhengtu Information and Zhengju Information, Giant Network, Giant Network's shareholders and our reorganized game development studios do not represent arm's-length prices and adjust any of their income in the form of a transfer pricing adjustment. In 2011, the high and new technology enterprise status of Zhengtu Information was renewed while that of Giant Network was not renewed, resulting in an income tax rate of 15% percent for Zhengtu Information and 25% for Giant Network. In addition, in 2013, Zhengtu Information was named a national key software enterprise for the tax years of 2011 and 2012, further reducing the applicable income tax rate for Zhengtu Information in those years to 10%. This difference in income tax rate may increase the risk that PRC tax authorities challenge the prices that Giant Network pays for services provided by Zhengtu Information pursuant to their contractual arrangements. A transfer pricing adjustment could result in a reduction of expense deductions recorded by Giant Network, which could in turn increase our tax liabilities. In addition, the PRC tax authorities may impose late payment fees and other penalties on Zhengtu Information, our other PRC subsidiaries or Giant Network for underpayment of taxes. For additional information regarding the preferential tax treatments of our various PRC entities, see Item 5. Operating and Financial Review and Prospects Operating Results Income Tax Expense China.

***We may lose the ability to use and enjoy assets held by Giant Network under contractual arrangements that are important to the operation of our business if Giant Network declares bankruptcy or becomes subject to a dissolution or liquidation proceeding.***

Under our contractual arrangements, Giant Network holds assets that are critical to our business operations, such as our licenses and permits, some of our core intellectual property, and/or our joint operation agreements relating to our games and game operations. Although the purchase option and cooperation agreement among Zhengtu Information, Giant Network and shareholders of Giant Network contain terms that specifically obligate the shareholders of Giant Network to ensure the valid existence of Giant Network, in the event the shareholders breach this obligation and voluntarily liquidate Giant Network, or if Giant Network declares bankruptcy and all or part of its assets became subject to liens or rights of third-party creditors, we might be unable to continue some or all of our business operations. Furthermore, if Giant Network was to undergo a voluntary or involuntary liquidation proceeding, its shareholders or unrelated third-party creditors might claim rights to some or all of Giant Network's assets and their rights could be senior to our rights under the contractual arrangements, thereby hindering our ability to operate our business.

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

Under the PRC Enterprise Income Tax Law, or the EIT Law, foreign-invested companies such as Zhengtu Information, and domestic companies such as Giant Network, are subject to a unified income tax rate of 25%. Various favorable income tax rates are, however, available for qualified enterprises in encouraged sectors of the economy. Companies that qualify as a high and new technology enterprise, or HNTE, a status which is reassessed every three years, are subject to an income tax rate of 15%. In addition, companies that qualify as a software development enterprise are exempt from income tax for two years and subject to an income tax rate of 12.5% for the following three years.

In 2008, the Shanghai government granted Zhengtu Information HNTE status, which was successfully renewed in 2011. In 2011, the Shanghai government recognized three of our PRC subsidiaries as software development enterprises, consisting of Jujia Network and Juhuo Network, two of our 51% owned game development studios, and Zhengju Information, which is our wholly-owned subsidiary. In addition, Beijing Giant Zhengtu, which is 51% owned by Zhengtu Information, 34% owned by Giant Network and 15% owned by Juyan Network, was also recognized as a software development enterprises in 2011 by the Beijing government.

We cannot assure you, however, that our PRC entities will be able to continue to qualify for preferential tax treatment. If any of our PRC entities that qualified for preferential tax treatments fails to continue to qualify in a subsequent year, our income tax expenses would increase, which may have a material adverse effect on our net income and results of operations. For additional information regarding the preferential tax treatments of our various PRC entities, see Item 5. Operating and Financial Review and Prospects Operating Results Income Tax Expense China.

---

**Table of Contents**

In addition, in 2011, 2012 and 2013, our PRC entities received financial incentives from the government in an aggregate amount of RMB47.7 million, RMB63.6 million and RMB44.8 million (US\$7.4 million), respectively, which were calculated with reference to taxable revenues and taxable income. To be eligible to apply for the government financial incentives, we are required to meet a number of financial and non-financial criteria and, even if we meet these criteria, the grant of any incentive is still subject to the discretion of the municipal government. Moreover, the central government or municipal government could at any time eliminate or reduce these government financial incentives. Since the government has discretion in the timing of payment and the amount of the financial incentive, we cannot assure you that we will be able to continue to enjoy these government financial incentives or receive such incentives promptly. The discontinuation, reduction or delay of these government financial incentives could have a material adverse effect on our business and results of operations.

***We may be classified as a resident enterprise under the PRC EIT Law; such classification could result in unfavorable tax consequences to us and our non-PRC shareholders.***

The EIT Law provides that enterprises established outside of China whose de facto management bodies are located in China are considered resident enterprises and are generally subject to the uniform 25% enterprise income tax rate on their worldwide income. In addition, a circular issued by the State Administration of Taxation regarding the standards used to classify certain PRC controlled enterprises established outside of China as resident enterprises, or Circular 82, clarified that dividends and other income paid by such resident enterprises will be considered to be PRC sourced income, subject to PRC enterprise income tax, currently at a rate of 10%, when recognized by non-PRC shareholders. This circular also subjects such resident enterprises to various reporting requirements with the PRC tax authorities. Under the implementation regulations to the EIT Law, a de facto management body is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. In addition, Circular 82 details that certain PRC controlled enterprises will be classified as resident enterprises if the following are located or resident in China: (i) senior management personnel and departments that are responsible for daily production, operation and management; (ii) financial and personnel decision making bodies; (iii) key properties, accounting books, company seal, and minutes of board meetings and shareholders meetings; and (iv) half or more of the directors or senior management having voting rights.

Although the determining criteria set forth in Circular 82 may reflect the State Administration of Taxation's general position on how the de facto management body test should be applied in determining the tax resident status of offshore enterprises, Circular 82 only applies to offshore enterprises controlled by PRC enterprises or PRC enterprise groups, not those controlled by individuals or foreign enterprises like us. Therefore, we do not currently consider our company or any of our overseas subsidiaries to be a PRC resident enterprise. However, if the PRC tax authorities determine that our Cayman Islands holding company is a resident enterprise, a number of unfavorable PRC tax consequences could follow. First, we may be subject to enterprise income tax at the rate of 25% on our worldwide income, as well as PRC enterprise income tax reporting obligations. Second, although under the EIT Law and the Implementing Rules dividends paid to our non-PRC holding companies from our PRC subsidiaries would qualify as tax-exempted income, any such dividends paid to our non-PRC holding companies may be subject to an enterprise income tax, and the PRC foreign exchange control authorities have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for PRC enterprise income tax purposes. We are actively monitoring the resident enterprise classification rules and our Cayman Islands holding company's facts and circumstances relative to the classification rules. Similar results could follow if our BVI subsidiary is considered a PRC resident enterprise.

***The PRC EIT Law will affect tax exemptions on the dividends we receive and we may not be able to obtain certain treaty benefits on such dividends.***

We are a holding company incorporated under the laws of the Cayman Islands. We conduct substantially all of our business through our PRC subsidiaries, Giant Network and its consolidated entities, and we derive substantially all of our income from these companies. Prior to January 1, 2008, dividends derived by foreign enterprises from business operations in China were not subject to the PRC withholding tax. However, such tax exemption ceased after January 1, 2008 and a withholding tax of 10% is imposed on all dividends declared and paid after January 1, 2008. In the third quarter of 2011, we declared and paid out a special dividend of US\$3.00 per share to our ADS and ordinary share shareholders, out of which the payout was financed partially through the declaration and payout of dividends to the Company by one of its PRC subsidiaries. As such, the dividends were subject to a 10% withholding tax and therefore, we accrued a one-time withholding income tax in the amount of RMB259.4 million associated with the repatriation of cash for the special dividend paid during the third quarter 2011.

---

**Table of Contents**

According to the Notice of the State Administration of Taxation on Summary Table of Treaty Rates for Dividends, or Circular 112, which was issued on January 29, 2008 and the Arrangement between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Tax Evasion, or the Double Taxation Arrangement (Hong Kong), which became effective on December 8, 2006, dividends from our PRC subsidiaries paid to us through our Hong Kong subsidiary may be subject to a withholding tax at a reduced rate of 5% if such Hong Kong entity owns at least 25% of the equity interest of the PRC company. The ultimate withholding tax rate will be determined by treaty between the PRC and the tax residence of the holder of the PRC subsidiaries. The State Administration of Taxation promulgated a tax notice on October 27, 2009, or Circular 601, which provides that tax treaty benefits will be denied to conduit or shell companies without business substance and a beneficial ownership analysis will be used based on a substance-over-the-form principle to determine whether or not to grant treaty benefits.

Beginning in 2013, Giant HK was deemed to be the beneficial owner of dividends paid to it by Zhengduo Information and Zhengtu Information, two of our PRC Subsidiaries, and accordingly such dividend payments were subject to a withholding tax at a reduced rate of 5%. We can provide no assurances, however, as to whether Giant HK will continue to be deemed the beneficial owner of dividends paid to it by our PRC Subsidiaries in the future, and therefore whether such dividends will be subject to a 5% reduced withholding tax rate or subject to the standard 10% withholding tax rate.

In addition, in connection with the reorganization of Zhengtu Information that we completed in May 2013, our entire equity interest in Zhengtu Information previously held by Eddia International and Giant HK is now held by Giant HK. Pursuant to the Announcement of the Administration of Taxation on Issues Concerning the Application of Special Tax treatment in the Equity Transfer of Non-Resident Enterprises by the State Administration of Taxation issued in 2013, due to the fact that Eddia International is organized in the British Virgin Islands and therefore does not qualify for a reduced withholding tax rate, while Giant HK is organized in Hong Kong and may qualify for a reduced withholding tax rate, any dividends paid by Zhengtu Information to Giant HK from earnings accumulated prior to the reorganization might be subject to the standard 10% withholding tax rate instead of the 5% reduced withholding tax rate.

***The recently adopted PRC tax reform pilot program, which was initiated in Shanghai and may be extended to other cities in the future, requires us to pay value-added tax instead of business tax in Shanghai and it could result in unfavorable tax consequences to us.***

The PRC government recently adopted a PRC tax reform pilot program, which was initiated in Shanghai and may be extended to other cities in the future. On November 16, 2011, the Ministry of Finance and the State Administration of Taxation jointly issued the Circular on the Pilot Program for the Collection of Value-Added Tax Instead of Business Tax, or Circular 110, and the Circular on the Pilot Program for the Collection of Value-Added Tax Instead of Business Tax in Transportation and Certain Modern Service Sectors in Shanghai, or Circular 111, to provide specific implementation rules for the pilot program, which became effective January 1, 2012. Pursuant to Circular 110 and Circular 111, starting from January 1, 2012, companies that are classified by Shanghai's local tax authorities as operating business in transportation or certain modern service sectors in Shanghai are required to pay a Value-Added Tax, or VAT, instead of the business tax. Specifically, a 17% rate applies to the movable property leasing services, an 11% rate applies to the transportation services and a 6% rate applies to certain other modern services, such as research and development, technological services, culture, logistics and consultation.

Currently, Giant Network continues to pay business tax on its net revenue at a rate of 5% and has not been required to transition to paying VAT. However, the interpretation and enforcement of this tax reform pilot program involve significant uncertainties. In the event that Giant Network is deemed to engage in business falling within the category

of certain modern service sectors or if the VAT tax reform pilot program is expanded to other sectors, Giant Network may also be required to pay VAT rather than business tax. Because the tax reform pilot program is subject to significant uncertainties with respect to interpretation and implementation, in the event that Giant Network are required to pay VAT rather than business tax, they may face unfavorable tax consequences, which may adversely affect our business, financial condition and results of operations.

***PRC laws and regulations establish 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 China.***

PRC laws and regulations, such as the M&A Rules promulgated by six PRC regulatory agencies in 2006 and amended in 2009, the Anti-Monopoly Law promulgated by the PRC National People's Congress in 2007 and the Circular on the Establishment of a National Security Review Mechanism for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors promulgated by the General Office of the PRC State Council in 2011, or the National Security Review Mechanism Circular, establish procedures and requirements that could make some acquisitions of PRC companies by foreign investors and companies more time-consuming and complex, including requirements in some instances that various governmental authorities be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise.



---

**Table of Contents**

In addition, the Rules of Ministry of Commerce on Implementation of Security Review Mechanism of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors promulgated by the MOFCOM in August 2011, or the MOFCOM Security Review Rules, effective September 1, 2011, which implements the National Security Review Mechanism Circular, provides that, a security review by MOFCOM is required for mergers and acquisitions of PRC domestic enterprises by foreign investors (i) having national defense and security concerns, and (ii) where the foreign investors may acquire the de facto control of the PRC domestic enterprises having national security concerns such as key farm products, key energy and resources, and key infrastructure, transportation, technology and major equipment manufacturing industries. Neither the National Security Review Mechanism Circular nor the MOFCOM Security Review Rules, however, defines the term of key or major, nor has it exhausted all the industries that may be deemed as sensitive industries subject to the security review. When deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to MOFCOM's security review, the principle of substance over form should be applied and foreign investors are prohibited from bypassing the security review requirement by way of structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. We may expand our business in part by acquiring complementary businesses. Complying with the requirements of the relevant PRC laws and regulations to complete such transactions could be time-consuming, and any required approval processes 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 and our investors face uncertainty with respect to indirect transfers of equity interests in PRC resident enterprises by their non-PRC holding companies.***

In connection with the EIT Law, the Ministry of Finance and State Administration of Taxation jointly issued, on April 30, 2009, the Notice on Issues Concerning Process of Enterprise Income Tax in Enterprise Restructuring Business, or Circular 59. On December 10, 2009, the State Administration of Taxation issued the Notice on Strengthening the Management on Enterprise Income Tax for Non-resident Enterprises Equity Transfer, or Circular 698. Both Circular 59 and Circular 698 are effective retroactively to January 1, 2008. Under the two circulars, non-PRC-resident enterprises may be subject to income tax on capital gains generated from their transfers of equity interests in PRC resident enterprises, or an indirect transfer. Using a substance over form principle, the PRC tax authorities have discretion under Circular 59 and Circular 698 to make adjustments to the taxable capital gains based on the difference between the fair value of the equity interests transferred and the cost of the investment. In addition, by promulgating and implementing the circulars, the PRC tax authorities have increased their scrutiny of the direct or indirect transfer of equity interests in a PRC resident enterprise by a non-PRC-resident enterprise. For example, Circular 698 specifies that the PRC State Administration of Taxation is entitled to redefine the nature of an equity transfer where offshore vehicles are interposed for tax-avoidance purposes and without reasonable commercial purpose.

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 China. Moreover, the implementation of Circular 698, such as the process and format of the reporting of an indirect transfer to the competent tax authority of the relevant PRC resident enterprise remains unclear. 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, disposal of our subsidiaries, acquisitions of complementary businesses, or disposal of shares or ADSs in our company, where non-PRC resident investors are involved. As a result, we and our non-PRC resident investors may, when doing transactions that involve the transfer of our shares or equity interests of our subsidiaries, become at risk of being taxed under Circular 698 and may be required to expend valuable resources to comply with Circular 698 or to establish that we or our non-PRC resident shareholders should not be taxed under Circular 698, which may have a material adverse

effect on our financial condition and results of operations or such non-PRC resident investors' investments in us.

***Intensified government regulation of internet cafés could limit our ability to maintain or increase our net revenues and expand our customer base.***

Starting in 2001, the PRC government began tightening its supervision of internet cafés, closing unlicensed internet cafés, requiring those remaining open to install software to prevent access to sites deemed subversive and requiring web portals to sign a pledge not to host subversive sites. In February 2007, 14 PRC national government authorities, including the MIIT, the MOC and the SAPPRT, jointly issued a notice suspending nationwide approval for the establishment of new internet cafés and enhancing the punishment for internet cafés admitting minors. This suspension may continue indefinitely. Furthermore, the PRC government's policy, which encourages the development of a limited number of national and regional internet café chains and discourages the establishment of independent internet cafés, may slow down the growth of internet cafés. Governmental authorities may from time to time impose stricter requirements, such as limits on the ages of customers and hours of operation, as a result of the occurrence or perception of, or media attention on, gang fights, fires and other incidents accruing at or related to internet cafés.

## **Table of Contents**

As internet cafés are one of the primary venue for users to play our games, any reduction in the number, or any slowdown in the growth, of internet cafés in China will limit our ability to maintain or increase our net revenues and expand our customer base, which will in turn materially and adversely affect our business and results of operations.

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

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

We are required to obtain applicable permits or approvals from different regulatory authorities in order to provide online game services. For example, an internet content provider, or ICP, must obtain a value-added telecommunications business operation license, or ICP license, from the MIIT or its local offices in order to engage in any commercial ICP operations within China. An online game operator must also obtain an internet culture operation license from the MOC, and an internet publishing license from SAPPRFT, in order to operate and distribute games through the internet. Any self-developed online game we operate needs to be approved by SAPPRFT prior to its launch and filed with the MOC within thirty days after its launch. Imported online games need to be approved by both SAPPRFT and MOC. Once any upgrade, expansion pack or new version of any existing game is launched, it must be filed with the MOC in the case of a self-developed game and approved by the MOC in the case of an imported game, and approval must be obtained from the SAPPRFT prior to its online publication.

Giant Network holds a valid ICP License, a valid internet culture operation license and a valid internet publishing license. As the online game industry continues to evolve and develop in China, new laws and regulations may be adopted from time to time to require additional licenses and permits other than those we currently have. While we believe that we comply in all material respects with all applicable PRC laws and regulations currently in effect, we cannot assure you that we will be able to obtain timely, or at all, required licenses or any other new license required in the future. We also cannot assure you that we will not be found in violation of any current or future PRC laws and regulations.

***Further strengthened supervision of the online game industry may adversely affect our online game operations.***

The authority, roles and responsibilities of the PRC governmental departments with oversight of the online game industry in China, including SAPPRFT and the MOC, are currently ambiguous and we may face stricter scrutiny in the future regarding the day-to-day operations of our online game business. For example, our online game business may be adversely affected by ambiguities and potential conflicts between notices issued by SAPPRFT and the MOC. SAPPRFT initially stated in the SAPPRFT Notice that it is the only governmental department with authority for examination and pre-approval of online games, and that all online game operators must obtain an internet publishing license to provide online game services. Pursuant to the SAPPRFT Notice, additional approvals from SAPPRFT are required when game operators release new versions or expansion packs, or make any changes to the originally approved online game. In addition, on July 1, 2009, SAPPRFT issued the Notice on Strengthening the Approval and Administration of Imported Online Games, in which SAPPRFT stated that it is the only governmental department authorized by the State Council to approve the importation of online games from offshore copyright owners. In the event of any failure to meet the above-mentioned requirements, an operator may face heavy penalties, such as being ordered to stop operation, or having its business license revoked. Our online game business may be adversely affected

by these two SAPPRFT notices. The launch of expansion packs and imported games might be delayed because of the extra approval required. Such delay in releasing expansion packs or imported games may result in higher costs for our online game operation and have an adverse effect on our game revenue.

On June 3, 2010, the MOC issued the Tentative Measures for Online Game Administration, or the Online Game Measures, which became effective on August 1, 2010, aiming to further strengthen the MOC's supervision of the online game industry. Specifically, the Online Game Measures reiterate that the MOC has the power to review the content of all online games except online game publications that have been pre-approved by SAPPRFT. However, the Online Game Measures do not clearly specify what constitutes online game publication. Furthermore, the Online Game Measures provide that all domestic online games must be filed with the MOC within 30 days after their launch, while all imported online games are subject to a content review prior to their launch. If a substantial change (for example, any significant modification to a game's storyline, language, tasks, or trading system) is made to an existing imported or domestic online game, it will be subject to a new content review.

## Table of Contents

Our online game business may be adversely affected by the Online Game Measures. The Online Game Measures do not set forth any specific procedure for the required filing and content review procedures for online games and therefore may cause delay when we try to file or apply for content review with the MOC. In addition, the Online Game Measures do not resolve certain inconsistencies and ambiguities resulting from pronouncements included in previous notices issued by SAPPRFT and the MOC. Due to the ambiguities here and elsewhere regarding the governmental departments, including SAPPRFT and the MOC, that have oversight of the online game industry, there may potentially be stricter and more abrupt scrutiny of our operations.

If any of our online game operating entities cannot comply with any of the stipulations of any PRC governmental department regarding the online game industry, we may be subject to various penalties and our online game business may be adversely affected.

***Regulation and censorship of information disseminated over the internet in China may adversely affect our business, and we may be liable for information displayed on, retrieved from, or linked to our 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 over the internet any content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is obscene, superstitious, fraudulent or defamatory. When internet content providers and internet publishers, including online game operators, find that information falling within the above scope is transmitted on their websites or is stored in their electronic bulletin service systems, they are required to terminate the transmission of such information or delete such information immediately, keep records, and report to relevant authorities. Failure to comply with these requirements could result in the revocation of our ICP license and other required licenses and the closure of our websites. Website operators may also be held liable for prohibited information displayed on, retrieved from or linked to their websites.

In addition, the MIIT has published regulations that subject website operators to potential liability for the actions of game players and others using their websites, including liability for violations of PRC laws prohibiting the dissemination of content deemed to be socially destabilizing.

As a result, we periodically make changes to our games based on feedback gathered from users and in order to comply with government regulations. For example, during the third quarter of 2009, we canceled several in-game monetization features in compliance with a virtual currency regulation issued by the Ministry of Culture, or MOC. The most important cancelled feature was the virtual treasure box, which contained in-game items worth more than the cost of the treasure box itself. We believe this change was the main reason for the subsequent temporary decrease in our active paying accounts, which fell by 7.9%, from approximately 1,204,000 during the second quarter of 2009 to approximately 1,108,000, during the third quarter of 2009. Future rule changes to our games could lead to declines in active paying accounts, which may materially and adversely affect our business, results of operation and financial condition.

As these regulations are subject to interpretation by the relevant authorities, it may not be possible for us to determine in all cases the type of content that could result in liability for us as an MMORPG developer and operator. In addition, we may not be able to control or restrict the content of other internet content providers linked to or accessible through our websites, or content generated or placed on our websites by our game players, despite our attempt to monitor such content. To the extent that regulatory authorities find any portion of our content objectionable, they may require us to curtail our games, which may reduce our game player base, the amount of time our games are played or the purchases of virtual items.

Furthermore, the Administrative Measures for Content Self-review by Internet Culture Business Entities, or the Content Self-review Administrative Measure, which took effect in December 2013, require Internet culture business entities to review the content of products and services to be provided prior to providing such content and services to the public. The content management system of an Internet culture business entity is required to specify the responsibilities, standards and processes for content review as well as accountability measures, and is required be filed with the local provincial branch of the MOC.

***Compliance with the laws or regulations governing virtual currency may result in us having to obtain additional approvals or adversely affect our game operation revenues.***

---

**Table of Contents**

On February 15, 2007, the MOC, the PBOC and other relevant government authorities jointly issued the Notice Concerning Further Deepening Internet Cafés and Online Game Management. Under the Internet Cafés Notice, the PBOC is directed to strengthen the administration of virtual currency in online games to avoid any adverse impact on the economy and financial system. The Internet Cafés Notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual game players should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency should only be used to purchase virtual items. In June 2009, the MOC and the Ministry of Commerce jointly published the Notice on Strengthening the Administration Work of the Virtual Currency in Online Games, or the Virtual Currency Notice, to require businesses that (i) issue online game virtual currency (in the form of prepaid cards and/or pre-payment or prepaid card points) or (ii) offer online game virtual currency transaction services to apply for approval from the MOC through its provincial branches within three months following the date of such notice. The Virtual Currency Notice prohibits businesses that issue online game virtual currency from providing services that would enable the trading of such virtual currency. Any business that fails to submit the requisite application will be subject to sanctions, including but not limited to warnings, mandatory corrective measures and fines. The Virtual Currency Notice also prohibits online game operators from allocating virtual items or virtual currency to players based on random selection through lucky draw, wager or lottery which involves cash or virtual currency directly paid by the players. In addition, the Virtual Currency Notice regulates, among other things, that game operators may not issue virtual currency to game players through means other than purchased by game players with legal currency. Moreover, any businesses that do not provide online game virtual currency transaction services are required to adopt technical measures to restrict the transfer of online game virtual currency among accounts of different game players. The MOC issued the Tentative Measures for Online Games Administrative, or the Online Game Measures, in June 2010, which provides, among other things, that virtual currency issued by online game operators may only be used in exchange for the operator's own online game products and services and may not be used to pay for the products and services of other entities. The above restrictions may limit our ability to maintain or increase our revenues and adversely affect our results of operations and business prospects.

The PRC State Administration of Taxation has also previously announced that it will tax game players on the income derived from the trading of virtual currencies at the rate of 20%. However, it is currently unclear how the tax will be collected or if there will be any effect on our game players or our business, but collection of such a tax might discourage players who are interested in trading virtual currencies from playing our games, which could reduce our revenues. Moreover, similar adverse public reaction may arise, and similar government policies may be adopted, in other jurisdictions where we license or operate our games, which could similarly adversely affect our revenues.

***There are currently no laws or regulations in the PRC governing virtual asset property rights and therefore it is not clear what liabilities, if any, online game operators may have relating to the loss of virtual assets.***

In the course of playing online games, some virtual assets, such as special equipment, player experience grades and other features of our players' game characters, are acquired and accumulated. Such virtual assets can be highly valued by online game players and in some cases are traded between players for actual money or real assets. In practice, virtual assets can be lost for various reasons, such as data loss caused by delay of network service or by a network crash. There are currently no PRC laws and regulations governing virtual asset property rights. As a result, it is unclear who the legal owner of virtual assets is and whether the ownership of virtual assets is protected by law. In addition, it is unclear under PRC law whether an operator of online games such as us would have any liability (whether in contract, tort or otherwise) for loss of such virtual assets by game players. Although we have not been sued by any game players for the loss of any virtual assets, including virtual currency, court cases involving the loss of virtual assets by other game operators in the PRC suggest that online game operators might not be held liable for losses, but instead only required to improve security systems. However, in the event of a loss of virtual assets

involving our online games, it is possible that we may be sued by game players and may be held liable for damages, which may negatively affect our business, financial condition and results of operations.

***Our business may be adversely affected by public opinion and government policies in China.***

Due to a relatively high degree of game player loyalty, easy access to personal computers and internet cafés, and the lack of other appealing forms of entertainment in China, many teenagers in China frequently play online games. This may result in these teenagers spending less time on or refraining from other activities, including their school work or other educational activities, which could result in adverse public reaction and stricter government regulation. For example, the PRC government has promulgated anti-fatigue-related regulations to limit the amount of time minors can play online games. See Risk Factors Risks Related to the Regulation of Our Business Our operations may be adversely affected by a broadening of the addiction-related regulations.



---

**Table of Contents**

The PRC government has also tightened its regulations on internet cafés, currently one of the primary places where online games are played, including prohibiting minors from using internet cafés, limiting the issuance of internet café operating licenses, and imposing higher capital and facility requirements for the establishment of internet cafés. See **Risk Factors – Risks Related to the Regulation of Our Business – Intensified government regulation of internet cafés** could limit our ability to maintain or increase our net revenues and expand our customer base. In addition, in January 2011, MIIT and seven other central government authorities jointly issued a circular pursuant to which online game operators are required to maintain a communication system that parents can use to monitor the activities of their children and to suspend their child’s online game account upon request. Additional government regulations, whether issued in response to adverse public opinion or otherwise, could be issued in the future and may have a material and adverse effect upon our business, results of operation and financial condition.

***Our operations may be adversely affected by a broadening of the addiction-related regulations.***

The PRC government may decide to adopt more stringent policies to combat perceived addiction to online games, including by broadening the anti-addiction system rules to cover adult players or adopting additional rules to protect minors. On April 15, 2007, eight PRC government authorities, including SAPPFRFT, the Ministry of Education and the MIIT issued a Notice on the Implementation of Online Game Anti-Addiction System to Protect the Physical and Psychological Health of Minors, or the Anti-Addiction Notice, requiring all PRC game operators to adopt an anti-addiction system in an effort to curb addiction to online games by minors. Under the anti-addiction system, three hours or less of continuous play is defined to be healthy, three to five hours is defined to be fatiguing, and five hours or more is defined to be unhealthy. Game operators are required to reduce the value of game benefits for minor players by half when those players reach the fatigue level, and to zero when they reach the unhealthy level. In addition, online game players in China are now required to register their identity card numbers before they can play an online game, which allows game operators to identify which players are minors. Failure to comply with the requirements under the Anti-Addiction Notice may subject us to penalties, including but not limited to suspension of our operation of online games, revocation of our licenses and approvals for our operations, rejection or suspension of our application for approvals, licenses, or filings for any new game, or prohibiting us from operating any new game. Although we currently do not permit minors to play our online games, if these restrictions are expanded to apply to adult players in the future, they could have a material and adverse effect on our business, financial condition and operating results.

On July 1, 2011, eight PRC government authorities, including the SAPPFRFT, the Ministry of Education, MIIT and five others, promulgated a further notice to strengthen the implementation of the anti-addiction system and real-name registration, entitled the Notice on Initializing the verification of Real-Name Registration for Anti-Addiction System on Internet Games, or the Real-Name Registration Notice, which took effect on October 1, 2011. The Real-Name Registration Notice’s main focus is to prevent minors from using an adult’s ID to play internet games and, accordingly, the notice provides more stringent punishment for online game operators for not implementing the anti-addiction and real name registration measures properly and effectively. The most severe punishment contemplated by the Real-Name Registration Notice includes suspension of operation of online games, revocation of game operator’s licenses and approvals, rejection or suspension of game operator’s application for approvals, licenses, or filings for any new game if such game operator is found to be in violation of any of the government issued notices including the Anti-Addiction Notice and the Real-Name Registration Notice. The Real-Name Registration Notice further increases our operating risks, as we will be required to allocate more resources to real-name verification and anti-addiction systems, which may lead to an increase in operating costs. In addition, if we are found to be violating the Real-Name Registration Notice, we may be required to suspend or discontinue our online game operations.

In February 2013, 15 PRC government authorities, including the GAPP, the Ministry of Education, the MOC and the MIIT, jointly issued the Work Plan for the Integrated Prevention of Minors Online Game Addiction, or the Work Plan,

implementing integrated measures by different authorities to prevent minors from being addicted to online games. Under the Work Plan, the current relevant regulations will be further clarified and additional implementation rules will be issued by relevant authorities. As a result, we may have to impose more stringent limits for minor game players, which may lead to an increase in our operating expenses and a reduction in our revenues from minor game players.

***Regulations relating to offshore investment activities by PRC residents may increase our administrative burdens and create regulatory uncertainties that could restrict our overseas and cross-border investment activity, and a failure by our shareholders who are PRC residents to make any required applications and filings pursuant to such regulations may prevent us from being able to distribute profits and could expose us and our PRC resident shareholders to liability under PRC law.***

---

**Table of Contents**

In October 2005, the State Administration of Foreign Exchange, or the SAFE, promulgated a Notice on Issues Relating to the Administration of Foreign Exchange in Fundraising and Return Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or Notice 75, which states that if PRC residents use assets or equity interests in their PRC entities as capital contributions to establish offshore companies or inject assets or equity interests of their PRC entities into offshore companies to raise capital overseas, they must register with local SAFE branches with respect to their overseas investments in offshore companies. They must also file amendments to their registrations if their offshore companies experience material events involving capital variation, such as changes in share capital, share transfers, mergers and acquisitions, spin-off transactions, long-term equity or debt investments or uses of assets in China to guarantee offshore obligations.

In addition, SAFE has further issued a series of implementation guidances, including the most recent Notice on of the State Administration of Foreign Exchange on Further Improving and Adjusting Foreign Exchange Administration Policies for Direct Investment, or Circular 59 and Notice of the General Affairs Department of the State Administration of Foreign Exchange on Issuing the Operation Rules for the Notice of the State Administration of Foreign Exchange on the Relevant Issues about Foreign Exchange Control over the Financing and Return Investment of Domestic Residents through Overseas Special Purpose Companies, or Circular 106. Circular 59 and Circular 106 standardize more specific and stringent supervision on the registration and supplemental registration for established special purpose vehicles, or SPVs, relating to Notice 75. In addition, Notice of the State Administration of Foreign Exchange on Issues concerning the Foreign Exchange Administration of Domestic Individuals' Participation in Equity Incentive Plans of Overseas Listed Companies, or Circular 7 requires registration with SAFE of stock options granted by overseas listed companies to any PRC individuals. Under these regulations, a PRC resident's failure to comply with the registration procedures set forth in such regulations may result in fines or sanctions imposed by the PRC government, including restrictions being imposed on the foreign exchange activities of the relevant PRC entity, such as limitations on the payment of dividends and other distributions to its offshore parent, as well as restrictions on the capital inflow from the offshore entity to the PRC entity.

We are committed to complying with and to ensuring that our shareholders who are subject to the regulations comply with the relevant rules. However, we cannot assure you that all of our shareholders who are PRC residents will comply with our request to make or obtain any applicable registrations or comply with other requirements required by Notice 75 or other related rules. Any failure by any of our shareholders who are PRC residents, or controlled by a PRC resident, to comply with relevant requirements under this regulation could subject us to fines or sanctions imposed by the PRC government, including restrictions on our PRC subsidiaries' abilities to pay dividends or make distributions to us and our ability to increase our investment in our PRC subsidiaries.

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

We are a Cayman Islands holding company and conduct substantially all of our operations through our PRC entities. We rely on dividends and other distributions on equity by our PRC entities for our cash requirements, including the funds to pay dividends on the ordinary shares underlying our ADSs. Under PRC laws and regulations, each PRC entity is only permitted to pay dividends out of its retained earnings, and each PRC entity is required to set aside at least 10% of its after-tax profit for its general reserves until the cumulative amount of such reserves reaches 50% of its registered capital. As a result of these and other restrictions under PRC laws and regulations, each PRC entity is restricted from transferring a portion of its assets to us as dividends, loans or advances, which restricted portion, including registered capital and the statutory reserve funds of the PRC entities, amounted to approximately RMB368.8 million, RMB404.7 million and RMB386.4 million (US\$63.8 million), or 14.8%, 12.6% and, 10.8% of our total consolidated net assets as of December 31, 2011, 2012 and 2013, respectively. Any limitation on the ability of our

PRC entities to transfer funds to us as dividends, loans or advances could materially and adversely limit our ability to pay dividends and to make offshore investments or acquisitions that could benefit our business.

In addition, any funds we transfer to our PRC subsidiaries, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval of PRC governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. Furthermore, each of our PRC entities is prohibited by PRC law from directly lending money to one another. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our PRC entities. These limitations on the free flow of funds between us and our PRC entities could restrict our ability to act in response to changing market conditions and reallocate funds among our PRC entities on a timely basis.

***We have not registered license agreements for all of our internationally exported games with the relevant PRC governmental authorities, which may result in certain restrictions that could impair our ability to expand our business internationally.***

## **Table of Contents**

Under the Software Export Administration and Statistic Measures, issued by several PRC agencies on October 25, 2001, all agreements which relate to the export of technology are required to be registered with the relevant PRC government authorities. In addition, the Measures for the Administration of Registration of Technology Import and Export Contracts, issued by the MOFCOM in February 2009, also specify registration requirements related to the export of technology. Under the Regulations on Administration of Import and Export of Technologies promulgated by the State Council, an export of technology is defined to include, among other things, the transfer or licensing of patents and know-how, and the provision of services related to technology.

We have entered into license agreements with third parties to operate our games internationally, which may be deemed to constitute the export of technology under the applicable PRC regulations. As a result, such licenses might need to be registered with the applicable PRC government authorities. Although the applicable regulations do not indicate what penalties might be applied for non-compliance, failure to register an agreement where such registration is required may result in restrictions concerning foreign exchange, banking and taxation matters relating to such agreements. We have not registered all of the game license agreements under which we authorize overseas third-parties to operate our online games, and if the above restrictions apply to our overseas game license agreements, our ability to license our games overseas may be impaired, and our business, financial condition and results of operations might be materially and adversely affected.

## **Risks Relating to China**

### ***There are uncertainties regarding the future growth of the online game industry in China.***

The online game industry, from which we derive substantially all of our revenues, is a relatively new and evolving industry. The growth of the online game industry and the level of demand and market acceptance of our games are subject to a high degree of uncertainty. Our future operating results will depend on numerous factors affecting the online game industry, many of which are beyond our control, including; (i) whether recent declines in the use of personal computers in general, and for purposes of accessing online games in particular, continue or accelerate in China and other markets in which we offer our games; (ii) the growth of mobile device (such as smart phones and tablets), internet and broadband users and penetration in China and other markets in which we offer our games, and the rate of any such growth; (iii) whether the online game industry, particularly in China and the rest of the Asia-Pacific region, continues to grow and the rate of any such growth;(iv) general economic conditions in China, particularly economic conditions adversely affecting discretionary consumer spending, such as the slowdown in China's economic growth that occurred between the first quarter of 2010 and the third quarter of 2012; (v) the availability and popularity of other forms of entertainment, particularly games of console systems, which are already popular in developed countries and may gain popularity in China; and (vi) changes in consumer demographics and public tastes and preferences.

There is no assurance that online games will continue to be popular in China or elsewhere. A decline in the popularity of online games would adversely affect our business and prospects.

### ***Our business, financial condition and results of operations may be adversely affected by a slowdown in China's economic growth rates.***

Substantially all of our operations are conducted in China and substantially all of our revenues are sourced from China. Accordingly, our business, financial condition and results of operations are influenced by economic and other developments in China.

While the Chinese economy has grown significantly in the past 30 years, the growth has been uneven geographically among various sectors of the economy, and during different periods. In addition, the rate of economic growth in China as reported by the National Bureau of Statistics has declined in recent years and may continue to decline in the near future, which may have adverse effects on our financial condition and results of operations. Risk of a material slowdown in China's economic growth rate is based on several current or emerging factors including: (i) overinvestment by the government and businesses and excessive credit offered by banks; (ii) a rudimentary monetary policy; (iii) excessive privileges to state-owned enterprises at the expense of private enterprises; (iv) the dwindling supply of surplus labor; (v) a decrease in exports due to weaker demand overseas; and (vi) failure to boost domestic consumption. Although we are uncertain about the extent to which the potential rapid slowdown of China's economic growth may impact our business in the short term and long term, there is a risk that our business, results of operations and prospects would be materially and adversely affected by a continued slowdown of China's growth rate.

**Table of Contents**

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

In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. The effect of legislation adopted over the past three decades has generally enhanced the protections afforded to various forms of foreign investment in China. Each of our PRC subsidiaries is a foreign-invested enterprise incorporated in China and therefore is subject to laws and regulations applicable to foreign investment in China in general and laws and regulations applicable to foreign-invested enterprises in particular. However, these laws, regulations and legal requirements change frequently, and their interpretation and enforcement are subject to the discretion of PRC administrative and court authorities. Accordingly, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy in China than in more developed legal systems. Furthermore, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. Accordingly, we cannot predict the effect of future developments in the PRC legal system, the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the legal protections available to us, and our foreign investors, including you.

***Contract drafting, interpretation and enforcement in China involve significant uncertainty.***

We have entered into numerous contracts governed by PRC law, many of which are material to our business. As compared with contracts in the United States, contracts governed by PRC law tend to contain less detail and are not as comprehensive in defining contracting parties' rights and obligations. As a result, contracts in China are more vulnerable to disputes and legal challenges. In addition, contract interpretation and enforcement in China is not as developed as in the United States, and the result of any contract dispute is subject to significant uncertainties. Therefore, we may be subject to disputes under our material contracts, and if such disputes arise, we may not prevail. Due to the materiality of certain contracts to our business, any dispute involving such contracts, even without merit, may materially and adversely affect our reputation and our business operations, and may cause the price of our ADSs to decline.

***Restrictions on the convertibility of Renminbi into foreign currencies may limit our ability to pay dividends in U.S. dollars or fund possible business activities outside China.***

Substantially all of our net revenues are currently generated in Renminbi. China's government imposes control over the convertibility of RMB into foreign currencies. The conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates announced by the People's Bank of China. Any future restrictions on currency exchanges may limit our ability to use net revenues generated in Renminbi to pay dividends in U.S. dollars or fund possible business activities outside China. Although the PRC government introduced the Foreign Exchange Administration Rules in 1996, as amended in August 2008, to allow greater convertibility of Renminbi for current account transactions, significant restrictions still remain, including primarily the restriction that enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents. In addition, remittance of foreign currencies abroad and conversion of Renminbi for capital account items, including direct investment and loans, is subject to government approval in China, and companies are required to open and maintain separate foreign exchange accounts for capital account items. We cannot assure you the PRC regulatory authorities will not impose more stringent restrictions on the convertibility of Renminbi in the future.

***You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in China based on the laws of the United States or other foreign jurisdictions, against us, our management or the experts named in this annual report.***

We conduct substantially all of our operations in China and substantially all of our assets are located in China. In addition, all of our directors and executive officers reside within greater China including Hong Kong. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon some of our directors and senior executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. It would also be difficult for investors to bring an original lawsuit against us or our directors or executive officers before a PRC court based on U.S. federal securities laws.



---

**Table of Contents**

***Fluctuation in the value of the Renminbi may have a material adverse effect on your investment.***

The value of the Renminbi against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies. The conversion of Renminbi into foreign currencies, including U.S. dollars, was historically based on exchange rates set by the PBOC. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi solely to the U.S. dollar. Under this revised policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. Following the removal of the U.S. dollar peg, the Renminbi has appreciated approximately 27% against the U.S. dollar as of the end of 2013. Substantially all of our revenues and costs are denominated in Renminbi. Any additional significant appreciation of the Renminbi may materially inflate our revenues and earnings as expressed in U.S. dollars without reflecting any material change in our results of operations.

***The audit report included in this annual report was prepared by auditors who are not inspected by the Public Company Accounting Oversight Board and, as such, our investors are deprived of the benefits of such inspection***

Our independent registered public accounting firm that issues the audit reports included in our annual reports filed with the US Securities and Exchange Commission, as auditors of companies that are traded publicly in the United States and a firm registered with the US Public Company Accounting Oversight Board (United States), or the PCAOB, is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditors are located in the Peoples' Republic of China, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the PRC authorities, our auditors are not currently inspected by the PCAOB.

Inspections of other firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections. Investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

***We may be adversely affected by the proceedings instituted recently by the SEC against five PRC-based accounting firms, including our independent registered public accounting firm.***

In December 2012, the SEC instituted proceedings under Rule 102(e)(1)(iii) of the SEC's Rules of Practice against five PRC-based accounting firms, including our independent registered public accounting firm, alleging that these firms had violated U.S. securities laws and the SEC's rules and regulations thereunder by failing to provide to the SEC the firms' work papers related to their audits of certain PRC-based companies that are publicly traded in the United States. Rule 102(e)(1)(iii) grants to the SEC the authority to deny to any person, temporarily or permanently, the ability to practice before the SEC who is found by the SEC, after notice and opportunity for a hearing, to have willfully violated, or willfully aided and abetted the violation of, any such laws or rules and regulations. On January 22, 2014, an initial administrative law decision was issued, censuring these accounting firms and suspending four of the five firms from practicing before the SEC for a period of six months. The decision is neither final nor legally effective unless and until reviewed and approved by the SEC. On February 12, 2014, four of these PRC-based accounting firms appealed this decision. Accordingly, the sanction will not become effective until after a full appeal process is

concluded and a final decision is issued by the SEC. The accounting firms can also further appeal the final decision of the SEC through the federal appellate courts.

We are not involved in the proceedings brought by the SEC against the accounting firms. However, our independent registered public accounting firm is one of the four accounting firms subject to the six month suspension from practicing before the SEC in the initial administrative law decision. We may therefore be adversely affected by the outcome of the proceedings, along with other U.S.-listed companies audited by these accounting firms.

**Table of Contents**

**Risks Related to Our Ordinary Shares and ADSs**

*The market price for our ADSs may be volatile which could result in a loss to shareholders.*

The trading price of our ADSs has been and may continue to be subject to wide fluctuations. Since we completed our initial public offering on November 6, 2007, the closing price of our ADSs on the New York Stock Exchange has ranged from US\$3.15 to US\$19.2 per ADS and the last reported closing price on April 25, 2014 was US\$11.74.

The market price for our ADSs is likely to be highly volatile and subject to wide fluctuations in response to a number of factors, including:

actual or anticipated fluctuations in our quarterly operating results;

announcements of competitive developments;

changes in the economic performance or market valuations of companies with comparable businesses;

negative market and investor perception in response to recent accounting irregularities at other PRC companies listed in the U.S.;

regulatory developments in China affecting us, our industry, our corporate structure or our advertisers;

announcements regarding litigation or administrative proceedings involving us;

changes in financial estimates by securities research analysts;

addition or departure of our executive officers;

issuance of material dividends;

sales or perceived sales of additional common shares or ADSs; and

failure to complete the going private transaction that we entered into in March 2014.

For example, on September 12, 2011, the trading price of our ADS declined from US\$8.00 to US\$4.61, which was primarily due to a special cash dividend of US\$3 per ADS that we issued to our shareholders as of record August 31, 2011.

In addition, the securities market has from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also have a material adverse effect on the market price of our ADSs.

***A significant percentage of our outstanding ordinary shares are held by a small number of our existing shareholders, and these shareholders may have significantly greater influence on us and our corporate actions by nature of the size of their shareholdings relative to our public shareholders.***

As of April 10, 2014, Yuzhu Shi, our founder and chairman, beneficially owned approximately 44.4% of our outstanding ordinary shares. As a result, Mr. Shi has significant influence in determining the outcome of any corporate transactions or other matters submitted to our shareholders for approval, including mergers, consolidations and schemes of arrangement, election and removal of directors and other significant corporate actions. Mr. Shi may not act in the best interests of our minority shareholders and may take actions even if they are opposed by our other shareholders. In addition, without the consent of Mr. Shi, we could be prevented from entering into transactions that might be beneficial to us. This concentration of ownership and voting power may also discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our ADSs.

## Table of Contents

A consortium including our chairman, Mr. Yuzhu Shi, entered into an agreement and plan of merger with us on March 17, 2014, pursuant to which they are expected to acquire all of our outstanding ordinary shares not currently owned by Mr. Shi and other consortium members. The consortium members' share ownership in our company effectively prevents a competing bid for our company by other potential acquirers, which may be against your best interests. Potential uncertainty involving the going private transaction contemplated thereby may adversely affect our business and the market price of our ADSs. See Risk Factors Risks related to Our ADSs Potential uncertainty or disputes involving the going private transaction may adversely affect our business and the market price of our ADSs.

***We may not consummate the transactions contemplated by the Merger Agreement or may suffer adverse effects in our efforts to close the transactions it contemplates.***

On March 17, 2014, we entered into an agreement and plan of merger, or the Merger Agreement, with Giant Investment Limited, or the Parent, and Giant Merger Limited, or the Merger Sub, to effectuate a going private proposal, or the Transactions. Pursuant to the terms and subject to the conditions of the Merger Agreement, Merger Sub would merge with and into us, and we would survive as a wholly-owned subsidiary of Parent. In connection with and at the effective time of the merger, each of our ordinary shares and ADSs outstanding immediately prior to the effective time of the merger would be cancelled in consideration for the right to receive US\$12.00 in cash without interest, except for those shares beneficially owned by the rollover shareholders immediately prior to the effective time of the merger, which shares would be cancelled for no consideration at the effective time of the merger, subject to applicable dissenters rights. The Merger Agreement contains several closing conditions, including certain shareholder approvals and other covenants that may be difficult to perform, and confers certain termination rights. There can be no assurance that this or any other transaction will be approved or consummated on a timely basis, or at all.

In addition, our efforts to close the transactions contemplated by the Merger Agreement may have any number of adverse effects on us, whether or not the transactions close, including:

our announcement or the pendency of the merger may adversely impact our business relationships, operating results and business generally;

our management's attention may be diverted from our ongoing business operations;

we may incur substantial amounts of costs, fees, expenses and charges related to the merger and the actual terms of the financing that will be obtained for the merger; and

we may face heightened risks of litigation, regulatory proceedings or enforcement matters that may be instituted against us and others relating to the merger.

In March and April 2014, we became aware that two complaints were filed by alleged holders of our ADSs against us, members of our board of directors, Parent and Merger Sub in the United States District Court for the Southern District of New York in connection with the Transactions. The lawsuits are purported class actions brought on behalf of all holders of our ADSs and are captioned *Tripp v. Giant Interactive Group Inc., et. al* and *Palkon v. Giant Interactive Group Inc., et al*. The representative plaintiffs allege, among other things, that members of our board breached fiduciary duties in connection with the proposed Transactions, which plaintiffs allege do not appropriately value our

company, were the result of an inadequate process overseen by conflicted directors and include preclusive deal protection devices. The lawsuits also claim that we, Parent and Merger Sub aided and abetted these violations. The complaints purport to seek, among other things, an injunction against the consummation of the Transactions and rescission in the event that the Transactions are consummated prior to the entry of the court's final judgment, an award of unspecified damages, costs and expenses, including attorneys' and experts' fees and expenses, and such other equitable relief that the court deems just and proper. On or about April 22, 2014, we became aware that a third class action complaint captioned *Sutherland, et al. v. Giant Interactive Group Inc., et al* (case no. 14 CV 2826) was filed on behalf of all holders of ADSs in the same court against us, our directors, Giant Investment Limited, Giant Merger Limited, Baring Private Equity Asia and Hony Capital Fund V, L.P., alleging that the proxy statement filed by us in connection with the proposed going private transaction is materially false and misleading and therefore violates Section 14(a) of the Securities Exchange Act of 1934. We and our board believe that the claims in these complaints are without merit and intend to defend against them vigorously. An adverse judgment for monetary damages could have an adverse effect on our operations and liquidity. A preliminary injunction could delay or jeopardize the completion of the Transactions, and an adverse judgment granting permanent injunctive relief could indefinitely enjoin completion of the merger.

***We have been named as a defendant in certain purported shareholder class action lawsuits that could have a material adverse impact on our operating results and financial condition.***

---

**Table of Contents**

We will need to defend against lawsuits described in Item 8. Financial Information – A. Consolidated Statements and Other Financial Information – Legal Proceedings, including any appeals of such lawsuits should our initial defense be successful. We are currently unable to estimate the possible loss or possible range of loss, if any, associated with the resolution of these lawsuits. An unfavorable outcome from the lawsuits, including any plaintiff's appeal of the judgment in these lawsuits, could have a material adverse effect on our consolidated financial position, results of operations, or cash flows in the future. The litigation process may utilize a material portion of our cash resources and divert management's attention from the day-to-day operations of our company, all of which could harm our business. There can be no assurance that we will prevail in any such appeal and any adverse outcome of these cases could have a material adverse effect on our business or results of operations.

***We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. holders of our ADSs or ordinary shares.***

Depending upon the value of our ADSs or ordinary shares and the nature of our assets and income over time, we could be classified as a passive foreign investment company or PFIC for U.S. federal income tax purposes. We will be classified as a PFIC in any taxable year if either: (a) the average quarterly value of our gross assets that produce passive income, or are held for the production of passive income, is at least 50% of the average quarterly value of our total gross assets, or (b) 75% or more of our gross income for the taxable year is passive income. According to these technical rules, we would likely become a PFIC for a given taxable year if our market capitalization were to decrease significantly while we hold substantial cash and cash equivalents in that year.

We believe that we were not a PFIC for U.S. federal income tax purposes for our taxable year ended December 31, 2013. However the application of the PFIC rules is subject to uncertainty in several respects, and we must make a separate determination after the close of each taxable year as to whether we were a PFIC for such year. As such, although we intend to conduct our business activities in a manner to reduce the risk of our classification as a PFIC in the future, as we currently hold, and expect to continue to hold, a substantial amount of cash and other passive assets, there can be no assurance that we will not be classified as a PFIC for 2014 or any future taxable year. If we are a PFIC for any taxable year during which a U.S. investor held our ADSs or ordinary shares, certain adverse U.S. federal income tax consequences would apply to the U.S. investor. See Item 10, Additional Information – Taxation – U.S. Federal Income Taxation – Passive foreign investment company.

***Your right to participate in any future rights offerings may be limited, which may cause dilution to your holdings.***

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. However, we cannot make rights available to you in the United States unless we register the rights and the securities to which they relate under the Securities Act or an exemption from the registration requirements is available. Also, under the deposit agreement, the depositary will not make rights available to you unless both the rights and any related securities are registered under the Securities Act, or the distribution of them to ADS holders is exempted from registration under the Securities Act. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. Accordingly, you may be unable to participate in our rights offerings and may experience dilution in your holdings.

***Because we are a Cayman Islands company, shareholders may face difficulties in protecting their interests through the U.S. federal courts. Shareholders may have less protection of their shareholder rights than they would if we were incorporated in a U.S. jurisdiction. In addition, shareholders may have difficulties in enforcing judgments obtained against us because our operations are based in the PRC.***

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

Moreover, most of our directors and officers are nationals and residents of countries other than the United States. Substantially all of our assets and a substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon us or these persons.



---

**Table of Contents**

The Cayman Islands courts are also unlikely:

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

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

There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will generally recognize as a valid judgment a final and conclusive judgment in *personam* obtained in the federal or state courts in the United States under which a sum of money is payable (other than a sum of money payable in respect of multiple damages, taxes or other charges of a like nature or in respect of a fine or other penalty) or, in certain circumstances, an in *personam* judgment for non-monetary relief, and would give a judgment based thereon provided that (a) such courts had proper jurisdiction over the parties subject to such judgment, (b) such courts did not contravene the rules of natural justice of the Cayman Islands, (c) such judgment was not obtained by fraud, (d) the enforcement of the judgment would not be contrary to the public policy of the Cayman Islands, (e) no new admissible evidence relevant to the action is submitted prior to the rendering of the judgment by the courts of the Cayman Islands, and (f) there is due compliance with the correct procedures under the laws of the Cayman Islands.

As a result of all of the above, our public shareholders may have more difficulties in protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a public company incorporated in a jurisdiction in the United States.

Finally, we conduct all of our operations in the PRC through our subsidiaries and affiliated entities established in the PRC. As mentioned above, all of our directors and officers also reside outside the United States and a substantial portion of the assets of those persons are located outside the United States. As a result, it may be difficult or impossible for shareholders to enforce a judgement or bring an action against us or against these individuals in the event that they believe that shareholders' rights have been infringed under the applicable securities laws or otherwise. There is uncertainty as to whether the courts of the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state due to the lack of a reciprocal treaty in the PRC providing statutory recognition of judgments obtained in the United States. Furthermore, it is uncertain whether such PRC courts would accept original actions brought in the PRC against us or such persons who reside outside the United States predicated upon the securities laws of the United States or any state. For more information regarding the relevant laws of the PRC, see Item 3. Key Information Risk Factors Risks Relating to China The PRC legal system embodies uncertainties which could limit the legal protections available to you and us.

***The voting rights of holders of ADSs are limited in several significant ways by the terms of the deposit agreement.***

Holders of our ADSs may only exercise their voting rights with respect to the underlying ordinary shares in accordance with the provisions of the deposit agreement. Upon receipt of voting instructions from a holder of ADSs in the manner set forth in the deposit agreement, the depository will endeavor to vote the underlying ordinary shares in accordance with these instructions. Under our amended and restated memorandum and articles of association and Cayman Islands law, the minimum notice period required for convening a general meeting is five days. When a general meeting is convened, you may not receive sufficient notice of a shareholders' meeting to permit you to

withdraw your ordinary shares to allow you to cast your vote with respect to any specific matter at the meeting. In addition, the depositary and its agents may not be able to send voting instructions to you or carry out your voting instructions in a timely manner. We will make all reasonable efforts to cause the depositary to extend voting rights to you in a timely manner, but we cannot assure you that you will receive the voting materials in time to ensure that you can instruct the depositary to vote your shares. Furthermore, the depositary and its agents will not be responsible for any failure to carry out any instructions to vote, for the manner in which any vote is cast or for the effect of any such vote. As a result, you may not be able to exercise your right to vote and you may lack recourse if your ordinary shares are not voted as you requested.

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

we have failed to timely provide the depositary with our notice of meeting and related voting materials;

we have instructed the depositary that we do not wish a discretionary proxy to be given;

we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting;

a matter to be voted on at the meeting would have a material adverse impact on shareholders; or

voting at the meeting is made on a show of hands.

## **Table of Contents**

The effect of this discretionary proxy is that you cannot prevent our ordinary shares underlying your ADSs from being voted, absent the situations described above, and it may make it more difficult for shareholders to influence the management of our company. Holders of our ordinary shares are not subject to this discretionary proxy.

### ***Shareholders may be subject to limitations on transfer of ADSs.***

ADSs, represented by American depositary receipts, are transferable on the books of the depositary. However, the depositary may close its books at any time or from time to time when it deems expedient in connection with the performance of its duties. The depositary may close its books from time to time for a number of reasons, including in connection with corporate events such as a rights offering, during which time the depositary needs to maintain an exact number of ADS holders on its books for a specified period. The depositary may also close its books in emergencies, and on weekends and public holidays. The depositary may refuse to deliver, transfer or register transfers of our ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary thinks it is necessary or advisable to do so in connection with the performance of its duties under the deposit agreement, including due to any requirement of law or any government or governmental body, or under any provision of the deposit agreement.

## **ITEM 4. INFORMATION ON THE COMPANY**

### **A. History and Development of the Company**

We commenced operations in 2004 through a PRC limited liability company named Shanghai Zhengtu Network Technology Co., Ltd., which changed its name to Shanghai Giant Network Technology Co., Ltd., or Giant Network, in October 2007. In order to implement an offshore holding company structure to comply with PRC laws imposing restrictions on foreign ownership in China's online game industry, in July 2006, Yuzhu Shi, our chairman, and his daughter, Jing Shi, together with some other individual shareholders established our current Cayman Islands holding company, Giant Network Technology Limited, which changed its name to Giant Interactive Group Inc., or Giant, in June 2007.

Following the establishment of our offshore holding structure, all of our online game business continues to be operated through Giant Network. The shareholders of Giant Network currently include Yuzhu Shi, who owns 80% of Giant Network's equity interests through his ownership of Shanghai Lanlin Bio-Technology Co., Ltd., and the additional PRC individuals who own the remaining 20%. We have entered into contractual arrangements with Giant Network pursuant to which our wholly owned subsidiary, Zhengtu Information, provides technical support and consulting services to Giant Network. In addition, we have entered into agreements with Giant Network and its shareholders, providing us with the ability to effectively control this entity. Accordingly, we have consolidated the historical results of Giant Network in our financial statements as a variable interest entity, pursuant to U.S. GAAP. For additional information on our organizational structure, see Item 4. Information on the Company—Organizational Structure and Item 7. Major Shareholders and Related Party Transactions—Related Party Transactions.

On November 6, 2007, we completed our initial public offering, which involved the sale by us and some of our shareholders of 65,777,036 of our ADSs, representing an equal number of our ordinary shares.

In 2009, with an aim to identify, recruit and incentivize talented individuals in online game development, in connection with our Win@Giant initiative, we began to reorganize many of our game development studios and established various subsidiaries that are generally 51% owned by us and 49% owned by the relevant development team members. We established Juhuo Network, Jujia Network and Juhe Network in 2009, Juquan Network, Juxin Network and Jufan Network (which was deregistered in 2013) in 2010, and Juhuan Network, Juzi Information, Jujia

Network II and Jujia Network III in 2012, and Beijing Haishen in 2013, respectively. For additional information regarding this reorganization, see Item 4. Information on the Company Business Overview Game Development and Sourcing Game Development.

In June 2013, some of our shareholders completed a secondary public offering of 12,650,000 ADSs representing 12,650,000 ordinary shares. We did not receive any proceeds from this offering.

On November 25, 2013, we received a non-binding proposal for privatization from our chairman and another shareholder, Baring Private Equity Asia, or Baring, and certain of their affiliated entities, which indicated that the consortium proposed to acquire all of our outstanding ordinary shares, including ordinary shares represented by ADSs, at a price of US\$11.75 in cash per ordinary share or ADS. On March 17, 2014, we entered into a definitive agreement and plan of merger, or the Merger Agreement, with Giant Investment Limited and Giant Merger Limited, a wholly owned subsidiary of Giant Investment Limited, pursuant to which Giant Investment Limited, a company owned by our chairman Mr. Shi, an affiliate of Baring and an affiliate of Hony Capital Fund V, L.P., will acquire all of our outstanding ordinary shares for cash consideration equal to US\$12.00 per ordinary share or per ADS. The merger, which is currently expected to close during the second half of 2014, is subject to customary closing conditions. If completed, the merger will result in us becoming a privately-held company and our ADSs will no longer be listed on the NYSE.

## **Table of Contents**

Our principal executive offices are located at 11/F No. 3 Building, 700 Yishan Road, Shanghai, 200233, People's Republic of China. Our telephone number at this address is +86 21 3397-9999 and our fax number is +86 21 3397-9948. Our website address is *www.ga-me.com*. The information contained on our website is not part of this annual report.

## **B. Business Overview**

### **Overview**

We are a leading online game developer and operator in China. We focus on massively multiplayer online role playing games, or MMORPGs, which are played through networked game servers on which tens of thousands of players are able to simultaneously connect and interact. In addition, we are expanding into webgames, which are played over the internet using a web browser, and mobile games, which are played on mobile phones or tablet computers. We commercially launched our first self-developed MMORPG, ZT Online, in January 2006. We now operate fifteen online games, among which twelve are self-developed, including the four games in the ZT Online franchise.

We believe that our success is largely attributable to our ability to internally develop, operate and market high quality MMORPGs tailored to China's hardcore game player audience, which generally include players between the ages of 18 and 40. As of December 31, 2013, our game development team consisted of approximately 840 members, which mainly includes dedicated product development and enhancement teams for each of our games.

We have built nationwide distribution and marketing networks to sell and market our prepaid game cards and game points. As of December 31, 2013, our distribution network consisted of more than 100 non-exclusive regional distributors and reached approximately 98,900 retail outlets, including internet cafés, software stores, supermarkets, bookstores, newspaper stands and convenience stores located throughout China. We also sell game points through our official game website.

We expect that our MMORPGs, whether self-developed or licensed from third parties, will continue to be our primary growth segment in 2014. We are, however, expanding into other game segments such as webgames and mobile games. In 2013, we launched three additional self-developed webgames. In addition, mobile game development is a new strategic area of focus for us and we expect to launch our first self-developed mobile game in 2014. We believe mobile is becoming a key platform for online access and we plan to continue delivering great game experiences regardless of how the games are played, whether through PCs, tablets, or mobile phones.

Although substantially all of our revenues are generated through our own game operations in China, we also derive revenues from licensing our games to third party operators in other territories, including other parts of Asia, North America, Europe, Russia and other Russian speaking territories. In addition, we have also licensed our micro-client version of ZT Online 2 to Qihoo 360, or Qihoo, for operation on Qihoo's game platform in China and we licensed several of our webgames such as The Sky and Genesis of the Empire to Jiuyou Times, 37wan and Baidu for operation on their platforms in China. We intend to continue expanding our distribution channels as well as overseas market through leveraging our relationships with third party operators.

In 2011, 2012 and 2013, our net revenues were RMB1,792.2 million, RMB2,152.0 million and RMB2,355.5 million (US\$389.1 million), respectively. Our net income for the same periods was RMB906.4 million, RMB1,072.0 million and RMB1,335.8 million (US\$220.7 million), respectively. Our quarterly peak concurrent users for all of the games we operate in China were 2,339,000, 2,370,000 and 2,319,000 for 2011, 2012 and 2013, respectively, and our quarterly average concurrent users for all of the games we operate in China were 642,000, 691,000 and 697,000 for 2011, 2012 and 2013, respectively.

## **Our Games**

We currently operate fifteen games, consisting of ten MMORPGs, one casual MMO game and four webgames. While each of our games is unique, they all share certain common characteristics, including their targeted market. Each of our MMORPGs targets China's hardcore online game market, which we define as players generally between the ages of 18 and 40. We believe that members of this demographic generally have greater disposable income and are more willing to spend money to improve their characters' standing in the game. We also believe that our ability to effectively target this market segment has helped facilitate our relatively high average revenue per user.

**Table of Contents**

The following table sets forth certain information relating to the games that we operate in China and/or license to third parties for operation in China, each as of March 31, 2014.

<b>Game</b>	<b>Style</b>	<b>Game Source</b>	<b>Launch Date/Status</b>
ZT Online	Free to Play 2D MMORPG	Self-Developed	First Quarter 2006
Giant Online	Free to Play 2.5D MMORPG	Self-Developed	Fourth Quarter 2007
ZT Online Classic Edition	Free to Play 2D MMORPG	Self-Developed	Third Quarter 2008
ZT Online Green Edition	Free to Play 2D MMORPG	Self-Developed	Second Half 2009
King of King III	Free to Play 3D MMORPG	Acquired	Second Half 2009
The Golden Land	Free to Play Strategy Webgame	Self-Developed	Second Half 2009
XT Online	Free to Play 2.5D MMORPG	Self-Developed	Third Quarter 2011
ZT Online 2	Free to Play 2D MMORPG	Self-Developed	Third Quarter 2011
Elsword	Free to Play 3D Casual MMO	Licensed	Fourth Quarter 2011
Allods Online	Free to Play 3D MMORPG	Licensed	Third Quarter 2012
World of Xianxia	Free to Play 3D MMORPG	Self-Developed	Second Quarter 2013
Genesis of the Empire	Free to play Webgame	Self-Developed	Fourth Quarter 2013
The Sky	Free to play Strategy Webgame	Self-Developed	Third Quarter 2013
Supreme Tai Chi	Free to Play Strategy Webgame	Self-Developed	Fourth Quarter 2013
Jianghu	Free to Play 2D MMORPG	Self-Developed	First Quarter 2014

The following table sets forth, for the periods indicated, certain user statistics for the games that we operate in China and/or license to third parties for operation in China.

	<b>March 31, 2013</b>	<b>June 30, 2013</b>	<b>September 30, 2013</b>	<b>December 31, 2013</b>
	(in thousands, except average revenues per user)			
Average Concurrent Users	690	702	697	698
Peak Concurrent Users	2,281	2,319	2,271	2,220
Active Paying Accounts	2,257	2,328	2,335	2,362
Average Revenues per User (RMB)	238	244	245	246

**ZT Online Franchise**

The ZT Online franchise consists of our internally developed games under our flagship ZT Online 1 Series and ZT Online 2. Revenues from the ZT Online franchise accounted for the substantial majority of our net revenues in each of 2011, 2012 and 2013. The ZT Online 1 Series consists of ZT Online, ZT Online Classic Edition, and ZT Online Green Edition.

**ZT Online**

ZT Online is a free-to-play 2D MMORPG with an ancient Chinese martial arts theme, and is both our first game and our first self-developed game. Players assume one of eight different roles, including soldiers and magicians, in ten different kingdoms. Players develop martial arts skills, use magical weapons and team up with other players to fight against monsters and players from other kingdoms. In addition, ZT Online offers expansion packs and other regular updates to enrich the overall gameplay experience. ZT Online is a free-to-play game, with virtual items available for purchase, such as weapons, clothing, pets, ceremonies and rites. ZT Online offers an uninterrupted play experience,

where players can choose to enter the game 24 hours a day, seven days a week. ZT Online can be accessed from any location with an internet connection.

***ZT Online Classic Edition***

ZT Online Classic Edition is a free-to-play 2D MMORPG based on the original version of ZT Online from its first year of operation in 2006, and excludes enhancements and updates made to ZT Online after 2006.

***ZT Online Green Edition***

ZT Online Green Edition is a free-to-play 2D MMORPG that features an in-game economy that emphasizes affordable gameplay. The game also includes additional maps, skills and items.



---

**Table of Contents*****ZT Online 2***

ZT Online 2 is an internally developed free-to-play 2D MMORPG martial arts sequel to our flagship game ZT Online. ZT Online 2 features new 2D graphics with added advanced 3D particle effects that improve the visual display. We adopted a new transaction-based revenue model in ZT Online 2, which differs significantly from the item-based revenue model that we use in most of our other online games. As a result, ZT Online 2 places less emphasis on purchasing virtual items and more emphasis on a player improving their character's ranking and abilities through in-game goals and quests. All virtual items (consumable or permanent) can be traded within the game among players in exchange for virtual coins. We generate revenue by selling game points to players who then convert them to virtual coins in ZT Online 2 and use them to purchase in-game items from other players. In addition, we also charge a transaction fee on each sale and purchase of in-game items between players. ZT Online 2 was developed by an internal studio that we reorganized into Jujia Network, one of our 51% owned game development studios. For a discussion of our game development studio reorganization, see Item 4. Information on the Company Business Overview Game Development and Sourcing Game Development.

***Giant Online***

Giant Online is an internally developed military-themed 2.5D MMORPG set in the modern era. In 2.5D games, the background and items are depicted in 3D, while the characters are depicted in 2D. Giant Online players may assume one of fourteen different roles, including assault troops and bomb experts. The game world is divided into numerous kingdoms. Each player must guide his or her character to develop skills and cooperate with other players from their kingdom to fight against those from other kingdoms. In addition to the functions that traditional MMORPGs provide, Giant Online includes a variety of other features and functions that we believe enhance the player experience. For example, players can equip their characters with numerous modern weapons, ranging from small-scale items such as pistols, to larger items like tanks and aircraft carriers. Large scale battles can be fought over land, sea and air. Apart from waging war, characters can also engage in various forms of in-game social interaction, such as friendship and even romance. Giant Online was developed by an internal studio that we reorganized into Juhuo Network, one of our 51% owned game development studios.

***King of King III***

King of Kings III, or KIII, is a three-dimensional MMORPG experience set in a European-style magical world. Players assume the roles of KIII heroes as they explore a virtual world of forests, medieval cities and castles. KIII is the third episode of the King of Kings series of MMORPGs, which was first launched in Taiwan in 1999. We acquired the intellectual property rights to KIII from Lager Network in 2007. In 2010, we transferred the intellectual property rights of KIII to our subsidiary, Huayi Giant, subsequently renamed Beijing Giant Zhengtu, of which our PRC entities currently own the entire equity interest. In connection with acquiring the entire equity interest of Beijing Giant Zhengtu, the intellectual property rights for KIII were transferred to Giant Network in 2013.

***The Golden Land***

The Golden Land is a free-to-play medieval strategy webgame that allows the player to control many fighting units at once, and combines different elements from shooter, role playing and strategy battle games. The story revolves around a medieval knight and his adventures in Europe. Players can advance by means of city construction, wild battles, questing, as well as participating in alliance battles. The Golden Land was developed by an internal studio that we reorganized into Juhe Network, one of our 51% owned game development studios. For a discussion of our game development studio reorganization, see Item 4. Information on the Company Business Overview Game Development and Sourcing Game Development.

***XT Online***

XT Online is a free-to-play 2.5D ancient Chinese martial arts MMORPG that enables players to practice different schools or styles of martial arts with the goal of becoming a master, while focusing on brotherhood and trust-building with other martial artists. Each player starts off as an apprentice under one of six powerful clans and goes on a quest to fight monsters, acquire powerful weapons and mystical pets, form guilds and take part in player versus player battles. XT Online was developed by Snow Wolf Software, a game development studio in which we hold a 40.76% equity interest and control 51% of the voting rights.

***Elsword***

Elsword is a 3D anime side-scrolling advanced casual MMO that we licensed for operation in China. The game is based on a Korean manga and allows a player's character to form a party or to go solo through hundreds of quests while leveling up and acquiring special virtual items. Players can also compete for rankings in player versus player mode. Elsword was developed by KOG Co., Ltd, or KOG, a South Korean game company.

## **Table of Contents**

### ***Allods Online***

Allods Online is a free-to-play 3D MMORPG that we licensed for operation in China. Players can choose from two warring factions, six races and eight different roles. Gameplay is centered on building ships to sail and explore the vast and magical world of Astral. Players can test their skills and earn rewards in player versus player scenarios on different maps and also participate in a guild system. Allods Online was developed by Mail.Ru Games, or Mail.Ru, a game company established in the Russian Federation, and is currently operated in the Russian speaking markets, the United States, Europe (United Kingdom, Germany and France), Turkey, Japan, Brazil, the Philippines and Taiwan.

### ***World of Xianxia***

World of Xianxia is a 3D MMORPG based on traditional Chinese mythological stories and folk tales, with battles among immortals, devils and humans. World of Xianxia presents unique gameplay such as player killing, or PK, between immortals and devils, a magic treasure system, and an innovative group versus group social structure, each of which are depicted by high quality graphics. World of Xianxia was developed by an internal studio that we reorganized into Juhuo Network, one of our 51% owned game development studios.

### ***Genesis of the Empire***

Genesis of the Empire is a flash-based action role playing webgame based on the storyline from the Romance of the Three Kingdoms, a classic Chinese novel. With high quality graphics and an innovative user interface developed by an experienced game design team, players are immersed in a very realistic environment. In addition, improving a character's skills no longer relies on simple quests and defeating monsters, but by participating in a variety of events and activities. The game begins with a mysterious boy who follows in the path of heroes to defend his country, save his people, and suppress rebellions. The shadows of his past will be unraveled as he ascends the stairs to success. Genesis of the Empire was developed by an internal studio that we reorganized into Juzi Information, one of our 51% owned game development studios.

### ***The Sky***

The Sky is a 2D flash-based action role playing webgame that incorporates certain core gameplay mechanics used in ZT Online 2. The Sky offers high quality graphics in the mysterious world of martial arts in which players encounter puzzle based obstacles with different paths to choose from. The Sky was developed by an internal studio that we reorganized into Jujia Network, one of our 51% owned game development studios.

### ***Supreme Tai Chi***

Supreme Tai Chi is an action role playing webgame with a unique hero system in which games can collect and play as one of the 108 characters from Water Margin (known in Chinese as Shui Hu Zhuan), a classic Chinese novel, or as one of the many gods from ancient Chinese mythology. Supreme Tai Chi was developed by Juzi Information, one of our 51% owned game development studios.

### ***Jianghu***

Jianghu is a 2D martial arts MMORPG produced by an internal development team lead by the company's President, Mr. Xuefeng Ji. Jianghu is this team's next flagship title following ZT Online 2 and has been under development for 3 years. The game features large-scale PK battles and user-generated content with dynamic gameplay that emphasizes user engagement and interaction. We conducted the first round of engineering testing for Jianghu in January 2014.

## Game Pipeline

The following table sets forth certain information relating to select games from our pipeline as of the date of this annual report. In addition to the games listed below, we have a number of MMORPG games and mobile games currently under development by our game studios.

<b>Game</b>	<b>Style</b>	<b>Game Source</b>	<b>Status</b>
Kung Fu BBQ	3D Mobile Game	Self-Developed	Development and Engineering Testing
Cang Tian 2	3D MMORPG	Licensed	Engineering Testing
Wildstar	MMORPG	Licensed	Localization
<b><i>Kung Fu BBQ</i></b>			

Kung Fu BBQ is our first self-developed mobile game. It is a turn-based card battle game that features Kung Fu and mythological characters using Unity 3D engine.

## **Table of Contents**

### ***Cang Tian 2***

Cang Tian 2 is a 3D MMORPG developed by WeMade Entertainment Inc., one of the leading online game developers in South Korea. Core development teams from both companies are currently working together to localize the game for the China market. Extensive work has been performed and changes have been made to the core gameplay, graphics and ingame economy in an effort to further enhance playability and user experience for the local Chinese gamers.

### ***Wildstar***

Wildstar is a fantasy/science fiction MMORPG in which players explore the fictional planet Nexus and discover secrets from the advanced Eldan race who have disappeared. The game features stylized art, an action combat system and player housing. The game lets players play as multiple factions, races, classes, and paths. Wildstar was developed by Carbine in California, a wholly-owned subsidiary of NCSOFT Corporation, one of the leading online game companies in South Korea.

### **Operation of Our Games**

Our platform support team and our maintenance team presently consist of approximately 120 personnel, and are responsible for managing our game platform and in-game environment.

We rely on our platform support team to maintain and upgrade our approximately 3,528 servers in 326 server groups located in internet data centers in four cities throughout China. We employ platform support personnel locally where our server groups are housed, and therefore, they are generally able to resolve hardware and/or software issues within several hours or less.

Our maintenance team closely monitors our in-game environment to ensure that internet connection and data transmission are adequate, game features are functioning properly, and harmful or illegal behaviors by players are identified and disciplined. Our maintenance team's input is often adopted in our subsequent game updates and enhancements.

### **Game Development and Sourcing**

Twelve of the fifteen games that we currently operate are self-developed. We have also licensed the rights to operate games in China from certain third party developers. In addition, we have expanded our game portfolio and our business in general, through acquisitions, investments and other strategic cooperation agreements.

### ***Game Development***

Our game development process generally begins with the approval of a new game concept by our project review committee. Following this initial approval, a new project is formally established and staff members are assigned to the project. The project team then further enhances the game development plan, including a proposed storyline, technical parameters and baseline artwork, before a formal kick-off of the project.

As of December 31, 2013, we employed approximately 840 game developers, including software programmers, platform technicians, artists and quality control personnel. Most of our software programmers and platform technicians have extensive game and software development experience. We rely on our quality control team at each stage of the game development process to ensure quality and playability.

In 2008, we introduced Win@Giant, an incubation program designed to, among other things, identify, recruit and incentivize talented individuals in the areas of game design and development. In 2009, in connection with our Win@Giant initiative, we began to reorganize our game development studios by establishing various subsidiaries that are 51% owned by us and 49% owned by the relevant development team members. Each reorganized studio only focuses on producing and supporting internally developed games, which we believe gives them greater incentive to make their games commercially successful. In addition, we generally establish a new 51% owned game development studio in connection with the Win@Giant initiative each time one of our internal studios creates a commercially successful game. Currently our most important 51% owned game development studios are Jujia Network, which supports ZT Online 2, and Juhuo Network, which supports World of Xianxia as well as Giant Online. For a discussion of risks relating to our game development studio reorganization, see Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry The reorganization of our game development studios could materially and adversely affect our results of operations as a portion of the profits from games developed or operated by these studios will be shared with the non-controlling shareholders of these studios.

## **Table of Contents**

### ***Game Updates and Enhancement***

For each game in operation we maintain a dedicated team that develops expansion packs, updates and patches. We derive many of our game enhancement ideas from our players by maintaining multiple channels through which they can provide comments and suggestions. These channels include online surveys, online discussion forums, instant messaging and our twenty-four hour telephone hotline.

As most of our games are self-developed, we do not need to spend time and resources to localize these games for the China market, which helps to reduce the time required to develop and release expansion packs and updates.

We release expansion packs, updates and patches for our games on a regular basis. Expansion packs are large enhancements that include many new features and generally require several months to develop. Updates are less extensive than expansion packs, but often include new maps, virtual items and services. We distribute updates electronically through our official game website. Patches are generally designed to fix bugs and are developed and released as needed.

### ***Game Licensing***

We license the rights to operate games in China from certain third party developers. In December 2009 we entered into a license agreement to operate Elsword, which was developed by KOG of South Korea, and in January 2010 we entered into a license agreement to operate Allods Online, which was developed by Mail.Ru of Russia. In addition, in March 2013, we entered into a license agreement to operate Cang Tian 2, a 3D MMORPG game developed by WeMade Entertainment of South Korea, and in April 2014 we entered into a license agreement to operate Wildstar, which was developed by Carbine in California, a wholly-owned subsidiary of NCSOFT Corporation of South Korea. The cost of games licensed from third party developers generally consists of an upfront licensing fee, which we typically pay in installments, and royalties, which are equal to a percentage of revenues we generate from operating the games. Generally our license agreements expire three to five years after the commencement of open beta testing. Our licensors also agree to provide us with basic technical support, as well as updates without additional charge.

### ***Acquisitions, Investments and Strategic Cooperation***

We have expanded our game portfolio, and our business in general, through acquisitions, investments, and other strategic cooperation arrangements. We have listed some examples of recent acquisitions and equity investments that we have made.

In 2008 we made an investment in the amount of US\$50.8 million in 51.com, formerly a China-based social networking company which transitioned into an online game developer and operator in recent years.

In 2009 we made an investment in the amount of US\$5.0 million in Mobile Embedded Technology Inc., a mobile platform operating company.

In April 2011, we committed to invest RMB30.0 million in Beijing Innovation Work Investment Center (LP), or Innovation Work, an early-stage China-based internet and technology company investment fund led by Mr. Kai-Fu Lee, a well-known business leader in the internet space in China. As of December 31, 2013, the total amount that we have paid to Innovation Work was RMB22.5 million (US\$3.7 million).

In September 2011, we invested US\$50 million in the Yunfeng E-Commerce Funds, for the purpose of purchasing ordinary shares of the Alibaba Group Holding Limited, China's leading e-commerce company. In February 2014, we

entered into an agreement to sell all of our limited partnership interest in the Yunfeng E-Commerce Funds to Tiger Global Mauritius Fund for approximately US\$199.1 million.



## **Table of Contents**

In October 2012, we committed to invest RMB8.0 million in Beijing Dijiang Network Technology Co., Ltd., or Dijiang Network, a mobile game development company. As of December 31, 2013, we paid RMB4.0 million to Dijiang Network.

In May 2013, we committed to invest US\$20 million in Yunfeng Fund II, L.P. The fund will make equity and equity-related investments in companies with substantially all of their current and/or future business operations in greater China, with a primary focus on companies in the telecommunications, technology and media, consumer products and healthcare industries. As of December 31, 2013, the total amount we have paid to Yunfeng Fund II, L.P. was US\$1.54 million.

In 2013, we invested RMB2.7 million (US\$0.4 million) in Beijing Woola Century Technology Co., Ltd, another mobile game development company.

In November 2013, we acquired the remaining 15% equity interest that we did not already own in Beijing Giant Zhengtu through the purchase of Juyan Network which holds this 15% equity interest in Beijing Giant Network. Following the transaction, we hold 51% of this equity interest through Zhengtu Information, 34% through Giant Network and 15% through Juyan Network.

In 2013, we sold approximately 26% of our equity interest in Glorious Mission Network Technology Co. Ltd., or Glorious Mission Network, to one of our co-investors in the company for approximately RMB 9.5 million (US\$1.6 million). Glorious Mission Network holds interests in several subsidiaries and was primarily responsible for the development of Glorious Mission, a first person shooter game that is playable from the perspective of China's military. Following this sale, we continue to hold approximately 19% of the equity interest in Glorious Mission Network.

## **Distribution and Marketing**

### ***Distribution***

Most of our games use the free-to-play business model. Players may purchase physical or virtual prepaid game cards and game points from our official game website, internet cafés and other distribution channels. Players may convert game points to virtual coins to purchase a wide range of virtual items and services in our games.

We maintain an official game website for each of the games that we operate and we distribute our game software to players free of charge.

We distribute our physical prepaid game cards through our network of distributors and our virtual prepaid game cards through our official game website as well as distributors. Our physical prepaid game cards generally expire two years after issuance, while our virtual prepaid game cards have no expiration date.

### ***Distribution Network***

As of December 31, 2013, our distribution network included more than 100 non-exclusive regional distributors. Our distributors purchase our prepaid game cards from us at a pre-set discount. They subsequently resell these prepaid game cards to retail outlets and sub-distributors, who then distribute them to internet cafés, newsstands, convenience stores, software stores and book stores. We require full payment prior to delivery of prepaid game cards to distributors. We offer our distributors volume-based incentives in the form of prepaid game cards which are accrued for and settled and paid to the distributors every three months.

We generally enter into an annual distribution agreement with a distributor for a designated sales territory. Our distribution agreements contain both sales goals and market penetration ratios, whereby the distributor is required to sell our prepaid game cards in an agreed upon minimum number of internet cafés in their designated territory. We also require each distributor to work closely with us and support our marketing team in marketing and promotional activities. Our distribution agreements are non-exclusive and do not prohibit our distributors from working with our competitors.

## **Table of Contents**

### ***Direct Online Sales***

We sell virtual prepaid game cards directly to players through our official game website using third-party online payment platforms, such as China Alipay (a system provided by Alipay.com Co., Ltd), China UnionPay (a system provided by Shanghai China UnionPay E-Payment Service Co., Ltd), 99Bill Corporation, China PnR (a system provided by Shanghai China Payment and Remittance Network Technology Co., Ltd) and e-payment platform (a system jointly supported by some major commercial banks, such as China Construction Bank and Agriculture Bank of China) to facilitate online payment within China. The above-mentioned third-party online payment service providers charge us service fees of approximately 0.3% of gross revenue of our direct online sales, which is significantly less than the discounts and volume-based incentives that we offer to our distributors.

### ***Licensing of Our Games and Joint Operation***

In addition to operating our games in China, we also license our games to overseas online game operators, and other PRC game companies. We currently license for operation in overseas markets ZT Online, ZT Online 2, World of Xianxia, The Golden Land, Genesis of the Empire, The Sky and Supreme Tai Chi. Although the operation territories differ for each game, we currently license games for operation in Taiwan, Hong Kong, Macau, South East Asia, South Korea, Russia, North America and Europe.

Pursuant to our overseas game license agreements, we generally allow the licensees to exclusively operate, promote, service and distribute our games and game-related products in the licensed territories. In return, we are entitled to ongoing royalties, which are based on the consumption of game points by players with game accounts registered with the licensees. The licensees are generally responsible for the sales and marketing of our games in the given territories. The licensees are also responsible for maintenance of the network infrastructure and customer service, while we are responsible for technical support, including providing upgrades and periodic updates of our games, on an if and when available basis. Our overseas license agreements are typically for a term of two to five years.

We also license our webgames and select other games to third parties for operation in China. We currently both self-operate and license to third parties in China The Golden Land. We do not self-operate our other three webgames, consisting of Genesis of the Empire, The Sky and Supreme Tai Chi, but instead license operation to third parties in China. In addition, we have also licensed ZT Online Green Edition to Tencent, and we have licensed the micro-client version of ZT Online 2 to Qihoo 360, each for operation in China.

### ***Marketing***

We advertise our games on internet portals such as 17173.com and qq.com, search engines such as baidu.com, internet security service providers' platforms such as Qihoo 360 Safe Guard, and internet café online platforms such as i-Café Mavin. Our internet advertisements link visitors directly to our game website, where they can register to play our games.

Besides online advertising, we also place commercials on television channels such as Jiangsu Satellite TV Network, flat screen ads on subways and buses in major cities, and LED screens in public areas in order to reach out to a larger audience. These traditional offline ads also help to build our brand awareness.

Due to the social appeal of online games, word-of-mouth is an important means to promote our games. We utilize various social media such as Sina's Weibo to market our games. One of our major ongoing marketing strategies is to continue to retain our existing players while attracting new players through existing marketing mechanisms.

## **Payment and Pricing**

We sell both physical and virtual prepaid game cards through our network of distributors, and we sell game points through our official game website. Each prepaid game card contains a unique access code and password that requires players to register on our official game website in order to load game points to their game account. Game points, whether purchased through prepaid game cards or directly through our website, may be allocated to any of our online games. Players may then convert their game points to virtual coins in a specific game and use the virtual coins to purchase virtual items or services in the game.

The prepaid game cards offered by our distributors are sold in a variety of denominations, ranging from RMB10 (approximately US\$1.7) to RMB500 (approximately US\$82.6). Purchasers can also purchase virtual prepaid game points on our official game website for any whole number denomination, starting at a minimum of RMB1 (approximately US\$0.17). We generally develop a pricing curve to set the retail prices for the virtual items that we offer in our games. Pricing curves are determined by a number of factors, including the demand and supply of in-game virtual items, power and value that a particular virtual item or service provides, and players' game playing patterns and spending habits. Since the commercial launch of our first game in January 2006, we have tracked and accumulated player data for all of our games, which provides us with an extensive database of player usage patterns to assist us in determining reasonable pricing curves for the virtual items in our games.

## **Table of Contents**

### **Customer Service**

We regard high quality customer service as one of our key differentiators when compared to our competitors. We are committed to providing prompt responses to our players' inquiries. We serve our customers primarily through the following channels:

a customer call center, which serves our customers 24 hours per day, seven days per week;

VIP on site services;

dedicated online discussion forums; and

email.

Examples of services we provide include addressing problems in loading game points to game accounts, retrieving forgotten passwords and recovering lost game accounts, virtual items and in-game characters. In addition, we also investigate and address irregularities in game operations reported by players, including eliminating cheating programs that enable a player's game characters to acquire superior in-game capabilities through illegal software.

As of December 31, 2013, our dedicated customer service team consisted of approximately 335 employees. We expect to maintain our customer service team at approximately the current size in the near future. In addition to providing customer support, our representatives also collect players' feedback and generate weekly reports for our management and game operation teams to keep them informed of any important issues raised and how problems were solved.

### **Our Proprietary Technology**

As a developer of MMORPGs, we have focused our technology development efforts on making our games truly massively multiplayer games. These efforts have resulted in proprietary server technology that enables a greater number of players to simultaneously interact with each other in our games. This technology allows us to cluster together a number of servers to create greater capacity for each of the shards in which our players' game characters exist. For example, in each of the games in the ZT Online franchise, over 40,000 players are able to interact with each other in a single shard, which we believe is more than most other MMORPGs in China.

### **Operational Infrastructure**

We believe we have a reliable and secure operational infrastructure to fully support our games. As of December 31, 2013, our server network for our game operations consisted of 3,528 servers in 326 server groups with a total capacity to accommodate up to six million concurrent online users. These servers, all of which are owned by us, are located at various internet data centers in the following four major cities throughout China: Shanghai, Beijing, Wuhan and Tianjin. Each server has a fully redundant power supply and diesel power generator backup in case of power shortage.

We directly access the internet backbone network through 76 gigabyte bandwidth lines jointly supplied by China Telecom and China Netcom. Our primary hardware suppliers include Hewlett-Packard, Huawei, Cisco and Dell, and we have entered into agreements with each of them for warranty and maintenance services for our hardware platform.

As of December 31, 2013, we employed approximately 120 technical support staff to maintain our current technology infrastructure and develop new software features to further enhance the functionality of our management and security systems.

### **Competition**

Our principal competitors include:

domestic online game developers and operators in China, including Tencent Holdings Ltd., Changyou.com Limited, Perfect World Co., Ltd., Shanda Games Limited, NetEase.com; and

overseas online game developers that license their games for operation in China, such as Blizzard Entertainment.

Our MMORPGs are currently competing with, among others, the following MMORPGs in China:

Fantasy Westward Journey, developed and operated by NetEase.com, Inc.;

World of Warcraft, developed by Blizzard Entertainment and operated by NetEase.com, Inc. in China;

**Table of Contents**

Tian Long Ba Bu, developed and operated by Changyou.com Limited;

Zhu Xian, developed and operated by Perfect World, Co., Ltd.;

MIR II, developed by Wemade Entertainment Co. Ltd. and operated by Shanda Games Limited in China;

Yu Long Zai Tian, developed and operated by Tencent Holdings Ltd.;

The Three Kingdoms, developed and operated by Shanghai Jiangyou Information Technology Co., Ltd.;

Havoc in Heaven, developed and operated by Shenzhen Molin Technology Co., Ltd.; and

Dragon, developed and operated by Guangzhou Jiuyu Network Technology Co., Ltd.

Other companies may compete with us in marketing activities, quality of online games, and for our distribution network. Some of our competitors have significantly greater financial and marketing resources than we do. For a discussion of risks relating to competition, see Item 3. Key Information Risk Factors Risks Related to Our Business and Industry We face significant competition, which could reduce our market share and adversely affect our business and net revenue.

**Intellectual Property**

Our intellectual property is an essential element of our business operations. Our intellectual property rights include copyrights, trademarks and domain names associated with the name Zheng Tu and ztgame in China, and other rights associated with our websites, technology platform, self-developed game software and other aspects of our business.

We rely on copyright, trademark, trade secret and other intellectual property law, as well as non-competition, confidentiality and license agreements with our employees, suppliers and business partners, and internal security measures to protect our intellectual property rights. Our employees are generally required to enter into agreements pursuant to which they undertake to keep confidential all information relating to our methods, business and trade secrets during, and for two years after, the period of their employment with us. We also protect our intellectual property, including the server side software for our online games, by maintaining stringent security controls at our offices and by requiring high security standards at the various internet data centers where our servers are housed.

The following table sets forth the software copyright registration information relating to our self-developed and acquired games that we registered with the State Copyright Bureau of China and operated as of March 31, 2014:

<b>Registered Software</b>	<b>Copyright Owner</b>
ZT Online Software Version 3.0	Zhengtu Information
Giant Online Software Version 1.0	Zhengtu Information

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

ZT Online Classic Software Version 1.0	Zhengtu Information
ZT Online Green Edition Software Version 2.0	Zhengtu Information
King of King III Software Version 2.0	Giant Network
The Golden Land Software Version 1.0	Zhengtu Information
XT Online Software Version 1.0	Snow Wolf Software
ZT Online 2 Software Version 2.0	Zhengju Information
Spirit of Warriors Software Version 2.0	Julun Network
World of Xianxia Software Version 0.6.0.0	Zhengju Information
Genesis of the Empire Version 1.0	Giant Network
The Sky Version 1.0	Giant Network
Supreme Tai Chi Version 1.0	Giant Network
Jianghu Version 1.0	Zhengju Information



## **Table of Contents**

We own the rights to over 50 domain names, including but not limited to our official websites and domain names registered in connection with ZT Online franchise. As of December 31, 2013, we own 769 registered trademarks in China and overseas and are in the process of applying for the registration of 304 trademarks in China and 28 trademarks overseas. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property. Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business. See Item 3. Key Information Risk Factors Risks Relating to Our Business Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

## **Insurance**

Insurance companies in China offer limited business insurance products. We have purchased a public liability insurance policy, which would cover certain third party personal injury or property damage incurred in connection with the operation of our business. Although we also understand that business interruption insurance is available to a limited extent in China, we have determined that, based on the relatively low risk of disruption, the cost of such insurance and the difficulties associated with obtaining such insurance on commercially reasonable terms, it is not practical to purchase such insurance. As a result, other than the public liability insurance policy described above, we do not have any business liability, disruption or litigation insurance coverage for our operations in China. Except for the public liability insurance policy described above, property insurance for our offices and fixed assets, and legally required automobile liability insurance, we do not carry any other property or casualty insurance. 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. Besides the legally required social insurance, we maintain commercial health insurance and life insurance coverage for all our employees and executive officers. In addition, we maintain director and officer insurance.

## **Facilities**

Our principal offices include approximately 11,200 square meters of space located at No. 3 Building, 700 Yishan Road, Shanghai, which we purchased in 2010. In addition, our principal research and development facilities are located at 988 Zhongkai Road, Zhongshan Street, Songjiang District, Shanghai, in facilities that consist of approximately 7,500 square meters of office space and approximately 91 staff apartments. We lease our Songjiang facilities from Shanghai Jiante, a related party that is controlled by Yuzhu Shi, our chairman. For a discussion of our lease agreement with Shanghai Jiante, see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions. We also lease additional office space in Shanghai, Hong Kong, Hangzhou, Beijing and Zhuhai. We believe our existing facilities are adequate for our current requirements and that additional space can be obtained on commercially reasonable terms to meet our future requirements.

## **Regulation**

Our business, including the operation of online games and the posting of online game-related content on our websites, is subject to various PRC laws and regulations relating to the telecommunications industry, the internet and the online game industry, and is regulated by various government authorities, including the State Council, the Ministry of Industry and Information Technology, or MIIT, the State Administration of Press, Publication, Radio, Film and Television, or SAPPRFT, the State Administration for Industry and Commerce, or SAIC, the Ministry of Culture, or MOC, the National Copyright Administration, or NCA, the Ministry of Public Security, or MPS, and the Bureau of State Secrecy, or BSS. For a description of legal risks relating to our ownership structure and business, see Item 3. Key Information Risk Factors Risks Related to the Regulation of Our Business.

The principal PRC regulations governing internet content as well as online game services in China include:

Telecommunications Regulations (2000);

the Internet Information Services Administrative Measures (2000);

the Administrative Measures on Internet Electronic Bulletin Board Services (2000);

the Tentative Measures for Administration of Internet Publication (2002);

the Measures on Computer Software Copyright Registration (2002);

the Notice of the Ministry of Culture on Enhancing the Supervision of the Internet Culture Market (2002);

the Notice on Enhancing the Content Review Work of Online Game Products (2004);

Some Opinions of the Ministry of Culture and the Ministry of Information Industry on the Development and Administration of Online Games (2005);

the Notice on the Work of Purification of Online Games (2005);

**Table of Contents**

the Notice on Strengthening the Administration of Foreign Investment in the Operation of Value-Added Telecommunication Business (2006);

the Notice on the Implementation of Online Game Anti-Addiction System to Protect the Physical and Psychological Health of Minors (2007);

the Notice Relating to Further Strengthening the Administration Work for Internet Cafés and Internet Games (2007);

the Administrative Provisions for the Publishing of Electronic Publications (2008);

the Administrative Rules for Foreign Investments in Telecommunications Enterprises (2008);

the Administrative Measures for Telecommunications Business Operating Licenses (2009);

the Administrative Measures for Software Products (2009);

the Notice on Strengthening the Administration of Virtual Currency in Online Games (2009);

the Notice Regarding the Consistent Implementation of the Stipulations on Three Provisions of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Internet Games and the Examination and Approval of Imported Internet Games (2009);

the Notice on Improving and Strengthening the Administration of Content in Online Games (2009);

the Tentative Measures for Online Game Administration (2010);

the Notice on the Implementation of the Tentative Measures for Online Game Administration (2010);

the Tentative Measures for Administration of Internet Culture (2011);

the Notice on Issues Relating to the Implementation of the Tentative Measures for Administration of Internet Culture (2011);

the Foreign Investment Industrial Guidance Catalogue (revised in 2011);

Several Provisions Regulating the Market Order for Internet Information Services (2011);

the Notice of Issues Related to the Foreign Exchange Administration for Domestic Individuals Participating in a Stock Incentive Plan of an Overseas Listed Company (2012);

Several Provisions on Regulating the Market Order for Internet Information Services (2012);

the Decision to Enhance the Protection of Network Information (2012);

Provisions on Several Issues Concerning the Application of Law for Trial of Civil Dispute Cases Involving Infringement of the Right to Network Dissemination of Information (2012);

Notice of the State Administration of Foreign Exchange on Further Improving and Adjusting Foreign Exchange Administration Policies for Direct Investment (2012);

Notice of the State Administration of Foreign Exchange on Issues concerning the Foreign Exchange Administration of Domestic Individuals' Participation in Equity Incentive Plans of Overseas Listed Companies (2012);

Rules of Protection on Information Network Dissemination Rights (2013);

the Administrative Measures for Content Self-review by Internet Culture Business Entities (2013);

the Announcement of the Administration of Taxation on Issues concerning the Application of Special Tax Treatment in the Equity Transfer of Non-Resident Enterprises (2013);

Decision of the State Council on Temporarily Adjusting Relevant Administrative Regulations and Administrative Approval or Special Administrative Measures on Foreign Investment Access Provided in Documents the State Council in China (Shanghai) Pilot Free Trade Zone;

the Integrated Prevention of Minors Online Game Addiction (2013); and

Order for the Protection of Telecommunication and Internet User Personal Information.

## **Table of Contents**

### **Restrictions on Foreign Ownership**

Current PRC laws and regulations impose substantial restrictions on foreign investors' ability to engage in online game businesses in China. Pursuant to these regulations, a foreign investor is currently prohibited from owning more than 50% of the equity interest in a foreign-invested telecommunications enterprise that provides value-added telecommunications services. Internet content service is classified as value-added telecommunications business. In addition, foreign-owned enterprises are currently not permitted to apply for several licenses that are essential for online game operations in China. As a result, we conduct our internet content and online game businesses in China through contractual arrangements entered into between one of our PRC subsidiaries, Zhengtu Information and Giant Network, which is wholly owned by Lu Zhang, Wei Liu, Chen Cheng, Tao Yue, Kai Chen, Haixiao Lin, Yonggui Wang, Fabing Qu, Yuliang Feng and Shanghai Lan Lin Bio-Technology Co., Ltd.

In July 2006, the MIIT issued the Notice on Strengthening the Administration of Foreign Investment in the Operation of Value-Added Telecommunication Business, or the MIIT Notice, which reiterates certain provisions under the Administrative Rules on Telecommunications Enterprises. According to the MIIT Notice, foreign investors can only operate a telecommunications business in China by establishing a telecommunications enterprise with a valid telecommunications business operation license. Domestic ICPs are prohibited from leasing, transferring or selling telecommunications business operation licenses to foreign investors in any form, or providing any resources, sites or facilities to foreign investors to facilitate the illegal operation of telecommunications businesses in China. The MIIT Notice also requires that ICPs (including their shareholders) shall directly own the domain names and registered trademarks that they use in daily operations. The MIIT Notice further requires each ICP license holder to have the necessary facilities for its approved business operations and to maintain such facilities within its licensed regions. In addition, all value-added telecommunication service providers are required to improve the network and information security, draft relevant information safety administration regulations and set up networks and information safety emergency plans.

In September 2009, the SAPPRFT, the State Bureau of Copyright and the National Office of Combating Pornography and Illegal Publications jointly published the Notice Regarding the Consistent Implementation of the Stipulations on Three Provisions of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Internet Games and the Examination and Approval of Imported Internet Games, or the SAPPRFT Notice. The SAPPRFT Notice restates the general principle espoused in recently promulgated regulations that foreign investment is not permitted in businesses that operate internet games in China. Article IV of the SAPPRFT Notice prohibits foreign investors from participating in internet game operating businesses via wholly-owned, equity joint venture or cooperative joint venture investments in China, and from controlling and participating in such businesses directly or indirectly through contractual or technical support arrangements. In the event of a violation of these provisions, SAPPRFT shall, in conjunction with the relevant departments of the State, investigate and handle the same in accordance with the law. In serious cases, the relevant licenses and registrations shall be cancelled. See Item 3. Key Information Risk Factors Risks Related to the Regulation of Our Business Substantial uncertainties and restrictions exist with respect to the application and implementation of PRC laws and regulations in the online game industry. If the PRC government finds that our past or current structure for our business operations does not comply with PRC laws and regulations, we may lose control of Giant Network, resulting in its deconsolidation, and could be subject to severe penalties, including ceasing our operations.

In the opinion of management and our PRC counsel, Grandall Law Firm (Shanghai), the ownership structure of Zhengtu Information and Giant Network and our contractual arrangements with Giant Network and its shareholders comply with all existing PRC laws, rules and regulations. However, there are substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations and there may be changes and other

developments in the PRC laws and regulations or their interpretations. Accordingly, we cannot assure you that PRC government authorities will ultimately take a view that is consistent with this opinion.

### **Regulation of Licenses**

Online game operators are required to hold a variety of permits and licenses, including:

***ICP License.*** Under current PRC laws and regulations, a commercial operator that provides internet content services must obtain a value-added telecommunications business operating license, or ICP license, from the appropriate telecommunications authorities in order to engage in any commercial internet content operations in China. Giant Network holds a valid ICP License.

***Internet Culture Operation License.*** With respect to the online game industry in China, since online games fall into the definition of internet culture products under the Tentative Measures for Administration of Internet Culture issued by MOC on February 17, 2011, a commercial operator of online games must obtain an internet culture operation license from the appropriate culture administrative authorities. Giant Network holds a valid internet culture operation license.

## **Table of Contents**

***Internet Publishing License.*** SAPPRFT and the MIIT jointly impose a license requirement on companies that engage in internet publishing, which is defined as any online transmission act by an internet information service provider to select, edit and publish content or programs on the internet, or transmit such content or programs for public browsing, perusal, use or downloading. According to the Tentative Measures for Administration of Internet Publication (2002), the provision of online games is identified as an internet publication activity. Therefore, an online game operator must obtain an internet publishing license from the appropriate administrative authorities in order to carry on its online game businesses in China. Giant Network holds a valid internet publishing license.

In addition to the aforementioned permits and licenses that are required for online game operators, additional approvals or registrations are required with respect to each online game that we operate. These include those described below under Regulation of Internet Content and Regulation of Information Security.

### **Regulation of Internet Content**

The PRC government promulgates measures relating to internet content through a number of ministries and agencies, including the MIIT, the MOC and SAPPRFT. These measures specifically prohibit internet activities, which include the operation of online games, that result in the publication of any content which is found to propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of China, or compromise State security or secrets. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its operations.

Under the Administrative Provisions on the Publishing of Electronic Publications promulgated on February 21, 2008, and other regulations issued by SAPPRFT, if a PRC company is contractually authorized to publish online games imported or licensed from abroad, it must obtain the approval of, and register the copyright license contract with SAPPRFT. In addition, according to the Notice on the Work of Purification of Online Games jointly issued by the MOC, the MIIT and other governmental authorities in June 2005, online games software that will be operated in China must be registered and filed as software products in accordance with the Administrative Measures on Software Products.

In accordance with the Notice on Enhancing the Content Review Work of Online Game Products (2004) promulgated by the MOC, imported and domestic online games are subject to a content review by or filing with the MOC prior to operation in China. On April 24, 2009, the MOC issued the Public Announcement on Regulating Applications for the Examination of the Content of Imported Online Game, or the MOC Announcement. The MOC Announcement emphasizes that enterprises operating imported online games must have the content of those games examined and approved by the MOC. On November 13, 2009, the MOC issued the Circular on Improving and Strengthening the Administration of Content in Online Games. This circular emphasizes that a correct culture value tendency shall be maintained to enhance the culture implication in online games, and game features such as leveling up by killing beasts, the player kill or PK system and the marriage system shall be restricted through registration guidance and technical measures to protect minors. This circular also requires online game operators to establish and maintain committees to monitor game content.

On June 3, 2010, the MOC issued the Tentative Measures for Online Game Administration, or the Online Game Measures. The Online Game Measures defines online games as game products and services composed of software programs and information databases, provided via the internet or mobile networks or other information networks and requires domestic online games to be filed with the MOC within 30 days of their initial launch, as well as in the event of any substantial change to the game, such as prominent modification to a game's storyline, language, tasks or trading system. The Online Game Measures also require that all imported online games be subject to content review prior to their launch.

On July 30, 2010, the MOC issued the Notice on the Implementation of the Tentative Measures for Online Game Administration. This notice emphasizes the protection of minors playing online games and requests online game operators to promote real-name registration of their game users.

On December 29, 2011, the MIIT issued Several Provisions Regulating the Market Order for Internet Information Services. These provisions indicate that MIIT will supervise internet information service activities according to law and that internet information service providers are not allowed to conduct certain activities such as maliciously interfering with the services of other internet service providers, maliciously interfering with the download, installation, operation and upgrade of software products related to internet information services, fabricating or spreading false statements that prejudice the legitimate interests of other internet service providers, and defaming the services or products of other internet service providers.



## **Table of Contents**

On August 12, 2013, the MOC issued the Administrative Measures for Content Self-review by Internet Culture Business Entities, or the Content Self-review Administrative Measure. The Administrative Measures require Internet culture business entities to review the content of products and services to be provided prior to providing such content and services to the public. The content management system of an Internet culture business entity is required to specify the responsibilities, standards and processes for content review as well as accountability measures, and is required be filed with the local provincial branch of the MOC.

## **Regulation of Information Security**

Internet content in China is also regulated and restricted in relation to state security. The Standing Committee of the National People's Congress, China's national legislative body, in 2000 enacted the Decision on Internet Security Protection in 2000, which was amended in August 2009, pursuant to which offenders can be subject to criminal punishment if they engage in any effort to gain improper entry into a computer or system of strategic importance, disseminate politically disruptive information, leak state secrets, spread false commercial information, or infringe intellectual property rights.

The MPS has promulgated measures that prohibit use of the internet in ways which result in the disclosure of state secrets or the spread of socially destabilizing content. The MPS has supervision and inspection rights in this regard, and we may be subject to the jurisdiction of its local security bureaus. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

In addition, the PRC Law on the Preservation of State Secrets requires an internet service provider to discontinue disseminating any information it believes disclose state secrets and to report to the state security and public security authorities. Failure to do so on a timely and adequate basis may subject the internet service provider to liability and penalties.

## **Import and Export Regulation**

Our ability to license intellectual property rights to online games developed outside of China, including for the purposes of these rules Hong Kong, Macau and Taiwan, is subject to several regulatory restrictions. We are required to obtain the approval of SAPPRFT for each imported internet game. In the event our imported internet games have not been examined and approved by SAPPRFT, SAPPRFT may instruct the relevant local department for the administration of press and publication to ban those games, and suspend their operation, and inform the department for the administration of telecommunications to cancel the relevant internet access service and close down the related websites. The Ministry of Commerce requires us to register any agreement with an exporter of technology, including those exporters based in Hong Kong, Macau, Taiwan and areas outside of China, whenever we import technologies such as online game software into China. In addition, the Ministry of Culture requires us to submit each online game that we wish to import for content review and approval. If we import into China and operate online games without obtaining game content approval, the Ministry of Culture may impose certain penalties on us, including the revocation of our internet culture operation license that is required to operate online games in China. Furthermore, the State Copyright Bureau requires us to register copyright license agreements that relate to imported software. Without completing registration with the State Copyright Bureau, we are not permitted to publish or reproduce imported game software in China. The Ministry of Information Industry also requires us to register online games that we wish to import in order to operate those imported online games in China.

Our ability to export our software is regulated in various ways. According to the Software Export Administration and Statistic Measures jointly issued by the Ministry of Commerce, the Ministry of Science and Technology, the National Bureau of Statistics of China and SAFE on October 25, 2001, we are required to submit our software export contracts

to the data center of the Ministry of Commerce and obtain a registration license. In addition, if the software is deemed to be software for which exports are restricted, we are required to obtain the Ministry of Commerce's approval before we may begin substantial negotiations regarding the software export and we are also required to obtain an approval certificate from the Ministry of Commerce before we sign the software export contract. If our software is deemed to contain a national secret, we must obtain approval from the Ministry of Science and Technology before we may commence substantial negotiations regarding the software export. Although these rules do not contain any explicit penalties for failure to comply with such registration requirements, failure to register an agreement where such registration is required may result in restrictions concerning foreign exchange, banking and taxation matters relating to such agreements. We have not registered all of the game license agreements under which we authorize overseas third-party online game operators to operate our online games, and so far we have not encountered any problems with respect to foreign exchange, banking and taxation matters relating to our license agreements, nor have we received any notice from any governmental authority requiring us to complete the registration of our game license agreements. See Item 3. Key Information Risk Factors Risks Related to the Regulation of Our Business We have not registered license agreements for all of our internationally exported games with the relevant PRC governmental authorities, which may result in certain restrictions that could impair our ability to expand our business internationally.

**Table of Contents**

**Intellectual Property Rights**

China has adopted comprehensive legislation governing intellectual property rights, including trademarks, patents and copyrights. China adheres to the main international conventions on intellectual property rights and became a member of the Agreement on Trade Related Aspects of Intellectual Property Rights upon its accession to the World Trade Organization in December 2001.

China amended its Copyright Law in 2001 and 2010 to widen the scope of works eligible for copyright protection. The amended Copyright Law extends copyright protection to cover internet activities and products disseminated over the internet. Copyrighted software is protected under the Copyright Law and other regulations. In addition, there is a voluntary registration system administered by the China Copyright Protection Center.

Registered trademarks are protected under the Trademark Law adopted in 1982 and revised in 2001. Trademarks can be registered with the Trademark Office of the SAIC for renewable ten-year periods. For licensed games, the localized trademarks and the trademark license agreements are required to be filed with the Trademark Office of the SAIC.

The PRC Patent Law protects external design patents, invention patents and utility patents. Invention patents are valid for 20 years, whereas utility patents and external design patents are each valid for ten years.

The MIIT amended its Administrative Measures on China Internet Domain Names in the PRC in 2004. According to the revised regulation, domain name owners are required to register their domain names. The regulation prohibits the registration and use of domain names with content that may:

be in violation of the basic principles set forth in the PRC Constitution;

jeopardize state security, disclose any state secret, subvert state power or harm national unification;

damage state honor or interests;

incite ethnic hatred or discrimination or damage ethnical unity;

harm state religious policies or advocate heresy or feudal superstition;

disseminate rumors, disrupt social order or sabotage social stability;

disseminate obscenity, pornography or induce gambling, violence, murder, terror or other crimes;

humiliate or slander any other person, or infringe the legal interests of any other person; or

be otherwise prohibited by PRC law or administrative regulation.

Domain name disputes are governed by the Measures on Domain Name Dispute Resolution of the China Internet Network Information Center promulgated by CNNIC, pursuant to which CNNIC can authorize domain name dispute resolution institutions to resolve such disputes.

The Rules of Protection of Information Network Dissemination Rights, promulgated by the State Council in May 2006 and amended in January 2013, address copyright issues relating to the internet. These rules require every organization or individual that disseminates a third party's work, performance, audio or visual recording product to the public through information networks to 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 of dissemination through information networks, and no organization or individual shall intentionally disable, destroy or otherwise assist others in disabling such protective measures unless permissible pursuant to applicable law. In addition, on December 17, 2012, the Supreme People's Court promulgated the Provisions on Several Issues Concerning the Application of Law for Trial of Civil Dispute Cases Involving Infringement of the Right to Network Dissemination of Information, which stipulate that the dissemination by network users or network service providers of works, performances or audio or video recordings without the permission of the holder of the rights to such dissemination will constitute infringement of such rights, and that network service providers that aid or abet any network user's infringement of the rights of another to network dissemination of any works or recordings may be liable for such network user's infringing activities.

## **Table of Contents**

### **Software Copyright Regulations**

In order to protect the rights and interests of computer software copyright owners, on December 20, 2001 the State Council enacted Regulations on the Protection of Computer Software. Subsequently, the State Bureau of Copyright formulated the Measures on the Registration of Computer Software Copyrights on February 20, 2002. According to the Regulations on the Protection of Computer Software, anyone who publishes, revises or translates computer software without the owner's approval shall be civilly liable. For the software copyrights of legal persons or other organizations, the term of protection for the software copyright is 50 years, ending on December 31st of the fiftieth year after the first publication of the software. The software copyright owner may follow the registration procedures of the State Bureau of Copyright and obtain a Software Copyright Registration Certificate, which is prima facie evidence of copyright ownership.

### **Software Development Activity Regulations**

On October 27, 2000, the MIIT issued the Administrative Measures on Software Products to regulate software products and promote the development of the software industry in China. This regulation has been amended and replaced by the new Software Measures issued by the MIIT on March 1, 2009. Pursuant to the new Software Measures, software developers or producers are allowed to sell or license their software products independently or through agents. Software products developed in China can be registered with the local provincial government authorities in charge of the information industry and filed with the MIIT. Upon registration, software products shall be granted registration certificates. Each registration certificate is valid for five years and may be renewed upon expiration. Software products developed in China that satisfy the requirements of the Software Measures and have been registered and filed in accordance with the Software Measures may enjoy preferential treatment under the relevant policies of the State Council. The MIIT and other relevant departments are authorized to supervise and inspect the development, production, sale and import and export of software products in China.

### **Internet Café Regulation**

Internet cafés are required to obtain an internet culture operation license from the MOC and then register with the SAIC, and are subject to requirements and regulations with respect to their location, size, number of computers, business hours and the age limit of customers. For instance, internet cafés are not permitted to operate during the hours from 12 a.m. to 8 a.m. or to allow minors to enter. The PRC government has promulgated several regulations that increase restrictions on internet cafés, which are currently one of the primary retail outlets for our prepaid game cards. A notice jointly issued by 14 PRC national government authorities, including the MIIT, the MOC and the SAPPRFT in February 2007, suspended nationwide approval for the establishment of new internet cafés and enhanced the punishment for internet cafés admitting minors. In 2008, 2009 and 2010, the MOC, the SAIC and other relevant government authorities, individually or jointly, issued several notices which provide various ways to strengthen the regulation of internet cafés, including investigating and punishing internet cafés that admit minors, punishing internet cafés without valid licenses, limiting the total number of internet cafés, screening unlawful games and websites, and improving the coordination of internet café and online game regulation. See Item 3. Key Information Risk Factors Risks Related to the Regulation of Our Business intensified government regulation of internet cafés could limit our ability to maintain or increase our net revenues and expand our customer base.

### **Virtual Currency Regulations**

According to the Notice Relating to Further Strengthening the Administration Work for Internet Cafés and Internet Games, the People's Bank of China has been directed to strengthen the administration of virtual currency in internet games to avoid any adverse impact to the real economy. This notice provides that the total amount of virtual currency

issued by internet game operators and the amount purchased by individual users should be strictly limited, the virtual transactions and the real transactions by way of electronic commerce should be strictly divided, and virtual currency should only be used to purchase virtual goods.

In June 2009, the MOC and the Ministry of Commerce jointly published the Notice on Strengthening the Administration Work of Virtual Currency in Online Games, or the Virtual Currency Notice, which required businesses that (i) issue online game virtual currency in the form of prepaid cards and/or pre-payment or prepaid card points or (ii) offer online game virtual currency transaction services, to apply for approval from the MOC through its provincial branches within three months following the date of such notice. The Virtual Currency Notice prohibits businesses that issue online game virtual currency from providing services that would enable the trading of such virtual currency. Any business that fails to submit the requisite application will be subject to sanctions, including but not limited to warnings, mandatory corrective measures and fines. The Virtual Currency Notice also prohibits online game operators from allocating virtual items or virtual currency to players based on random selection through lucky draw, wager or lottery which involves cash or virtual currency directly paid by the players. The Virtual Currency Notice also prohibits game operators from issuing virtual currency to game players through means other than sale to game players in exchange for legal currency. Moreover, any businesses that do not provide online game virtual currency transaction services are required to adopt technical measures to restrict the transfer of online game virtual currency among accounts of different game players.

## **Table of Contents**

On July 20, 2009, the MOC promulgated the Filing Guidelines on Online Game Virtual Currency Issuing Enterprises and Online Game Virtual Currency Trading Enterprises, which specifically defines issuing enterprise and trading enterprise and stipulates that a single enterprise may not operate both types of business. The Online Game Measures indicate that the issuance of virtual currency falls within the scope of online game operations, and provides that virtual currency issued by online game operators may only be used in exchange for the operator's own online game products and services and may not be used to pay for the products and services of other entities. In addition, when applying for permission to issue virtual currency, a virtual currency issuer must file detailed information about its currency with the MOC, including form, extent of circulation, unit purchase price, and how the virtual currency will be refunded upon termination of services. Issuers are prohibited from altering the unit purchase price of the virtual currency after filing, and must complete filing procedures with the MOC or its local counterparts before issuing new types of virtual currency.

On May 31, 2010, the SAIC issued the Tentative Measures for the Administration of Online Commodities Trading and Relevant Services, or the Online Commodities Trading Measures, which stipulate various obligations of online service providers, and particularly their obligation to protect the interests of customers. Under the Online Commodities Trading Measures, online service providers must ensure that information they release online is authentic, accurate, complete and sufficient and must comply with all applicable laws in respect of intellectual property rights protection and anti-unfair competition.

## **Privacy Protection**

PRC law does not prohibit internet content providers from collecting and analyzing the personal information of their users. We require our players to accept an end user license agreement pursuant to which they agree to provide certain personal information to us. PRC law prohibits internet content providers from disclosing to third parties any information transmitted by users through their networks unless otherwise permitted by law. If an internet content provider violates these regulations, the MIIT or its local bureaus may impose penalties, and the internet content provider may be liable for damages caused to its users. In addition, the MIIT promulgated Several Provisions on Regulating the Market Order for Internet Information Services, which became effective as of March 15, 2012. This regulation stipulates that ICPs may not, without users' consent, collect information on users that can be used, alone or in combination with other information, to identify the user, or User Personal Information, and may not provide any User Personal Information to third parties without user prior consent. ICPs may only collect User Personal Information necessary to provide their services and must expressly inform the users of the method, content and purpose of the collection and processing of such User Personal Information. In addition, an ICP may use User Personal Information only for the stated purposes under the ICP's scope of services. ICPs are also required to ensure the proper security of User Personal Information, and take immediate remedial measures if User Personal Information is suspected to have been disclosed. If the consequences of any such disclosure are expected to be serious, the ICP must immediately report the incident to the telecommunications regulatory authorities and cooperate with the authorities in their investigations. In addition, the PRC government has the power and authority to order ICPs to submit personal information of an internet user if such user posts any prohibited content or engages in any illegal activity on the internet.

On December 28, 2012, the Standing Committee of the National People's Congress enacted the Decision to Enhance the Protection of Network Information, or the Information Protection Decision, to further enhance the protection of User Personal Information in electronic form. The Information Protection Decision provides that ICPs must expressly inform their users of the purpose, manner and scope of the ICP's collection and use of User Personal Information, publish the ICP's standards for their collection and use of User Personal Information, and collect and use User Personal Information only with the consent of the users and only within the scope of such consent. The Information Protection Decision also mandates that ICPs and their employees must keep strictly confidential User Personal Information that

they collect, and that ICPs must take such technical and other measures as are necessary to safeguard the information against disclosure.

On July 16, 2013, the MIIT issued the Order for the Protection of Telecommunication and Internet User Personal Information or the Order. Most requirements under the Order that are relevant to ICP operators are consistent with the requirements already established under the MIIT provisions as discussed elsewhere in this annual report. Under the Order, these requirements are often stricter and have a wider scope. If an ICP operator wishes to collect or use personal information, it may do so only if such collection is necessary for the services it provides. Further, the operator must disclose to its users the purpose, method and scope of any such collection or use, and must obtain consent from its users whose information is being collected or used. ICP operators are also required to establish and publish their rules relating to personal information collection or use, keep any collected information strictly confidential, and take technological and other measures to maintain the security of such information. ICP operators are required to cease any collection or use of the user personal information, and de-register the relevant user account, when a given user stops using the relevant Internet service. ICP operators are further prohibited from divulging, distorting or destroying any such personal information, or selling or providing such information unlawfully to other parties. In addition, if an ICP operator appoints an agent to undertake any marketing or technical services that involve the collection or use of personal information, the ICP operator is still required to supervise and manage the protection of the information. As to penalties, in very broad terms, the Order states that violators may face warnings, fines, and disclosure to the public and, in severe cases, criminal liability.



## **Table of Contents**

### **Protection of Minors**

In April 2007, eight government authorities, including among others the MIIT, SAPPRFT and the Ministry of Education, jointly issued the Notice on the Implementation of Online Game Anti-Addiction System to Protect the Physical and Psychological Health of Minors, or the Anti-Addiction Notice, requiring all PRC game operators to adopt an anti-addiction system in an effort to curb addictive behavior by minors under the age of 18. Under the Anti-Addiction Notice, three hours or less of continuous play by minors is considered to be healthy, three to five hours of continuous play by minors is considered to be fatiguing, and five hours or more of continuous play by minors is considered to be unhealthy. Game operators are required to reduce the value of game benefits by half if the minor player has reached the fatiguing level, and to reduce the value of game benefits to zero if the minor player has reached the unhealthy level. The Anti-Addiction Notice does not limit adults' playing time. In order to implement the Anti-Addiction Notice, game operators must adopt a real-name registration system, which will require online game players to register their real identification information before they can play online games to verify their age and identity. Failure to comply with the requirements under the Anti-Addiction Notice may subject us to penalties, including but not limited to suspension of our operation of online games, revocation of our game operation licenses and approvals, rejection or suspension of our application for approvals, licenses, or filings for any new game, or prohibiting us from operating any new game.

On January 15, 2011, MOC, MIIT and six other central government authorities jointly issued a circular entitled Implementation of Online Game Monitor System of the Guardians of Minors, or the Monitor System Circular, aiming to provide specific protection measures to monitor the online game activities of minors and curb addictive online game playing behaviors of minors. Pursuant to the Monitor System Circular, online game operators are required to maintain a parental communication system, monitor the online game activities of minors, and suspend the account of a minor if so requested by the minor's parents or guardians. The monitoring system was formally implemented on March 1, 2011.

On July 1, 2011, the SAPPRFT, the MIIT, the Ministry of Education and five other governmental authorities issued a Notice on Initializing the Verification of Real-Name Registration for the Anti-Addiction System on Internet Games, or the Real-Name Registration Notice to strengthen the implementation of the anti-addiction system and real-name registration. The Real-Name Registration Notice's main focus is to prevent minors from using an adult's identification information to play internet games and, accordingly, the notice imposes stringent punishments on online game operators that do not implement the required anti-addiction and real-name registration measures properly and effectively. The most severe punishment contemplated by the Real-Name Registration Notice includes suspension of online game operations, revocation of a game operator's licenses and approvals, rejection or suspension of a game operator's application for approvals, licenses, or filings for any new game.

In February 2013, 15 PRC government authorities, including the Ministry of Education, the MOC and the MIIT, jointly issued the Work Plan for the Integrated Prevention of Minors Online Game Addiction, or the Work Plan, implementing integrated measures by different authorities to prevent minors from being addicted to online games. Under the Work Plan, the current relevant regulations regarding online games will be further clarified and additional implementation rules will be issued; and as a result, online game operators will be required to implement measures to protect minors.

### **Employment Contracts**

On June 29, 2007, the National People's Congress promulgated the Employment Contract Law, or ECL. The ECL requires employers to provide written contracts to their employees, restricts the use of temporary workers and aims to give employees long-term job security. Pursuant to the ECL, employment contracts lawfully concluded prior to the

implementation of the ECL and continuing as of the date of its implementation shall continue to be performed.

Under the PRC Social Insurance Law and the Administrative Measures on Housing Fund, employees are required to participate in pension insurance, work-related injury insurance, medical insurance, unemployment insurance, maternity insurance and housing funds and employers are required, together with their employees or separately, to pay the social insurance premiums and housing funds for their employees.

---

**Table of Contents****Overseas Investment by Domestic Resident Regulations**

In October 2005, SAFE issued the Notice on Issues Relating to the Administration of Foreign Exchange in Fundraising and Return Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or Notice 75. Under Notice 75, PRC residents, whether natural or legal person, must register with the relevant local SAFE branch prior to their establishment or control of an offshore entity established for the purpose of overseas equity financing involving onshore assets or equity interests held by them, and must also make filings with SAFE thereafter upon the occurrence of certain material capital changes. The notice applies retroactively to direct or indirect investments previously made by PRC residents in offshore companies. From then on, SAFE has issued a series of subsequent guidance to its local branches for implementing Notice 75, including the most recent Notice of the State Administration of Foreign Exchange on Further Improving and Adjusting Foreign Exchange Administration Policies for Direct Investment, or Circular 59 and Notice of the General Affairs Department of the State Administration of Foreign Exchange on Issuing the Operating Rules for the Notice of the State Administration of Foreign Exchange on the Relevant Issues about Foreign Exchange Control over the Financing and Return Investment of Domestic Residents through Overseas Special Purpose Companies, or Circular 106. Circular 59 and Circular 106 standardize more specific and stringent supervision on the registration and supplemental registration for established special purpose vehicles, or SPVs, relating to Notice 75. Specifically it requires PRC residents holding any equity interest in SPVs, directly or indirectly, controlling or nominal, to register with SAFE and imposes obligations on the PRC subsidiaries of SPVs to encourage the relevant PRC residents to comply with their registration requirements. In addition, Notice of the State Administration of Foreign Exchange on Issues concerning the Foreign Exchange Administration of Domestic Individuals Participation in Equity Incentive Plans of Overseas Listed Companies, or Circular 7 requires registration with SAFE of stock options granted by overseas listed companies to any PRC individuals. The registration and filing procedures under Notice 75 and relevant regulations referred to hereinbefore are prerequisites for other approval and registration procedures necessary for capital inflow from the offshore entity, such as inbound investments or shareholders loans, or capital outflow to the offshore entity, such as the payment of profits or dividends, income at liquidation, equity sale proceeds, or the return of funds upon a capital reduction.

**M&A Regulations**

In August 8, 2006, six government agencies including the Ministry of Commerce, the State Assets Supervision and Administration Commission, or SASAC, the State Administration for Taxation, the State Administration for Industry and Commerce, the CSRC, and SAFE, jointly promulgated the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the M&A Rule. Under the M&A Rule, acquisition of any PRC enterprise, directly or indirectly, by a foreign investor must be approved by the Ministry of Commerce or its local branches. In addition, when such foreign investor and the acquired PRC enterprise have any affiliate relationship, special approval from the Ministry of Commerce is required. The M&A Rule also contains a provision requiring offshore SPVs formed for listing purposes through the acquisition of PRC domestic companies and controlled by PRC individuals to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange.

On September 21, 2006, the CSRC published on its official website procedures regarding its approval of overseas listings by SPVs. The CSRC approval procedures require the filing of a number of documents with the CSRC and it would generally require several months to complete the approval process. However, other than documents required to be submitted, no other details with respect to the timing, criteria and process for obtaining any required approval from CSRC have been specified. Therefore, it remains unclear how the New M&A Rule or the CSRC procedures will be interpreted, amended and implemented by the relevant authorities.



---

**Table of Contents****Employee Share Options**

In December 2006, the People's Bank of China promulgated the Administrative Measures on Individual Person Foreign Exchange, or the PBOC Regulation, setting forth the respective requirements for foreign exchange transactions by individuals (both PRC or non-PRC citizens) under the current account and the capital account. In January 2007, SAFE issued the implementation rules for the PBOC Regulation, which specified the approval requirement for certain capital account transactions such as a domestic individual's participation in the employee stock ownership plan or stock option plan of an overseas listed company. In February 2012, the SAFE promulgated the Notice on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in the Stock Incentive Plan of an Overseas-Listed Company, or the Stock Option Rule. Under the Stock Option Rule, PRC domestic individuals who will participate in any stock incentive plan including the employment stock ownership plan or the stock option plan or similar plan of an overseas listed company are required to appoint a PRC agent to register with the relevant local SAFE branch and deal with the relevant foreign exchange matters related to the stock incentive plan in the PRC. Under the Stock Option Rule, PRC domestic individuals include PRC citizens, including Hong Kong, Macao and Taiwan nationals, and foreign nationals who have continuously resided in China for at least a year. A PRC agent may be a domestic company participating in the stock incentive plan or a domestic institution that is qualified to engage in an asset custodian business and has been duly designated by a domestic company. The individuals' foreign currency dominated income received from the sale of shares or dividends distributed by the overseas-listed company that is repatriated back to China shall first be remitted into a collective foreign exchange account opened and managed by the PRC agent before distribution to such individuals in a foreign currency or in RMB. Failure to comply with the Stock Option Rule may subject the plan participants, the company offering the plan or the relevant intermediaries to penalties under China's foreign exchange regime. In addition, the General Administration of Taxation has issued certain circulars concerning employee stock options. Pursuant to these circulars, our employees working in China who exercise stock options will be subject to PRC individual income tax. Our PRC subsidiaries have obligations to file documents related to employee stock options with the relevant tax authorities and withhold individual income taxes for those employees who exercise their stock options. If our employees fail to pay and we fail to withhold the required income taxes, we may face sanctions imposed by tax authorities or other PRC government authorities.

**Cross-Border Direct Investment in Renminbi**

On October 12, 2011, MOFCOM issued the Notice of the Ministry of Commerce on Issues Concerning Cross-Border Direct Investment in Renminbi, which provides that foreign investors are permitted to make direct investments in China with legally obtained offshore Renminbi. The offshore Renminbi as mentioned in this notice refers to (i) Renminbi obtained by foreign investors from Renminbi settlement of cross-border trades, Renminbi profits as well as Renminbi from share transfer, capital reduction, liquidation and advance recovery of investment which are legally obtained by foreign investors from within China and remitted out of China, and (ii) Renminbi legally obtained by foreign investors from outside China, without limitation Renminbi obtained by means such as an offshore issue of RMB-denominated bonds or stocks. The foreign direct investments in Renminbi shall also be subject to the requirements of laws and regulations on foreign investments and other relevant provisions, and shall comply with the national industrial policies on foreign investments and relevant provisions on the security review of mergers and acquisitions by foreign investors and the anti-monopoly examination. On October 13, 2011, the PBOC issued the Management Rules on the Settlement of Foreign Direct Invested Renminbi, which provide that foreign invested enterprises with RMB-dominated foreign direct investment must register with the PBOC or its local branch after obtaining the permit from MOFCOM.

**C. Organizational Structure**

The following diagram illustrates our current corporate structure and the place of formation and affiliation of each of our subsidiaries and Giant Network and its consolidated entities as of the date of this annual report: <sup>(1)</sup>

**Table of Contents**

57

**Table of Contents**

- (1) For risks relating to our current corporate structure, see Risk Factors Risks Related to the Regulation of Our Business.
- (2) Agreements that provide us with effective control over Giant Network, include irrevocable powers of attorney, share pledge agreements, purchase options and cooperation agreements, asset purchase option agreement.
- (3) The economic benefits and losses of Giant Network accrue to Zhengtu Information pursuant to an exclusive technical consulting and services agreement, and an online game software sales and licensing agreement.
- (4) Shanghai Lanlin Bio-Technology Co., Ltd., or Shanghai Lanlin, is wholly beneficially owned by Yuzhu Shi, our chairman, through (i) his 95% interest in Giant Investment Co., Ltd. (which holds a 90% interest in Shanghai Lanlin), (ii) a written statement by Jinhua Niu (who holds a 5% interest in Giant Investment Co., Ltd.) disclaiming all ownership rights in Giant Investment Co., Ltd. in favor of Yuzhu Shi and (iii) a proxy shareholding agreement with Kai Chen (who holds a 10% interest in Shanghai Lanlin) which gives Yuzhu Shi all beneficial ownership rights of Kai Chen's shares in Shanghai Lanlin.
- (5) Kai Chen holds 0.6% on his own behalf, 0.8% on behalf of Min Tang, 0.5% on behalf of Yonghua Lu, 0.3% on behalf of Yong Chu, 0.6% on behalf of Yongjun Fei, 0.2% on behalf of Zhaoyou Huang, 0.3% on behalf of Wenqing Wang, 0.2% on behalf of Jin Xu, 0.8% on behalf of Yan Zeng and 0.3% on behalf of Lianlong Zhang.
- (6) Zhengtu Information owns 40.76% of the equity interest in Snow Wolf Software, but pursuant to contractual arrangements holds 51.07% of the voting right.
- (7) In March 2014, Giant Network increased its registered capital through a capital contribution of RMB2.5 million from Shanghai Lanlin, which increased Shanghai Lanlin's equity percentage in Giant Network from 75% to 80%, with a proportionate dilution of the equity percentage of the other equity holders.

**Contractual Arrangements with Giant Network and Its Shareholders**

In order to comply with PRC laws restricting foreign ownership in the online game business in China, we operate our online game business in China through Giant Network. Our relationships with Giant Network and its shareholders are governed by a series of contractual arrangements, which are described below, relating to business operations, consulting services, and certain shareholder rights and corporate governance matters. Amendments to these contractual agreements, including any change in pricing, loan approvals or payment of dividends, must be approved by our board of directors. Zhengtu Information effectively has control over Giant Network through control of Giant Network's management and the assignment to Zhengtu Information of Giant Network's shareholders' rights. As a result of these contractual arrangements, we are considered the primary beneficiary of Giant Network and its consolidated entities and, accordingly, we consolidate the results of operations of Giant Network and its consolidated entities in our financial statements.

***Agreements that Provide Us with the Substantial Ability to Control and an Option to Acquire Giant Network***

We have entered into certain agreements that provide us with the substantial ability to control Giant Network, and we have obtained an exclusive option to purchase all of the equity interests of Giant Network. These agreements include:

***Irrevocable Powers of Attorney.***

Under irrevocable powers of attorney, each of the shareholders of Giant Network has granted to the designee of Zhengtu Information, Yuzhu Shi, the power to exercise all voting rights of such shareholder, including but not limited to the power to determine the sale or transfer of all or part of such shareholder's equity interest in, and appoint and elect the directors, general managers and other senior management of, Giant Network. No payments are required to be made under these irrevocable powers of attorney. These irrevocable powers of attorney will expire in September, 2016 and will be automatically renewed for another ten years unless otherwise objected to by Zhengtu Information. However, these irrevocable powers of attorney will be terminated if Zhengtu Information replaces its designee, at which time each of the shareholders will issue a new power of attorney to such new designee.



*Share Pledge Agreement.*

Under the share pledge agreement by and among Zhengtu Information, Giant Network and the shareholders of Giant Network, each of the shareholders has pledged all of their equity interests in Giant Network to Zhengtu Information to guarantee the performance of Giant Network under the relevant service agreements including the exclusive technical consulting and service agreement, the online game software sales and licensing agreement and other paid services or licensing agreements that are entered into between Zhengtu Information and Giant Network from time to time. Each of the shareholders of Giant Network also agreed that, without the prior written consent of Zhengtu Information, they will not transfer or create a pledge over their equity interests in Giant Network, or initiate board or shareholder meetings of Giant Network to pass any resolution to sell, transfer or create a pledge over their equity interests in Giant Network, unless such transfer is conducted pursuant to the purchase option and cooperation agreement or such transfer or pledge would not affect the pledge's effectiveness and the shareholder provides prior written notice to Zhengtu Information.

## Table of Contents

In the event Giant Network is liquidated or dissolved, subject to any requirements under applicable PRC law, all of its assets must be sold to Zhengtu Information or an eligible party designated by Zhengtu Information at a purchase price equal to the net asset value of Giant Network or the minimum price permissible by PRC law. Giant Network's shareholders are required to remit to Zhengtu Information any proceeds that are distributed to them in connection with Giant Network's liquidation or dissolution, subject to PRC law.

If Giant Network or any of the shareholders of Giant Network breaches its respective contractual obligations under the share pledge agreement, Zhengtu Information, as pledgee, will be entitled to demand the immediate repayment of all outstanding amounts under the relevant service agreements, or enforce the pledge. Presently, Zhengtu Information would not be able to hold equity interests in Giant Network itself upon enforcement of the pledge due to restrictions on foreign ownership of operators of online games in China. However, Zhengtu Information may still enforce the pledge by obtaining proceeds from the sale of the pledged property in a transaction mutually agreed upon with Giant Network or by petitioning the court to have the pledged property auctioned. According to the irrevocable powers of attorney described above, Yuzhu Shi, as the attorney-in-fact of all the shareholders of Giant Network, may approve the sale of a pledged interest to any individual or entity designated by Zhengtu Information and permissible by PRC law. The agreement will continue to be effective until the expiration of all relevant service agreements. See Item 3. Key Information Risk Factors Risks Related to the Regulation of Our Business Substantial uncertainties and restrictions exist with respect to the application and implementation of PRC laws and regulations in the online game industry. If the PRC government finds that our past or current structure for our business operations does not comply with PRC laws and regulations, we could be subject to severe penalties, including ceasing our operations.

In addition, after Giant Network has increased its registered capital by a capital contribution of RMB2.5 million by Shanghai Lanlin, Shanghai Lanlin entered into a share pledge agreement dated March 18, 2014 with Zhengtu Information and Giant Network, or the 80% Share Pledge Agreement, pursuant to which Shanghai Lanlin has pledged all of its equity interests in Giant Network, equal to 80% of equity interests of Giant Network in total, to Zhengtu Information to guarantee (i) the contractual obligations of Shanghai Lanlin under the power of attorney dated September 7, 2006; (ii) the contractual obligations of Shanghai Lanlin and Giant Network under the purchase option and cooperation agreement dated September 7, 2006, asset purchase agreement dated March 18, 2014 and this share pledge agreement dated March 18, 2014; and (iii) the contractual obligations of Giant Network under the relevant service agreements including the exclusive technical consulting and service agreement, the online game software sales and licensing agreement and other paid services or licensing agreements that are entered into between Zhengtu Information and Giant Network from time to time. Shanghai Lanlin, as pledger, agreed that, without the prior written consent of Zhengtu Information, it will not transfer or create a pledge over its equity interests in Giant Network. Giant Network also guaranteed that, without the prior written consent of Zhengtu Information, it will not assist or allow Shanghai Lanlin to transfer or create a pledge over its equity interests in Giant Network.

If Giant Network or Shanghai Lanlin breaches its respective contractual obligations under the 80% Share Pledge Agreement, Zhengtu Information, as pledgee, will be entitled to seek all the remedies for breach permissible by PRC law and the relevant provisions under the 80% Share Pledge Agreement, including but not limited to sell or auction the pledged shares to get repayment in priority. The agreement will continue to be effective until the performance of the contractual obligations under the relevant agreements.

The 80% Share Pledge Agreement by Shanghai Lanlin has been registered with the local PRC Administration of Industry and Commerce on March 28, 2014.

## **Table of Contents**

### *Purchase Option and Cooperation Agreement.*

Pursuant to the purchase option and cooperation agreement among Zhengtu Information, Giant Network and shareholders of Giant Network, each of the shareholders has irrevocably and unconditionally granted Zhengtu Information or its designee an exclusive option to purchase, at any time if and when permitted under PRC law, all or any portion of their equity interests in Giant Network for an aggregate purchase price of RMB10,000,000, or the minimum price permissible by PRC law. Any consideration received from the sale by Giant Network's shareholders or any persons or entities designated by them will be remitted to Giant Network. The agreement will continue to be effective until all equity interests in Giant Network have been transferred to Zhengtu Information or its designee. This agreement provides further that if any profits or dividends of Giant Network are remitted to its shareholders or Yuzhu Shi, who is a designated recipient by those shareholders, these recipients will be required to transfer all such amounts to Zhengtu Information in accordance with any applicable PRC laws and regulations. Furthermore, if any loans or other funds are remitted to Yuzhu Shi and the shareholders of Giant Network, or any persons or entities designated by them, these recipients will be required to remit those proceeds back to Giant Network. Zhengtu Information will extend its financial support to Giant Network including, but not limited to, advancing payments for any losses incurred by Giant Network. In the event that Giant Network is liquidated or dissolved, subject to any requirements under applicable PRC law, all the assets of Giant Network will be sold to Zhengtu Information at the minimum price permissible by PRC law. If Giant Network or any of its shareholders materially breaches any of its obligations under the purchase option and cooperation agreement, Zhengtu Information can request that corrective remedies be made within a reasonable period of time. If the breach is not corrected, Zhengtu Information can, among other things, request compensation for all damages and losses.

### *Asset Purchase Option Agreement.*

Pursuant to the asset purchase option agreement dated March 18, 2014 among Zhengtu Information, Giant Network and Shanghai Lanlin, Giant Network has irrevocably and unconditionally granted Zhengtu Information or its designee an exclusive option to purchase, at any time if and when permitted under PRC law, all or any portion of its assets for an aggregate purchase price of the net book value of such assets, or the minimum price permissible by PRC law. Shanghai Lanlin, which holds a 80% interest in Giant Network, has agreed Giant Network to grant such asset purchase option to Zhengtu Information. The agreement will continue to be effective until all assets in Giant Network have been transferred to Zhengtu Information or its designee.

### ***Exclusive Technical Consulting and Services Agreement and Online Game Software Sales and Licensing Agreement between Zhengtu Information and Giant Network***

We have entered into a series of contractual arrangements with Giant Network through our PRC subsidiary Zhengtu Information, pursuant to which economic interests in Giant Network are transferred to us and financial results of Giant Network are consolidated in our financial statements:

#### *Exclusive Technical Consulting and Service Agreements.*

Pursuant to the original exclusive technical consulting and services agreement dated September 7, 2006, Zhengtu Information is the exclusive provider of technical support and consulting services to Giant Network in exchange for service fees, which are determined with reference to the costs and expenses incurred by Zhengtu Information and Giant Network. Under this agreement, Giant Network may not, among other things, transfer its rights and obligations thereunder to any third party without the prior written consent of Zhengtu Information. If Giant Network breaches the exclusive technical consulting and service agreement, Zhengtu Information can demand such breaches be corrected within sixty days and is entitled to receive compensation for all damages and losses. This agreement has a term of ten

years and is renewable at the option of Zhengtu Information. In January 2012, Zhengtu Information and Giant Network entered into a supplemental agreement, pursuant to which Zhengtu Information allowed Zhengju Information to serve as the exclusive service provider for technical support and consulting services to Giant Network in connection with the operation of ZT Online 2. In March 2014, Zhengtu Information and Giant Network entered into an additional supplemental agreement which clarified that Giant Network shall have a right to damages, but not a right to terminate, if Zhengtu Information breaches the exclusive technical consulting and services agreement.

*Online Game Software Sales and Licensing Agreements.*

Under the online game software sales and licensing agreement dated September 6, 2006 and its supplemental agreements between Zhengtu Information and Giant Network, Zhengtu Information has agreed to grant Giant Network an exclusive license within China to operate our games, including ZT Online and Giant Online, and to sell certain other game-related products. In March 2014, Zhengtu Information and Giant Network entered into another supplemental agreement which clarified that Giant Network shall have a right to damages, but not a right to terminate, if Zhengtu Information breaches the online game software sales and licensing agreement. See Item 3. Key Information

Risk Factors Risks Related to the Regulation of Our Business The contractual arrangements with Giant Network and its 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.

**Table of Contents**

***Exclusive Technical Consulting and Services Agreement and Online Game Software Sales and Licensing Agreement between Zhengju Information and Giant Network***

In 2011, one of our PRC subsidiaries, Zhengju Information, was recognized as a software development enterprise and subject to the preferential tax treatment from 2012. Accordingly, we registered the software copyright of ZT Online 2 and World of Xianxia under the name of Zhengju Information. Pursuant to exclusive technical consulting and services agreements entered into in 2012 and 2013 between Zhengju Information and Giant Network, Zhengju Information provides Giant Network with technical support and consulting services in exchange for service fees in connection with ZT Online 2, World of Xianxia, Allods Online and Elsword. The amount of the service fees under the aforementioned agreements are determined with reference to the costs and expenses incurred by both parties. Both of the agreements has a term of ten years and is renewable at the option of Zhengju Information.

Zhengju Information has also granted Giant Network an exclusive license within China to distribute and operate ZT Online 2 and World of Xianxia, two of our self-developed MMORPGs, through various online game software sales and licensing agreements as amended from time to time. Pursuant to these agreements, Giant Network pays a monthly royalty fee, while Zhengju Information retains ownership of all of the intellectual property rights associated with these games. These agreements will continue to be effective until both parties agree to terminate the agreements.

In addition, Zhengju Information has granted Giant Network an exclusive sublicense within China to distribute and operate Elsword and Allods Online, two online games that we have licensed from third party developers. Pursuant to these sublicenses, Giant Network pays Zhengju Information a monthly royalty. Zhengju Information has received exclusive licenses from the owners and developers of Elsword and Allods Online, respectively, who retain all the intellectual property rights associated with these two games.

***Sales and Licensing Agreement and Technical Consulting Service Agreement that Transfer Economic Benefits from Giant Network to Our Game Development Studios.***

In 2008, we introduced Win@Giant, an incubation program designed to identify, recruit and incentivize talented individuals in the areas of game design and development. In 2009, in connection with our Win@Giant initiative, we began reorganizing our game development studios by establishing various subsidiaries that are 51% owned by us and 49% owned by the key members of the relevant development team. Each reorganized studio is only focused on producing and supporting internally developed games, which we believe gives them greater incentive to make their games commercially successful. Currently, ZT Online 2 is supported by Jujia Network, Giant Online and World of Xianxia are supported by Juhuo Network and XT Online is supported by Snow Wolf Software. Set forth below is a summary of the contractual arrangements pursuant to which Giant Network transfers portion of the revenue generated by these games to the relevant reorganized studio.

Pursuant to a series of platform software and game software sales and licensing agreements, as amended from time to time, certain of our 51% owned game development studios license to Giant Network on an exclusive basis the platform software for a game they support, or the online game they developed, in exchange for a fixed initial fee and a monthly royalty fee. Pursuant to these arrangements, Giant Network holds an exclusive license to the platform software for ZT Online 2 from Jujia Network, for World of Xianxia and Giant Online from Juhuo Network, and for XT Online from Snow Wolf Software.

In addition, pursuant to the technical consulting and service agreement dated December 5, 2013 and January 2, 2014, Jujia Network and Juhuo Network, respectively, agreed to provide Giant Network with technical support and consulting services in connection with the business of Giant Network in exchange for service fees. The amount of these service fees are determined with reference to the costs and expenses incurred by both parties. Both of the

agreements have a term of five years and are renewable at the option of Jujia Network or Juhuo Network, respectively.

During the years ended December 31, 2011, 2012 and 2013, total fees charged under the exclusive technical consulting and services agreements, online game software sales and licensing agreements and platform software sales and licensing agreements summarized above totaled approximately RMB1,474 million, RMB1,776 million and RMB1,777 million (US\$294 million), respectively, which represented substantially all of Giant Network's operating profits for each of these three years.

## **Table of Contents**

### **Going Private Transaction**

On November 25, 2013, we received a preliminary, non-binding proposal from the buyer consortium (which at the time comprised Mr. Yuzhu Shi, our founder and chairman, and Baring Private Equity Asia, or Baring) to acquire all of our outstanding shares and ADSs not currently owned by Mr. Yuzhu Shi (and possibly other rollover shareholders) in a going private transaction for US\$11.75 per share or per ADS in cash, subject to certain conditions. Our board of directors has formed a special committee of independent directors to consider the proposal, which retained two financial advisors and legal counsel to assist it in this process. Upon the unanimous recommendation of the special committee and unanimous approval of our board of directors (except for Mr. Yuzhu Shi who abstained himself from voting on the proposal), on March 17, 2014, we entered into an Agreement and Plan of Merger, or the Merger Agreement, which would effectuate the going private proposal, with Giant Investment Limited, or the Parent, and Giant Merger Limited, or the Merger Sub. Pursuant to the terms and subject to the conditions of the Merger Agreement, Merger Sub would merge with and into us, and we would survive as a wholly-owned subsidiary of Parent. In connection with and at the effective time of the merger, each of our shares or ADSs that is outstanding immediately prior to the effective time of the merger would be cancelled in consideration for the right to receive \$12.00 in cash without interest, except for those shares beneficially owned by the Rollover Holders as defined in the Merger Agreement, which shares would be cancelled for no consideration at the effective time of the merger, subject to applicable dissenters rights. If the merger closes pursuant to the Merger Agreement, we would cease to be listed on the New York Stock Exchange, or the NYSE, or a public reporting company in the U.S. The Merger Agreement is subject to closing conditions, including certain shareholder approvals, and there can be no assurance that this or any other transaction will be approved or consummated.

### **D. Property, Plant and Equipment**

See Item 4. Information on the Company Business Overview Facilities and Information on the Company Operational Infrastructure.

### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

There are no unresolved staff comments.

### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following discussion of our financial condition and results of operations is based upon and should be read in conjunction with our consolidated financial statements and their related notes included in this annual report. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. See Introduction Forward Looking Statements. In evaluating our business, you should carefully consider the information provided under Item 3.D, Key Information Risk Factors. We caution you that our businesses and financial performance are subject to substantial risks and uncertainties.

#### **A. Operating Results**

##### **Overview**

We are a leading online game developer and operator in China. We focus on massively multiplayer online role playing games, or MMORPGs, which are played through networked game servers on which tens of thousands of players are able to simultaneously connect and interact.

In 2006, we commercially launched ZT Online, our first internally-developed MMORPG game. We currently operate fifteen online games, among which twelve are self-developed, including the four games in the ZT Online franchise.

We offer virtual items and services available for in-game purchase in our free-to-play games. Players of our games can obtain virtual items and services by using game points purchased through our distribution network in the form of physical or virtual prepaid game cards or directly on our official game website.

In addition to our historical success with internally developed games, we have expanded our game pipeline by licensing games from third party developers. In December 2009 and January 2010, respectively, we acquired the exclusive China operation licenses for Elsword, a 3D Casual MMO, and Allods Online, a 3D MMORPG. Elsword was commercially launched in the fourth quarter of 2011 while Allods Online was commercially launched in the third quarter of 2012. In addition, in March 2013, we acquired the exclusive China operation license for Cang Tian 2, a 3D MMORPG game developed by WeMade Entertainment of South Korea, and in April 2014, we acquired the exclusive China operation license for Wildstar, a MMORPG game developed by Carbine in California, a wholly-owned subsidiary of NCSOFT Corporation of South Korea.



## **Table of Contents**

Although substantially all of our revenues are generated through our own game operations in China, we also derive revenues from licensing our games to third party operators in other territories including other parts of Asia, North America, Europe, Russia and other Russian speaking territories.

In 2011, 2012 and 2013, our net revenues were RMB1,792.2 million, RMB2,152.0 million and RMB2,355.5 million (US\$389.1 million), respectively. Our net income for the same years was RMB906.4 million, RMB1,072.0 million and RMB1,335.8 million (US\$220.7 million), respectively. As of December 31, 2011, December 31, 2012 and December 31, 2013, deferred revenues and advances from distributors totaled RMB611.5 million, RMB579.5 million and RMB436.3 million (US\$72.1 million), respectively. Deferred revenues and advances from distributors represent amounts that we have received from sales of our prepaid game cards and game points that have not yet been recognized as net revenues.

Our PCU for all of the games we operate in China were 2,339,000, 2,370,000 and 2,319,000 for 2011, 2012 and 2013, respectively. Our ACU for 2011, 2012, and 2013, calculated using an average of our quarterly ACU were 642,000, 691,000 and 697,000, respectively.

## **Factors Affecting Our Results of Operations**

We have benefited from a number of trends that have contributed to the growth of the online game industry in China, including overall economic growth that has resulted in increased disposable income and discretionary consumer spending; increasing use of the internet with the growth of personal computers and broadband internet penetration; growing popularity of online games compared with other forms of entertainment; and favorable demographic trends, particularly the growth in China's core online game-playing population. However, increasing competitiveness in the online game industry in China presents new challenges to our business.

Company-specific factors that may affect our future financial condition and results of operations include the following:

the availability, quality and playability of our games;

the number of games that we offer players, and our pricing relative to our competitors;

the popularity of our competitors' games and the growing competitiveness in the market;

our research and development expenses, which tend to be higher during the development stage of a new game as we need to hire additional developers, and our ability to incorporate the latest gaming technologies and graphics into our games;

the reorganization of our game development studios and the profit sharing mechanism in connection with such reorganization;

cost of expansion and purchase of servers and equipment in anticipation of new games;

changes in our game rules and the corresponding impact on player behaviors and purchasing patterns;

the quality, variety and popularity of virtual items and services available for purchase in our free-to-play games and related in-game promotional efforts;

license fees and royalty payments for games which we license from third party developers;

the amount of overseas licensing net revenues generated through our licensing arrangements with operators of our games;

our introduction of new online games, which may attract players away from our established games, and the mix of sales of our games;

change in pricing strategies for our new games and its impact on our operating metrics;

the mix of sales through our distributors (who purchase prepaid game cards at a discount to their face value) and direct sales of game points to players through our website;

the breadth and depth of our distribution network and the corresponding availability of our prepaid game cards;

the success of our advertising and promotional efforts;

seasonality of our sales of prepaid game cards and revenue recognition based on our game players' behavior, during and around the Chinese New Year holidays in the first quarter and the National Day holidays in the fourth quarter, when fewer of our targeted players play our games;

the period of time over which we recognize revenue for virtual items in our free-to-play games, which in certain cases is based on the estimated lifespan of those virtual items, as adjusted from time to time; and

the success of our investments and merger and acquisition activities.

**Table of Contents****Reorganization of Our Game Development Studios**

As a result of our game development studio reorganization, which began in 2009, a portion of the net income generated by games developed or supported by our game development studios is attributed to the non-controlling shareholders of the studios. Although we believe this reorganization has helped increase our net revenues and gross margin, our net income may have been adversely affected as a result of the profit-sharing mechanism. This outcome is most pronounced in the case of ZT Online 2 which contributed a substantial portion of our net revenues in 2012 and 2013, and to a lesser extent with World of Xianxia which materially contributed to our net revenue in 2013. If revenues generated from ZT Online 2 and World of Xianxia continue to grow, we believe that our top line growth stimulated by this new profit-sharing mechanism will help mitigate the adverse impact from the net revenues attributable to the non-controlling shareholders of Jujia Network and Juhuo Network, the game development studios that developed and support ZT Online 2 and World of Xianxia, respectively. For a discussion of risks relating to our game development studio reorganization, see Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry The reorganization of our game development studios could materially and adversely affect our results of operations as a portion of the profits from games developed or operated by these studios will be shared with the non-controlling shareholders of these studios.

**Key Operating Metrics**

Our management uses a number of user statistics to evaluate the performance of our company, including, among others, average concurrent users, peak concurrent users, active paying accounts and average revenues per user. The following tables set forth the above-mentioned quarterly user statistics of our company for the periods indicated.

	<b>March 31, 2013</b>	<b>June 30, 2013</b>	<b>September 30, 2013</b>	<b>December 31, 2013</b>
	(in thousands, except average revenues per user)			
Average Concurrent Users	690	702	697	698
Peak Concurrent Users	2,281	2,319	2,271	2,220
Active Paying Accounts	2,257	2,328	2,335	2,362
Average Revenues per User (RMB)	238	244	245	246

Along with the growth in our online game net revenues, the number of our average concurrent users and active paying accounts generally continued to grow in 2013 primarily as a result of the growth of ZT Online 2 and World of Xianxia.

**Net Revenue**

Our net revenues consist of online game net revenues, licensing net revenues, and other net revenues. The following table sets forth a breakdown of our net revenues for the years indicated.

<b>For the Year Ended December 31,</b>					
<b>2011</b>		<b>2012</b>		<b>2013</b>	
(RMB)	% of Net revenues	(RMB)	% of Net revenues	(RMB)	(US\$) % of Net revenues
<b>(in millions, except percentages)</b>					

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

<b>Net revenue:</b>							
Online games	1,701.4	95.0%	2,075.0	96.4%	2,309.3	381.5	98.0%
Licensing revenues	54.5	3.0%	52.2	2.4%	41.9	6.9	1.8%
Other revenue, net	36.3	2.0%	24.8	1.2%	4.3	0.7	0.2%
<b>Total net revenue</b>	<b>1,792.2</b>	<b>100.0%</b>	<b>2,152.0</b>	<b>100.0%</b>	<b>2,355.5</b>	<b>389.1</b>	<b>100.0%</b>

**Table of Contents****Online Games Revenues**

Online game net revenues represent revenues that we generate from operating our online games in China. Our online game net revenues are shown net of sales discounts, business taxes and local surcharges related to the sale of prepaid game cards and game points. Our sales discounts consist of distributor discounts, which averaged 6% of the face value of our prepaid game cards sold in 2013, and volume-based incentives, which we pay to distributors in the form of prepaid game cards up to generally 2% to 4% of the total amount sold by our distributors.

Business taxes and local surcharges are generally equal to 5.6% of the proceeds we receive from the sale of our prepaid game cards and game points. In 2011, 2012 and 2013, we paid business taxes in the amount of RMB111.2 million, RMB125.5 million and RMB131.3 million (US\$21.7 million), respectively, representing 6.2%, 5.8% and 5.6%, respectively, of our total net revenues in those years.

In addition to generating online game net revenues by selling our prepaid game cards through our distribution network, we also sell game points directly through our official game website. For sales made through our website, we receive the full purchase price less an online payment processing service fee that equals approximately 0.3% of the purchase price, which we reflect in our cost of services. In 2013, 45.7% of our sales proceeds were derived from prepaid game cards sold through our distributors as compared to 55.4% in 2012, and the remaining 54.3% of our sales proceeds were derived from direct sales through our website as compared to 44.6% in 2012. We expect the direct sales through our website to continue to grow in 2014 due to the increasing acceptance of online payment system by players.

**Licensing Revenues**

Licensing net revenues consist of net revenues generated from the licensing of our games to third parties for operation outside of China. Our license agreements with third party operators generally provide for an initial license fee and a monthly revenue-based royalty fee. The initial license fee is recognized ratably over the term of the license. The royalty fees are generally equal to a fix percentage of the revenues generated by the third party operators from operating our games. In the future, we expect our licensing net revenues to increase as we continue to look for additional strategic licensing opportunities for our games to be operated in overseas markets.

**Cost of Services**

Our cost of services consist of a portion of our value-added taxes and surcharges, compensation for employees and other personnel operating our games, computer equipment maintenance, depreciation of equipment, co-location and internet access fees and the amortization of software and other intangible assets, including licensing fees. The following table sets forth a breakdown of our cost of services by amounts and percentages of our net revenues for the periods indicated.

	For the Year Ended December 31,						
	2011		2012		2013		
	(RMB)	% of Net revenues	(RMB)	% of Net revenues	(RMB)	(US\$)	% of Net revenues
	(in millions, except percentages)						
<b>Net revenue</b>	1,792.2	100%	2,152.0	100.0%	2,355.5	389.1	100.00%

**Cost of services:**

Sales taxes and surcharges	(72.8)	(4.1)%	(83.6)	(3.9)%	(87.0)	(14.4)	(3.7)%
Compensation	(51.4)	(2.9)%	(65.4)	(3.0)%	(65.0)	(10.7)	(2.8)%
Computer maintenance, co-location and internet access fees	(55.1)	(3.1)%	(57.7)	(2.7)%	(57.7)	(9.5)	(2.4)%
Depreciation and amortization	(48.4)	(2.7)%	(44.8)	(2.1)%	(34.9)	(5.8)	(1.5)%
Licensing fees	(19.7)	(1.1)%	(23.4)	(1.1)%	(17.3)	(2.9)	(0.7)%
Miscellaneous	(9.8)	(0.5)%	(13.5)	(0.6)%	(36.8)	(6.0)	(1.6)%
<b>Total cost of services</b>	<b>(257.2)</b>	<b>(14.4)%</b>	<b>(288.4)</b>	<b>(13.4)%</b>	<b>(298.7)</b>	<b>(49.3)</b>	<b>(12.7)%</b>

***Sales Taxes and Related Surcharges***

Our cost of services includes value-added tax or VAT, and related surcharges that our direct PRC subsidiaries, such as Zhengtu Information, Jujia Network, Juhuo Network and Snow Wolf Software, pay on revenues derived from contractual arrangements with Giant Network. Giant Network incurs additional business taxes and related surcharges in connection with sales of our prepaid game cards and game points. However, we present our net revenues net of these taxes and related surcharges paid by Giant Network. See Item 5. Operating and Financial Review and Prospects Income Tax Expense China.

**Table of Contents*****Compensation***

We include compensation expenses for our employees that are directly involved in the operation of our online games, including our maintenance team, platform team and customer support team, in cost of services. Compensation expenses include employee wages, share-based compensation and welfare benefits, such as social insurance, medical insurance, housing subsidies, unemployment insurance and pension benefits. We expect compensation expenses to decrease in 2014 primarily due to a decrease in share-based compensation expense associated with restricted shares grants made in 2011 which is the direct result of the application of the accelerated amortization method pursuant to our accounting policy.

***Computer Maintenance Co-location and Internet Access Fees***

Our costs associated with the maintenance of computer equipment, co-location and internet access fees primarily consist of co-location and internet access fees charged by third-party internet data centers from which we operate our servers. Another large component of these expenses is server maintenance costs. We typically rely on internet data centers to resolve our minor server problems, but use our own Shanghai-based maintenance team to resolve more complicated problems. In 2014, we expect our co-location and internet access fees and server maintenance costs to remain relatively stable as compared to 2013. We may, however, decide to install servers in new locations across China, which would further increase our costs.

***Depreciation and Amortization***

Our depreciation of equipment and the amortization of our software and other intangible assets relate primarily to depreciation of our servers and other computer equipment as well as capitalized product development costs. We include depreciation and amortization expenses within our cost of services when the relevant assets are directly related to the operation of our platform and online games. Depreciation and amortization expenses are characterized as operating expenses in all other cases. In 2014, we expect these expenses to decrease as some of our fully depreciated equipment are still in good condition and do not need to be replaced.

***Licensing Fees***

Our game licensing fees consist of upfront licensing fees, which we generally pay in several installments, and ongoing royalty fees, which are generally equal to a percentage of the revenues we generate from operation of the relevant game. Upfront licensing fees are amortized on a straight-line basis over the shorter of the license period or the useful economic life of the relevant game. We expect our licensing fees to increase in 2014 in connection with the launch of Cang Tian 2, our third licensed game.

**Operating (Expenses) Income**

Operating expenses consist of research and product development, sales and marketing, general and administrative, government financial incentives, and impairment of intangible assets. The following table sets forth a breakdown of our operating expenses by amount and percentage of our net revenues for the years indicated.

<b>For the Year Ended December 31,</b>			
<b>2011</b>	<b>2012</b>	<b>2013</b>	
<b>(RMB)</b>	<b>(RMB)</b>	<b>(RMB)</b>	<b>(US\$)</b>

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

	% of Net revenues		% of Net revenues		% of Net revenues		
	<b>(in millions, except percentages)</b>						
<b>Net revenue</b>	1,792.2	100.0%	2,152.0	100.00%	2,355.5	389.1	100.00%
<b>Operating (expenses) income:</b>							
Research and product development	(230.2)	(12.8)%	(326.8)	(15.2%)	(321.0)	(53.0)	(13.6%)
Sales and marketing	(170.0)	(9.5)%	(146.5)	(6.8%)	(175.8)	(29.0)	(7.5%)
General and administrative	(103.7)	(5.8)%	(148.7)	(6.9%)	(135.7)	(22.4)	(5.8%)
Government financial incentives	47.7	2.7%	63.6	3.0%	44.8	7.4	1.9%
Impairment of intangible assets							
<b>Total operating expenses</b>	<b>(456.2)</b>	<b>(25.4)%</b>	<b>(558.4)</b>	<b>(25.9%)</b>	<b>(587.7)</b>	<b>(97.0)</b>	<b>(25.0%)</b>
<b>Research and Product Development</b>							

Our research and product development expenses primarily consist of employee wages, share-based compensation and welfare benefits for our game development teams, as well as the cost of software and the depreciation of the computers and equipment used by those teams.

In 2014, we expect our research and product development expenses to increase as we expect the average labor cost for developers to increase and we expect an increase in headcount as a result of our efforts in the development of webgames and mobile game.



## **Table of Contents**

### ***Sales and Marketing***

Our sales and marketing expenses primarily consist of advertising, including television and internet portal advertisements, and advertisements on flat screens on subways and buses. Our sales and marketing expenses also include employee wages, share-based compensation, and welfare benefits for our sales and marketing team, cost of promotional events, and purchase of promotional souvenirs.

### ***General and Administrative***

Our general and administrative expenses primarily consist of salary, benefits and share-based compensation for our general management, finance and administrative personnel, as well as professional service fees and other expenses. We expect our general and administrative expenses to decrease in 2014 due to a decrease in share-based compensation expense as a result of the application of our accelerated amortization accounting policy to restricted share grants made in 2011.

### ***Government Financial Incentives***

The government financial incentives that Zhengtu Information, Zhengduo Information, Zhengju Information, Jujia Network, Juhuo Network, and Giant Network receive from the Shanghai local government are calculated with reference to their sales tax and enterprise income tax. Although the financial incentives that we have already received are not subject to repayment to the local government, our eligibility to apply for these incentives in the future is conditional upon these companies maintaining good standing in our present district in Shanghai and the continued qualification of our games as high-tech projects. In addition, our ongoing eligibility for these financial incentives is further subject to the discretion of the Shanghai local government, and either the central government or the local government could at any time terminate or reduce such financial incentives. Because we have no basis to reasonably estimate the amount of financial incentives that we will receive from the government, if any, we recognized these amounts on our income statement only upon receipt of the funds.

## **Income Tax Expense**

### ***Cayman Islands and British Virgin Islands***

Under the current laws of Cayman Islands and British Virgin Islands, the company and its subsidiaries incorporated in the British Virgin Islands, or the BVI, are not subject to tax on their income or capital gains. In addition, there is no income or other tax of the Cayman Islands or the British Islands imposed by withholding or otherwise on any dividend payment to be made to or by the company or its BVI subsidiaries.

### ***Hong Kong***

Giant HK, our wholly owned subsidiary incorporated in Hong Kong, is subject to Hong Kong corporate income tax at a rate of 16.5% on the estimated assessable profits arising in Hong Kong.

### ***China***

All of our online game revenue is generated in China and therefore is subject to China's enterprise income tax. Under the current laws of China, foreign invested companies such as Zhengtu Information, and domestic companies such as Giant Network, are subject to a unified income tax rate of 25%. Various favorable income tax rates are, however, available to qualified enterprises in certain government encouraged sectors. Companies that qualify as a high and new

technology enterprise, or HNTE, a status which is reassessed every three years, are subject to an income tax rate of 15%. In addition, companies that qualify as a software development enterprise are exempt from income tax for the first two years and then subject to a reduced income tax rate of 12.5% for the following three years.

In 2008, the Shanghai government granted HNTE status to Zhengtu Information and Giant Network, which resulted in an income tax rate of 15% for these companies for the three-year period ending December 31, 2010. In 2011, Zhengtu Information successfully renewed its HNTE status, thereby extending its 15% tax rate through December 31, 2013. However, Giant Network's HNTE status was not renewed. The change in HNTE status of Giant Network in 2011 did not have a material impact on our effective tax rate as the substantial majority of Giant Network's net revenues were paid to our PRC subsidiaries pursuant to contractual arrangements. For a summary of these contractual arrangements see Item 4.C, Information on the Company Organizational Structure

In 2011, the Shanghai government recognized Jujia Network, Juhuo Network and Zhengju Information, as software development enterprises. In 2012, the tax authority exempted Jujia Network and Juhuo Network from income tax for 2011 and 2012, and reduced the tax rate from 25% to 12.5% for the following three years from 2013 to 2015. In 2013, the tax authority exempted Zhengju Information from income tax for 2012 and 2013, and reduced the tax rate from 25% to 12.5% for the following three years from 2014 to 2016. Although most of our other PRC entities were subject to the standard income tax rate of 25% in 2011, 2012 and 2013, the contribution to our income from these entities was not material in those years.

---

**Table of Contents**

Under the current laws of China, the profits of a foreign-invested enterprise that are distributed to its immediate holding company outside the PRC are subject to a withholding tax rate of 10%. A lower withholding tax rate is applied if there is a tax treaty or arrangement between the PRC and the jurisdiction of the foreign holding company. For example, holding companies in Hong Kong that own more than 25% of the equity interest in a PRC company are subject to a 5% withholding tax rate if the Hong Kong holding companies are regarded as the beneficial owners of such dividends. Accordingly, dividends that were previously paid by Zhengtu Information to Eddia International were subject to a 10% withholding tax, and dividends paid by our PRC subsidiaries to Giant HK are subject to a 5% withholding tax provided that Giant HK is treated as the beneficial owner of the dividends. Following the reorganization of Zhengtu Information that we completed in May 2013, our entire equity interest in Zhengtu Information previously held by Eddia International and Giant HK is now held by Giant HK. Accordingly, any dividends paid by Zhengtu Information to Giant HK from retained earnings accumulated after the reorganization are subject to a 5% withholding tax. See Risk Factors-Risks Related to the Regulation of Our Business- The PRC EIT Law will affect tax exemptions on the dividends we receive and we may not be able to obtain certain treaty benefits on such dividends.

**Net Income (Loss) Attributable to Non-Controlling Interests**

Net income (loss) attributable to non-controlling interests, primarily relates to the non-controlling interests in our various game development studios following our studio reorganization. Several of our games are supported by game development studios that are 51% owned by us and 49% owned by the relevant key members of the studios, including ZT Online 2 which is supported by Jujia Network and World of Xianxia which is supported by Juhuo Network. Accordingly, the non-controlling shareholders of Jujia Network and Juhuo Network are entitled to a portion of the net income generated by the games that they developed and supported. We account for this portion of net income as net income attributable to non-controlling interests. For a summary of the cooperation agreements with our 51% owned game development studios, see Item 4.C, Information on the Company Organizational Structure Sales and Licensing Agreement and Technical Consulting Service Agreement that Transfer Economic Benefits from Giant Network to Our Game Development Studios.

**Critical Accounting Policies**

We prepare our financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities on the date of the financial statements and the reported amounts of net revenues and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that we believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degree of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements as their application places the most significant demands on our management's judgment.

***Revenue Recognition***

We generate our online game revenue from the sale of our prepaid game cards through our distribution network and the sale of game points directly through our official game website. Amounts that we receive for the sale of prepaid game cards prior to their registration to a specific player account are accounted as advances from distributors on our consolidated balance sheet. Once a prepaid game card is registered to a specific player account, amounts received are accounted for as deferred revenues on our consolidated balance sheet. Game points purchased from us on our official game website are automatically credited to the purchaser's game account, and the related purchase price is accounted

for as deferred revenues.

For our free-to-play games, we recognize revenue only after a player uses game points registered to that player's game account to purchase a virtual item or service as follows:

for all virtual services, and consumable virtual items, including those that are consumed at a predetermined time or that otherwise have limitations on repeated use, we recognize revenue either ratably or upon consumption depending on whether services and items are recognized as time-based or usage-based.

for permanent virtual items, or those that are not consumed at a predetermined time or otherwise do not have a limitation on repeated use, we recognize revenue over the estimated lifespan of the virtual item, which is determined on the basis of historical player usage patterns and playing behaviors. However, when the estimated lifespan of certain permanent virtual items is unable to be reasonably determined, the related revenues are recognized over the estimated lifespan of the game. The range of the estimated useful lives is three to four years.

for unused non-permanent consumable items, we recognize revenues immediately once the designated player is deemed inactive.

## **Table of Contents**

Future player usage patterns may differ from the historical usage patterns on which our revenue recognition is based, particularly as our games mature and provide additional operating data, which enables us to refine our estimates. Nevertheless, we are committed to continually monitoring each of our games' actual operational statistics and usage patterns, comparing these actual statistics with our original estimates and refining our estimates and assumptions when they are materially different from the actual statistics.

### ***Licensing Revenues***

We license certain of our games to overseas third-party operators. The royalty income is determined based on an agreed upon percentage of game points consumed by the players with accounts registered with the game vendors, net of applicable withholding tax, which becomes fixed and determinable at the time actual usage occurs. The related royalty income is recognized on a monthly basis as the game vendors confirm their sales activities for the period, provided that the collectability is reasonably assured.

### ***Consolidation of Variable Interest Entity***

We have adopted ASC Subtopic 810-10 Consolidation: Overall, or ASC 810-10. ASC 810-10 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

PRC laws and regulations currently prohibit or restrict foreign-invested companies from providing internet content services, which includes operating online games. To comply with these foreign ownership restrictions, we operate our online game business in China through Giant Network. Giant Network holds the licenses and approvals that are required to operate our online game business. Zhengtu Information has entered into a series of contractual arrangements with Giant Network and its shareholders. Despite the lack of technical majority ownership, there exists a parent-subsidiary relationship between us and Giant Network through an irrevocable proxy agreement, whereby the equity holders of Giant Network effectively assigned all of their voting rights underlying their equity interest in Giant Network to us. As a result of these contractual arrangements, we have the substantial ability to control Giant Network and absorb substantially all the profits and expected losses of Giant Network. Therefore, we are considered the primary beneficiary of Giant Network. Accordingly, Giant Network is a variable interest entity of our company under U.S. GAAP and we consolidate its results in our consolidated financial statements. Any changes in PRC laws and regulations that affect our ability to control Giant Network might preclude us from consolidating Giant Network in the future.

### ***Available-for-Sale Securities***

We have designated our investment in 51.com as available-for-sale securities. Such available-for-sale securities are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income in shareholders' equity. Realized gains or losses are charged to earnings during the period in which the gain or loss is realized. If we determine a decline in fair value is other-than-temporary, the cost basis of the individual security is written down to fair value as a new cost basis and the amount of the write-down is accounted for as a realized loss. The new cost basis will not be changed for subsequent recoveries in fair value. Determination of whether declines in value are other-than-temporary requires significant judgment. The fair value of our available-for-sale securities were estimated using an enterprise value allocation model, or EVA model. The EVA model requires input of highly subjective assumptions including the expected stock price volatility and the probability of occurrence of certain events. Unfavorable changes in these estimates and assumptions could materially impact our financial position and results of operations. On December 31, 2013, the total fair value of our available-for-sale securities was RMB74.8

million (US\$12.4 million). An unrealized loss of RMB1.6 million (US\$0.3 million) was recognized in other comprehensive income for the year ended December 31, 2013.

***Held-to-Maturity Securities***

The securities that we have the positive intent and ability to hold to maturity are classified as held-to-maturity securities and are stated at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Interest income from the held-to-maturity securities is recognized when earned. Premiums and discounts, if any, are amortized or accreted over the life of the related security as an adjustment to interest income using the effective-interest method. For individual securities classified as held-to-maturity securities, we evaluate whether a decline in fair value below the amortized cost basis is other-than-temporary using estimated fair values of the pledged collaterals or financial guarantees. If we do not intend or are not required to sell an impaired debt security before the recovery of its amortized cost basis, the impairment is considered temporary and the held-to-maturity security continue to be recognized at the amortized cost. When we intend to sell an impaired debt security or it is more likely than not that it will be required to sell prior to recovery of its amortized cost basis, an other-than-temporary impairment loss equal to the entire excess of the debt security's amortized cost basis over its fair value is recognized at the balance sheet date.

---

**Table of Contents*****Long-term Investments***

We account for investments in investees over which we do not have significant influence using the cost method of accounting in accordance with ASC subtopic 325-20 Investments-Other: Cost Method Investments, or ASC 325-20. Pursuant to ASC 325-20, we carry the investments at cost and only adjust for other-than-temporary declines in fair value and distributions of earnings. We regularly evaluate the impairment of cost method investments based on the performance and financial position of the investee as well as other evidence of estimated market values. Such evaluation includes, but is not limited to, reviewing an investee's cash position, recent financing, projected and historical financial performance, cash flow forecasts and current and future financing needs. An impairment loss is recognized in the consolidated statements of comprehensive income equal to the excess of the investment's cost over its fair value at the balance sheet date of the reporting period for which the assessment is made. The fair value would then become the new cost basis of investment. We did not recognize any impairment loss on long-term investments for the year ended December 31, 2013.

***Investment in Equity Investees***

Investments in equity investees represent investments in entities in which the company can exercise significant influence but does not own a majority equity interest or control, and are accounted for using the equity method of accounting in accordance with ASC subtopic 323-10 Investments-Equity Method and Joint Ventures: Overall, or ASC 323-10.

Under the equity method, we initially record an investment at cost and prospectively recognize our proportionate share of each equity investee's net income or loss on its consolidated statements of comprehensive income. The difference between the cost of the equity investee and the amount of the underlying equity in the net assets of the equity investee is recognized as equity method goodwill included in equity method investment on the consolidated balance sheets. We also evaluate the equity method investments for impairment under ASC 323-10. An impairment loss on the equity method investments is recognized in the consolidated statements of comprehensive income when the decline in value is determined to be other-than-temporary. As of December 31, 2012, the Company recognized an RMB3,211,404 loss for Shanghai Juxi Network Technology Co., Ltd., or Juxi Network as the decline in its value was determined to be other-than-temporary. As of December 31, 2013, there was no impairment charges recorded with respect to investments in our investee companies that are accounted for using the equity method.

***Impairment of Intangible Assets***

We review our intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We assess the recoverability of those intangible assets by comparing the carrying amount to the estimated future undiscounted cash flow associated with them. If the future net undiscounted cash flow is less than the carrying amount of the intangible assets, such intangible assets are considered impaired and an expense is recognized equal to the amount required to reduce the carrying amount of such intangible assets to their then fair value. We recorded impairment charge of RMB13.1 million and RMB 20.1 million (US\$3.3 million) for the year ended December 31, 2012 and 2013, respectively, relating to the abandonment of certain prelaunch projects and one previously launched game that was underperforming.

***Goodwill***

Goodwill represents the excess of the purchase price over the estimated fair value of net tangible and identifiable intangible assets acquired. Our goodwill outstanding at December 31, 2013 was related to our acquisition of three subsidiaries. In accordance with the provisions of ASC subtopic 350 or ASC 350, Goodwill and Other Intangible

Assets, goodwill amounts are not amortized, but rather are tested for impairment at least annually or more frequently if there are indicators of impairment present.

In accordance with ASC 350, we have assigned and assessed goodwill for impairment at the reporting unit level. A reporting unit is an operating segment or one level below the operating segment. We have determined that it has one reporting unit, which is also its only reportable segment.

The performance of the impairment test involves a two-step process. The first step of the impairment test involves comparing the fair value of the reporting unit with its carrying amount, including goodwill. Fair value is primarily determined by computing the future discounted cash flows expected to be generated by the reporting unit. If the carrying value exceeds the fair value, goodwill may be impaired. If this occurs, we perform the second step of the goodwill impairment test to determine the amount of impairment loss. The fair value of the reporting unit is allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of the reporting unit goodwill. If the carrying amount of the goodwill is greater than its implied fair value, the excess is recognized as an impairment loss. The annual goodwill impairment test is performed on December 31 of each year.



## **Table of Contents**

In accordance with Accounting Standards Update No. 2011-08, or ASU 2011-08, Testing Goodwill for Impairment, issued by the Financial Accounting Standards Board, or the FASB, we have the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative test. If we believe, as a result of the qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The qualitative assessment included an in-depth analysis of factors, including general economic conditions, industry and market conditions, financial factors (such as revenue growth) and the price of our ADS, as well as other drivers of a fair value analysis.

No impairment loss was recognized for the years ended December 31, 2011, 2012 and 2013.

## ***Income Taxes***

We follow the liability method in accounting for income taxes in accordance with ASC subtopic 740-10 Income Taxes: Overall, or ASC 740-10. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect in the year in which the differences are expected to reverse. We record a valuation allowance to offset deferred tax assets if based on the weight of available evidence, it is more-likely-than-not that all or some portion of the deferred tax assets will not be realized. The effect on deferred taxes of a tax rate change is recognized as an increase or decrease to income tax expense during the year in which the change takes effect.

As of December 31, 2013, management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. In the event that the Company determines all or part of the net deferred tax assets are not realizable in the future, the Company will make an adjustment to the valuation allowance which would be charged to earnings in the period when such determination is made. As of December 31, 2013, our deferred tax assets amounted to RMB158.4 million (US\$26.2 million).

## ***Accounting for Uncertain Income Tax Positions***

The Company applies the provisions of ASC 740-10 to account for uncertainties in income taxes. ASC 740-10 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold of a tax position required to be met before being recognized in the financial statements. The Company's estimated liability for unrecognized tax benefits are periodically assessed for adequacy and may be affected by changing interpretations of laws, rulings by tax authorities, changes and or developments with respect to tax audits, and the expiration of the statute of limitations. In future periods, these changes in facts and circumstances may require the Company to adjust the recognition and measurement estimates with regard to changes in individual tax positions. Changes in recognition and measurement estimates are recognized in the period when the change occurs. The Company has elected to classify interest and penalties related to an uncertain tax position, if and when required, as part of income tax expense in the Company's consolidated statements of operations and comprehensive income.

## ***Share-Based Compensation***

We have accounted for share-based compensation that we pay to directors, management, employees, consultants and other eligible persons pursuant to the Employee Share Option Scheme, or the 2006 Plan, and the 2007 Performance Incentive Plan, or the 2007 Plan, in accordance with ASC subtopic 718-10 Compensation—Stock Compensation: Overall, or ASC 718-10, and ASC subtopic 505-50 Equity: Equity based Payment to Non-employees, or ASC 505-50. Under the fair value recognition provisions of ASC 718-10, share-based compensation cost is measured at the grant

date and service performance date for share options and restricted shares issued to employees and non-employees, respectively, based on the fair value of the award and is recognized as an expense on an accelerated recognition basis, net of estimated forfeitures, over the requisite service period, which is generally the vesting period.

We use the binomial option pricing model to determine the fair value of our share options. The binomial model requires us to input certain complex and subjective assumptions, including our expected share price volatility over the term of the award, expected employee share option exercise behavior, risk-free interest rates and the expected forfeiture rate. With respect to expected share price volatility, we reference historical volatilities of the shares of several comparable companies. The risk-free interest rate for periods within the life of the share option is based on the U.S. Treasury yield curve in effect at the time of the related grant. We use historical turnover data to estimate the employee forfeiture rate. The fair value of a restricted share is simply the closing price of the unrestricted share as of the valuation date minus the present value of the expected dividends during the vesting period. The risk-free rate for periods within the contractual life of the share is based on the U.S. Treasury yield curve in effect at the time of grant.

**Table of Contents**

If factors change and we employ different assumptions to estimate our share-based compensation expense for new awards in the future, or if we decide to use a different pricing model, our share-based compensation in future periods may differ significantly from what we have recorded in prior periods and could materially affect our gross profit, income from operations, net income and net income per share.

The application of the principles provided in ASC 718-10 may be subject to further interpretation and refinement over time. There are significant differences among pricing models and there is a possibility that we will adopt different pricing models in the future. This may result in a lack of consistency in future periods and materially affect the fair value estimates of our share-based compensation. It may also result in a lack of comparability with other companies that use different models, methods and assumptions.

As of December 31, 2013, the amounts of unrecognized share-based compensation cost related to share-based options and restricted shares issued to employees were RMB0.1 million (US\$0.01 million) and RMB92.9 million (US\$15.3 million). The deferred cost of share-based options and restricted shares are expected to be recognized over a weighted-average vesting period of 0.45 years and 2.19 years, respectively. To the extent the actual forfeiture rate is different from the original estimate, actual share-based compensation related to these awards may be different from the expectation.

**Results of Operations**

	2011		2012		2013		% of Net revenues
	(RMB)	% of Net revenues	(RMB)	% of Net revenues	(RMB)	(US\$)	
	(in millions, except percentages)						
<b>Total net revenue</b>	<b>1,792.2</b>	<b>100.0%</b>	<b>2,152.0</b>	<b>100.0%</b>	<b>2,355.5</b>	<b>389.1</b>	<b>100.0%</b>
Cost of services	(257.2)	(14.4)%	(288.4)	(13.4)%	(298.7)	(49.3)	(12.7)%
<b>Gross profit</b>	<b>1,535.0</b>	<b>85.6%</b>	<b>1,863.6</b>	<b>86.6%</b>	<b>2,056.8</b>	<b>339.8</b>	<b>87.3%</b>
<b>Operating (expenses) income:</b>							
Research and product development	(230.2)	(12.8)%	(326.8)	(15.2)%	(321.0)	(53.0)	(13.6)%
Sales and marketing	(170.0)	(9.5)%	(146.5)	(6.8)%	(175.8)	(29.0)	(7.5)%
General and administrative	(103.7)	(5.8)%	(148.7)	(6.9)%	(135.7)	(22.4)	(5.8)%
Government financial incentives	47.7	2.7%	63.6	3.0%	44.8	7.4	1.9%
<b>Total operating expenses</b>	<b>(456.2)</b>	<b>(25.4)%</b>	<b>(558.4)</b>	<b>(25.9)%</b>	<b>(587.7)</b>	<b>(97.0)</b>	<b>(25.0)%</b>
<b>Income from operations</b>	<b>1,078.8</b>	<b>60.2%</b>	<b>1,305.2</b>	<b>60.7%</b>	<b>1,469.1</b>	<b>242.8</b>	<b>62.3%</b>
Interest income	141.6	7.9%	105.8	4.9%	128.6	21.2	5.5%
Investment income (loss)	3.0	0.2%	(243.6)	(11.3)%	8.2	1.4	0.3%
Other income, net	43.6	2.4%	34.8	1.6%	32.9	5.4	1.4%
<b>Income before income tax expenses</b>	<b>1,267.0</b>	<b>70.7%</b>	<b>1,202.2</b>	<b>55.9%</b>	<b>1,638.8</b>	<b>270.8</b>	<b>69.5%</b>
Income tax expenses	(352.4)	(19.7)%	(124.2)	(5.8)%	(296.6)	(49.0)	(12.6)%
<b>Share of losses of equity investees</b>	<b>(8.2)</b>	<b>(0.5)%</b>	<b>(6.1)</b>	<b>(0.3)%</b>	<b>(6.4)</b>	<b>(1.1)</b>	<b>(0.3)%</b>
<b>Net income</b>	<b>906.4</b>	<b>50.5%</b>	<b>1,071.9</b>	<b>49.8%</b>	<b>1,335.8</b>	<b>220.7</b>	<b>56.6%</b>

*Year Ended December 31, 2013 Compared to Year Ended December 31, 2012*

**Net Revenues.** Our total net revenues increased by 9.5% from RMB2,152.0 million in 2012 to RMB2,355.5 million (US\$389.1 million) in 2013. Net revenues from online games increased 11.3% from RMB2,075.0 million in 2012 to RMB2,309.3 million (US\$381.5 million) in 2013. The increase was mainly attributable to the growth in revenue generated from ZT Online 2 and World of Xianxia. Net revenues from licensing decreased 19.7% from RMB52.2 million in 2012 to RMB41.9 million (US\$6.9 million) in 2013, while other net revenues also decreased from RMB24.8 million in 2012 to RMB4.3 million (US\$0.7 million) in 2013.

**Cost of Services.** Our cost of services increased by 3.6% from RMB288.4 million in 2012 to RMB298.7 million (US\$49.3 million) in 2013. This increase was primarily attributable to the higher costs accrued for the Company's licensed games.

**Gross Profit and Margin.** Our gross profits increased 10.4% from RMB1,863.6 million in 2012 to RMB2,056.8 million (US\$339.8 million) in 2013, primarily due to the increase in our net revenues. Our gross profit margin increased from 86.6% in 2012 to 87.3% in 2013.

**Operating Expenses.** Our operating expenses increased 5.2% from RMB558.4 million in 2012 to RMB587.7 million (US\$97.0 million) in 2013. The increase in our operating expenses was primarily due to higher sales and marketing expenses, and lower government financial incentives, partially offset by a decrease in our general and administrative expenses.

---

**Table of Contents**

**Research and Product Development.** Our research and product development expenses decreased 1.8% from RMB326.8 million in 2012 to RMB321.0 million (US\$53.0 million) in 2013. The decrease in our research and product development expenses was primarily due to decreased share-based compensation expenses related to the restricted shares granted at the end of November 2011, partially offset by an increase in cash compensation due to expansion of the R&D team, regular pay raises and performance based bonuses. We expect our research and product development expenses to increase in 2014 as we continue to expand our game pipeline through internal game development.

**Sales and Marketing.** Our sales and marketing expenses increased 20.0% from RMB146.5 million in 2012 to RMB175.8 million (US\$29.0 million) in 2013. The increase in our sales and marketing expenses was primarily due to the marketing campaigns for World of Xianxia, as well as for the expansion packs for ZT Online 1 and ZT Online 2. Our advertising expenses increased 37.3% from RMB 93.4 million in 2012 to RMB128.3 million (US\$21.2 million) in 2013.

**General and Administrative.** Our general and administrative expenses decreased 8.7% from RMB148.7 million in 2012 to RMB135.7 million (US\$22.4 million) in 2013. The decrease in our general and administrative expenses was primarily due to the decreased share-based compensation related to the restricted shares granted at the end of November 2011.

**Government Financial Incentives.** The amount of government financial incentives we received decreased by 29.6% from RMB63.6 million in 2012 to RMB 44.8 million (US\$7.4 million) in 2013. This financial incentive mainly relates to the refund of business tax, value-added tax, and enterprise income tax from the Shanghai municipal government.

**Income from Operations.** As the result of the foregoing, our income from operations increased 12.6% from RMB1,305.2 million in 2012 to RMB1,469.1 million (US\$242.8 million) in 2013. As a percentage of total net revenues, income from operations increased from 60.7% in 2012 to 62.3% in 2013.

**Interest Income.** Our interest income increased 21.6% from RMB105.8 million in 2012 to RMB128.6 million (US\$21.2 million) in 2013. The increase in our interest income was mainly attributable to the growing cash balance and higher returns on certain short-term investments.

**Investment Income.** In 2013, we recorded investment income of RMB8.2 million (US\$1.4 million), which was primarily due to interest payments from our Minsheng convertible bond and the proceeds from the equity transfer of Glorious Mission.

**Income Tax Expenses.** Our income tax expense increased 138.8% from RMB124.2 million in 2012 to RMB296.6 million (US\$49.0 million) in 2013. The increase in our income tax expense was mainly due to a withholding tax accrued in the fourth quarter 2013 in connection with the repatriation of cash in connection with the payment of cash dividend.

**Net Income (Loss) Attributable to Non-Controlling Interests.** In 2013, our net income attributable to non-controlling interests was RMB82.8 million (US\$13.7 million), compared to a net income attributable to non-controlling interests of RMB78.2 million in 2012. This increase was due to the full year effect in 2013 of revenue sharing with non-controlling shareholders.

**Net Income Attributable to Our Shareholders.** Net income attributable to our shareholders increased 26.1% from RMB993.7 million in 2012 to RMB1,253 million (US\$207 million) in 2013. As a percentage of total net revenues, net income attributable to our shareholders increased from 46.2% in 2012 to 53.2% in 2013, which was mainly due to the

investment loss of RMB240.7 million pertaining to our investment in 51.com which was recorded during the fourth quarter 2012, though the income tax expenses increased in 2013.

**Dividends.** We paid dividends to our shareholders in the amount of RMB446.3 million and RMB972.7 million (US\$160.7 million) in 2012 and 2013, respectively.

***Year Ended December 31, 2012 Compared to Year Ended December 31, 2011***

**Net Revenues.** Our total net revenues increased by 20.1% from RMB1,792.2 million in 2011 to RMB2,152.0 million in 2012. Net revenues from online games increased 22.1% from RMB1,701.4 million in 2011 to RMB2,075.0 million in 2012. The increase was mainly attributable to the growth in revenue generated from ZT Online 2. Net revenues from licensing decreased 4.3% from RMB54.5 million in 2011 to RMB52.2 million in 2012, while other net revenues also decreased from RMB36.3 million in 2011 to RMB24.8 million in 2012.

**Cost of Services.** Our cost of services increased by 12.1% from RMB257.2 million in 2011 to RMB288.4 million in 2012. The increase in our cost of services was primarily attributable to an increase in value-added tax due to the increase in net revenues and an increase in compensation expense for our personnel.

---

**Table of Contents**

**Gross Profit and Margin.** Our gross profits increased 21.4% from RMB1,535.0 million in 2011 to RMB1,863.6 million in 2012, primarily due to the increase in our net revenues. Our gross profit margin increased from 85.6% in 2011 to 86.6% in 2012.

**Operating Expenses.** Our operating expenses increased 22.4% from RMB456.2 million in 2011 to RMB558.4 million in 2012. The increase in our operating expenses was primarily due to an increase in our research and development, or R&D, expenses, and our general and administrative expenses, partially offset by a decrease in our sales and marketing expenses and higher government financial incentives in 2012 as compared to 2011.

**Research and Product Development.** Our research and product development expenses increased 42.0% from RMB230.2 million in 2011 to RMB326.8 million in 2012. The increase in our research and product development expenses was primarily due to the R&D department's expansion to accommodate additional product development, increased cash compensation including regular pay raises and performance based bonuses, and increased share-based compensation expenses related to restricted shares granted at the end of November 2011.

**Sales and Marketing.** Our sales and marketing expenses decreased 13.8% from RMB170.0 million in 2011 to RMB146.5 million in 2012. The decrease in our sales and marketing expenses was primarily due to the significant advertising expense incurred for the launch of ZT Online 2 and Elsword in 2011. Our advertising expenses decreased 11.3% from RMB105.3 million in 2011 to RMB93.4 million in 2012.

**General and Administrative.** Our general and administrative expenses increased 43.4% from RMB103.7 million in 2011 to RMB148.7 million in 2012. The increase in our general and administrative expenses was primarily due to the higher share-based compensation related to the restricted shares granted at the end of November 2011 and fewer reimbursements related to our ADR program in fiscal year 2012 as compared to fiscal year 2011.

**Government Financial Incentives.** The amount of government financial incentives we received increased 33.3% from RMB47.7 million in 2011 to RMB63.6 million in 2012. This financial incentive mainly relates to the refund of business tax, value-added tax, and enterprise income tax from the Shanghai municipal government.

**Income from Operations.** As the result of the foregoing, our income from operations increased 21.0% from RMB1,078.8 million in 2011 to RMB1,305.2 million in 2012. As a percentage of total net revenues, income from operations increased from 60.2% in 2011 to 60.7% in 2012.

**Interest Income.** Our interest income decreased 25.3% from RMB141.6 million in 2011 to RMB105.8 million in 2012. The decrease in our interest income was mainly attributable to the lower interest income earned from a lower cash balance in 2012 compared to 2011, which was caused by the payment of a special cash dividend of US\$3.00 per ADS or ordinary share in September 2011.

**Investment Income (Loss).** In 2012, we recorded investment losses of RMB243.6 million, which was primarily due to the write-down of our investment in 51.com as the decline in its fair value was determined to be other-than-temporary. This investment loss resulted from lower than expected core business revenue and operating cash flow, and delays in research and development activities and planned promotion campaigns for newly launched games.

**Income Tax Expenses.** Our income tax expense decreased 64.8% from RMB352.4 million in 2011 to RMB124.2 million in 2012. The decrease in our income tax expense was mainly due to a one-time withholding tax accrued in the second quarter 2011 in connection with the repatriation of cash for a special cash dividend paid in September 2011, partially offset by the recognition of RMB63.0 million in deferred tax assets (an increase in deferred tax asset on the balance sheet and a corresponding income tax benefit on the income statement).

***Net Income (Loss) Attributable to Non-Controlling Interests.*** In 2012, our net income attributable to non-controlling interests was RMB78.2 million, compared to a net income attributable to non-controlling interests of RMB26.4 million in 2011. This increase was due to the full year effect in 2012 of revenue sharing with non-controlling shareholders, compared with approximately six months of such revenue sharing in 2011.

***Net Income Attributable to Our Shareholders.*** Net income attributable to our shareholders increased 12.9% from RMB880.0 million in 2011 to RMB993.7 million in 2012. As a percentage of total net revenues, net income attributable to our shareholders decreased from 49.1% in 2011 to 46.2% in 2012, which was mainly due to the investment loss of RMB240.7 million pertaining to our investment in 51.com which was recorded during the fourth quarter 2012.



---

**Table of Contents**

*Dividends.* We paid dividends to our shareholders in the amount of RMB4,810.2 million and RMB446.3 million in 2011 and 2012, respectively.

**B. Liquidity and Capital Resources****Cash Flows and Working Capital**

As of December 31, 2013, we had RMB1,021.4 million (US\$168.7 million) in cash and cash equivalents, of which RMB245.1 million (US\$40.5 million) was held by our PRC subsidiaries and was subject to PRC foreign exchange regulations for remitting overseas, RMB455.4 million (US\$75.2 million) was held by the Company's offshore holding companies outside of the PRC and RMB320.9 million (US\$53.0 million) was held by Giant Network, and its subsidiaries. Although we consolidate the results of Giant Network and its subsidiaries in our consolidated financial statements, we do not have direct access to the cash and cash equivalents or future earnings of these entities. However, these cash balances can be indirectly utilized by us for our normal operations pursuant to the contractual arrangements that provide us with the substantial ability to control Giant Network, its subsidiaries and their operations.

In addition, to fund any unforeseen cash requirements, we may need to rely on dividends and other distributions on equity paid by our PRC subsidiaries. PRC regulations currently permit payment of dividends by a PRC company only out of retained earnings as determined in accordance with accounting standards and regulations in China. The significant differences between the retained earnings as determined in accordance with PRC accounting standards as compared to those as presented in our financial statements are mainly due to revenue recognition using a cash basis (under the PRC accounting standards) versus an accrual basis (under US GAAP) and the corresponding impact on deferred tax. As of December 31, 2013, combined retained earnings for our PRC subsidiaries as determined in accordance with PRC accounting standards and US GAAP was RMB3,870.6 million (US\$639.4 million) and RMB3,430.0 million (US\$566.6 million), respectively. In addition, wholly foreign-owned enterprises in China are required to allocate at least 10% of their respective after-tax profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends.

Under the current laws of China, the profits or dividends of a foreign-invested enterprise, when distributed to its immediate holding company outside the PRC, are subject to a withholding tax rate of 10%. A lower withholding tax rate is applied if there is a tax treaty or arrangement between the PRC and the jurisdiction of the foreign holding company. For example, holding companies in Hong Kong that own more than 25% of the equity interest in a PRC company are subject to a 5% withholding tax rate. Accordingly, dividends that our PRC subsidiaries pay Giant HK are subject to a 5% withholding tax, provided that Giant HK can be regarded as the beneficial owner of such dividends. For a discussion of risks relating to tax treaty benefits, see Risk Factors Risks Related to the Regulation of Our Business The PRC EIT Law will affect tax exemptions on the dividends we receive and we may not be able to obtain certain treaty benefits on such dividends.

As of December 31, 2013, total amount of retained earnings of our PRC subsidiaries that are available for distribution to our offshore holding companies as dividends was RMB4,247.0 million (US\$701.5 million). In November 2013, due to a non-binding proposal for privatization from our chairman and another shareholder (and certain of their affiliated entities), we anticipated the repatriation of earnings from our PRC subsidiaries. Under applicable SAFE regulations, the accumulated after-tax profits of our PRC subsidiaries are distributable in foreign currencies to our offshore holding entities, and from such offshore holding entities to us, without further SAFE or any other PRC regulatory approval, provided that our PRC subsidiaries make appropriations for the statutory reserves, withhold applicable taxes on the dividend payments, and comply with certain procedural requirements. As such, we do not expect the SAFE approval requirements to have any material impact on us. As of December 31, 2013, the accrued and unpaid foreign

withholding taxes in relation to the undistributed earnings of all our PRC subsidiaries was US\$58.5 million, which mainly represents the withholding taxes related to the portion of Zhengtu Information's undistributed earnings of US\$537.4 million accumulated prior to December 31, 2013 and Zhengju Information's undistributed earnings of US\$112.5 million accumulated prior to December 31, 2013.

We believe that our current cash and cash equivalents and cash flows from operations will be sufficient to meet our anticipated cash needs for more than 12 months. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments, or acquisitions we may decide to pursue. Under the terms of the Merger Agreement, we are not permitted to pay any dividends or repurchase any of our ordinary shares pending consummation of the going private merger. As a result, on March 16, 2014, our board of directors resolved to suspend our previously announced share repurchase program and dividend policy.

**Table of Contents**

The following table sets forth a summary of our cash flows for the periods indicated:

	<b>For the Year Ended December 31,</b>			
	<b>2011</b>	<b>2012</b>	<b>2013</b>	
	<b>(RMB)</b>	<b>(RMB)</b>	<b>(RMB)</b>	<b>(US\$)</b>
	<b>(in millions)</b>			
Net of cash provided by operating activities	1,274.7	1,491.0	1,486.9	245.6
Net cash provided by (used in) investing activities	1,653.3	27.9	(2,053.3)	(339.2)
Net cash used in financing activities	(4,709.5)	(527.4)	(359.4)	(59.4)
Cash and cash equivalents at the end of the year	950.3	1,943.1	1,021.4	168.7

**Operating Activities**

For 2011, 2012 and 2013, our net cash provided by operating activities primarily resulted from our net income of RMB906.4 million, RMB1,072.0 million and RMB1,335.8 million (US\$220.7 million), respectively. Cash flows from advances from distributors in 2011, 2012 and 2013 were RMB6.8 million cash inflow, RMB11.1 million cash inflow and RMB23.0 million (US\$3.8 million) cash outflow, respectively. Cash flows from deferred revenues in each of these periods was RMB86.4 million cash inflow, RMB43.2 million cash outflow and, RMB119.2 million (US\$19.7 million) cash outflow, respectively. Advances from distributors and deferred revenues represent proceeds that we have received for sales of our prepaid game cards from our distributors and game points purchased on our website that have not yet been recognized as revenues. See [Item 5 Critical Accounting Policies Revenue Recognition Online Game Net Revenues](#) above.

**Investing Activities**

In 2011, our net cash provided by investing activities was RMB1,653.3 million, which was mainly attributable to the maturity of certain short-term investments during the year in the amount of RMB6,047.5 million, partially offset by cash payments for short-term investments in the amount of RMB3,733.3 million, an investment in the amount of RMB317.1 million, an investment in held-to-maturity securities in the amount of RMB100 million, and the purchase of property and equipment in the amount of RMB244.6 million. The RMB100 million held-to-maturity securities relate to a five year trust arrangement with Resources SZITIC Trust Co. Ltd., which used the proceeds from this trust arrangement to finance certain real estate development projects.

In 2012, our net cash provided by investing activities was RMB27.9 million, which was mainly attributable to the maturity during the year of certain short-term investments in the amount of RMB939.0 million, partially offset by cash payments for short-term investments in the amount of RMB758.6 million. RMB600.0 million of the RMB758.6 million short-term investments relate to two trust arrangements with Huaneng Guicheng Trust Co., Ltd., which used both of these trust arrangements to finance certain real estate development projects.

In 2013, our net cash used in investing activities was RMB2,053.3 million (US\$339.2 million), which was mainly attributable to cash payments for short-term investments in the amount of RMB2,839.9 million (US\$469.1 million), partially offset by the maturity during the year of certain short-term investments in the amount of RMB873.8 million (US\$144.3 million). RMB952.0 million (US\$157.3 million) of the RMB2,839.9 million short-term investments relate to an asset management plan with China Minsheng Bank and Minsheng Royal Asset Management Co., Ltd, and RMB1,597.2 million (US\$263.8 million) of the RMB2,839.9 million short-term investments relate to a financial product offered by China Merchants Bank. For a discussion of risks relating to our investment activities, see [Item 3. Key Information Risk Factors Risks Related to Our Business and Industry](#) As an online game company, our

experience with investment activities is limited.

### **Financing Activities**

Our financing activities include paying dividends, repurchasing our shares in the open market and issuing shares upon the exercise of stock options.

In 2011, our net cash used in financing activities was RMB4,709.5 million, which was mainly attributable to dividends paid to shareholders in the amount of RMB4,810.2 million, partially offset by our receipt of RMB138.5 million in proceeds from the exercise of stock options by our officers, directors and employees.

In 2012, our net cash used in financing activities was RMB527.4 million, which was mainly attributable to dividends paid to shareholders in the amount of RMB446.3 million.

## **Table of Contents**

In 2013, our net cash used in financing activities was RMB359.4 million (US\$59.4 million), which was mainly attributable to dividends paid to shareholders in the amount of RMB972.7 million (US\$160.7 million), partially offset by our receipt of RMB27.7 million (US\$4.6 million) in proceeds from the exercise of stock options by our officers, directors and employees.

## **Capital Expenditures**

Our capital expenditures were RMB279.8 million, RMB75.6 million and RMB162.4 million (US\$26.8 million) in 2011, 2012 and 2013, respectively. In 2011, our capital expenditures were primarily related to the purchase and renovation of our office building on Yishan Road which amounted to RMB208.2 million. In 2012, our capital expenditures were mainly used to purchase servers and specific software. In 2013, our capital expenditures were mainly used to purchase servers, land use rights and game licenses. We expect our capital expenditures to increase in 2014 due to our intention to purchase additional game servers and internet software products.

## **C. Research and Development**

In the fourth quarter of 2008, we introduced Win@Giant, an incubation program designed to, among other things, identify, recruit and incentivize talented individuals in the areas of game design and development. Beginning in 2009, in connection with our Win@Giant initiative, we began reorganizing our game development studios by establishing various subsidiaries that are 51% owned by us and 49% owned by the relevant development team members. Each reorganized studio is only focused upon producing and supporting their own internally developed games, which we believe gives them greater incentive to make their games commercially successful. As a result of this reorganization, World of Xianxia is supported by Juhuo Network, and ZT Online 2 is supported by Jujia Network, while other internally developed games are supported by these and other of our 51% owned studios. Our research and product development expenses were RMB230.2 million, RMB326.8 million and RMB321.0 million (US\$53.0 million) in 2011, 2012 and 2013, respectively. For a discussion of risks relating to our game development studio reorganization, see **Risk Factors**. The reorganization of our game development studios could materially and adversely affect our results of operations as a portion of the profits from games developed or operated by these studios will be shared with the non-controlling shareholder of these studios.

## **D. Trend Information**

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the year ended December 31, 2013 that are reasonably likely to have a material adverse effect on our revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

## **E. Off-balance Sheet Arrangements**

We do not have any outstanding off-balance sheet guarantees, interest rate swap transactions or foreign currency contracts. We do not engage in trading activities involving non-exchange traded contracts. In our ongoing business, we do not enter into transactions involving, or otherwise form relationships with, unconsolidated entities or financial partnerships that are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

## **F. Tabular Disclosure of Contractual Obligations**

In April 2011, we committed to invest a total of RMB30.0 million in Innovation Work, an investment fund led by Mr. Kai-Fu Lee that focuses on early-stage internet and technology companies operating in China. As of December 31, 2013, we have invested RMB22.5 million (US\$3.7 million) in Innovation Work. In May 2013, we committed to invest a total of US\$20 million in Yunfeng Fund II, L.P. and we have paid US\$3.29 million as of March 31, 2014.

We entered into operating lease arrangements mainly relating to our office premises and IDC space rental. Payments under operating leases are expensed on a straight-line basis over the periods of the respective leases. The terms of the leases do not contain rent escalation or contingent rents. Our total rental expenses were RMB77.3 million, RMB75.3 million and RMB75.7 million (US\$12.5 million) for the years ended December 31, 2011, 2012 and 2013, respectively.

Our capital commitments for the construction of the additional office space and purchases of property and equipment as of December 31, 2013 were approximately RMB99.3 million (US\$16.4 million).

As of December 31, 2013, we had a commitment to pay licensing fees to a third party of RMB21.2 million (US\$3.5 million), according to previously agreed payment terms.

**Table of Contents**

A summary of our contractual obligations at December 31, 2013 is as follows:

	Contractual Obligations					Total RMB	Total US\$
	Less than 1 Year RMB	1 Year RMB	3 Years RMB	3 to 5 Years RMB	More than 5 Years RMB		
Capital commitments	99,300					99,300	16,403
Operating leases <sup>(1)</sup>	30,209	1,900				32,109	5,304
Licensing fees	21,188					21,188	3,500
Investment commitments	124,550					124,550	20,574
<b>Total</b>	<b>275,247</b>	<b>1,900</b>				<b>277,147</b>	<b>45,781</b>

(1) Operating leases are for office premises and research and development facilities.

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. Directors and Senior Management**

The following table sets forth information regarding our directors and executive officers as of March 31, 2014. The business address of each of our directors and executive officers is 11/F No. 3 Building, No. 700 Yishan Road, Shanghai 200233, People's Republic of China.

Name	Age	Position
Yuzhu Shi	51	Chairman of the Board of Directors
Wei Liu	46	Director, Chief Executive Officer
Xuefeng Ji	35	Director, President
Andrew Y. Yan	57	Independent Director
Jason Nanchun Jiang	41	Independent Director
Peter Andrew Schloss	53	Independent Director
Jazy Zhang	45	Chief Financial Officer
Shiliang Song	36	Chief Technology Officer
Min Tang	44	Vice President of Media and Human Resources
Yonghua Lu	53	Vice President of Sales and Marketing
Yongjun Fei	46	Vice President of Office Administration, Legal Affairs and Intellectual Property Rights
Guoqiang Ding	35	Vice President of Research and Development
Cheng Peng	32	Vice President of Research and Development
Meng Wu	29	Vice President of Research and Development

*Mr. Yuzhu Shi* is the chairman of our board of directors. Mr. Shi served as chief executive officer of our company from its founding until April 2013. Mr. Shi also serves as a director for Giant Investment Co., Ltd., Stone Holding Co., Ltd. and Union Sky Holding Group Limited. He was awarded the "People Who Mattered to China Reform" in 1994, "CCTV Economic People of the Year in China" in 2001 and "Excellent Entrepreneur of Privately-Owned

Enterprise and Hong Kong Redbud Cup Excellent Entrepreneur in 2004. Mr. Shi obtained his bachelor's degree in mathematics from Zhejiang University in 1984.

*Ms. Wei Liu* has been a director of our company since October 2006 and chief executive officer of our company since April 2013. From September 2007 to April 2013, Ms. Liu served as president of our company. Prior to joining us, Ms. Liu was a vice general manager, and later the general manager, of Shanghai Jiante Bio-Technology Co., Ltd. from 2001 to 2004. From 1996 to 2000, Ms. Liu served as an executive general manager at Zhuhai Selan Yidai Co., Ltd. From 1992 to 1995, Ms. Liu served as a secretary, office administrator and vice president of Zhuhai Giant Group. Ms. Liu has also served as a general manager of Shanghai Golden Partner Biotech Co., Ltd from 2004 to 2007. Ms. Liu received her bachelor's degrees in Chinese literature and sociology from Nankai University in 1990, and received her master's degree in business administration from the China Europe International Business School in 2006.

*Mr. Xuefeng Ji* has been the president of our company since April 2013 and a director of our company since September 2013. From April 2012 to April 2013, Mr. Ji served as senior vice president of product development at the company. From September 2009 to April 2012, he served as a vice president primarily in charge of product development, quality control and project management. Mr. Ji acted as the game statistic designer for ZT Online and later the principal designer and project manager of ZT Online from 2005 to 2007. From 2007 to 2009, Mr. Ji acted as the general manager of the ZT Online project division. Mr. Ji received his bachelor's degree in applied mathematics from Fudan University in 2002 and his master's degree in mathematics from Fudan University in 2005.



**Table of Contents**

*Mr. Andrew Y. Yan* has served as an independent director of our company since October 2006. Mr. Yan currently serves as the founding managing partner of SAIF Partners. Prior to joining SAIF, he was the managing director and head of the Hong Kong office of the Emerging Markets Partnership, the management company of AIG Asia Infrastructure Funds from 1994 to 2001. From 1989 to 1994, he worked in the World Bank, Hudson Institute and Sprint International Corporation as an economist, research fellow and director for Asia, respectively, in Washington D.C. From 1982 to 1984, he was the chief engineer at the Jianghuai Airplane Corporation of China. Mr. Yan received his bachelor degree in Engineering from the Nanjing Aeronautic Institute in the PRC in 1982 and received his master of arts degree in International Political Economy from Princeton University in 1989. Mr. Yan was a recipient of China's 2012 National A Thousand Talents Program and is currently a member of its evaluation committee. He is a founding director of China Venture and Private Equity Association, and a director of Peking University Endowment Investment Committee. He was voted by the China Venture Capital Association as The Venture Investor of the Year in both 2004 and 2007. He was also selected as one of the Fifty Finest Private Equity Investors in the World by Private Equity International in 2007, and as No. 1 Venture Capitalist of the Year by Forbes (China) in 2008 and 2009. He was also selected as the Venture Capital Professional of the Year by Asia Venture Capital Journal in 2009. Mr. Yan is also currently an independent non-executive director of China Resources Land Ltd., CPMC Holdings Limited, China Petroleum & Chemical Corporation and Fosun International Ltd.; and a non-executive director of Digital China Holdings Ltd., China Huiyuan Juice Group Limited, eSun Holdings Limited and Guodian Technology & Environment Group Corporation Limited (all eight companies above-mentioned are listed on the Hong Kong Stock Exchange, and China Petroleum & Chemical Corporation is also listed on the New York Stock Exchange); and a director of Acorn International Inc. (listed on the New York Stock Exchange), ATA Inc. (listed on the Nasdaq) and China Digital TV Holding Co., Ltd. (listed on the Shenzhen Stock Exchange). The Board of Directors has determined that Mr. Yan's other commitments do not interfere with the abilities of Mr. Yan to effectively serve as a director and member of our audit committee.

*Mr. Jason Nanchun Jiang* is an independent director of our company. He has served as the chairman of the board of directors and chief executive officer of Focus Media Holding Limited since 2003. Starting in 2003, Mr. Jiang was general manager of Aiqi Advertising, an advertising company founded by his immediate family members in 1997, which was renamed Focus Media Advertisement in May 2003. Mr. Jiang received a bachelor's degree in Chinese language and literature from Huadong Normal University in 1995.

*Mr. Peter Andrew Schloss* is an independent director of our company. Mr. Schloss is a partner and member of the investment committee of Phoenix Media Fund L.P., a private equity fund established by the Phoenix Television Group (HKSE: 2008). Mr. Schloss is also an independent director and the audit committee chairman of YY Inc. Previously, Mr. Schloss served as the chief executive officer of Allied Pacific Sports Network Limited. From 2004 to 2007, Mr. Schloss was an executive director of TOM Online Inc. He served as chief financial officer of TOM Online Inc. from December 2003 to September 2005 and chief legal officer of TOM Online Inc. from September 2005 to September 2007. Mr. Schloss was the general counsel at IBM China/Hong Kong Corporation from 1989 to 1991. From 1991 to 1996, he was the general counsel of Satellite Television Asian Region Limited, and was a director of that company from 1993 to 1996 as well as director of Asia Satellite Telecommunications Company Limited from November 1991 to June 1993. He was also an investment banker of ING Barings and head of its Asia Media, Internet and Technology Group from 1999 to 2001. Mr. Schloss received a bachelor's degree in political science and a juris doctor degree from Tulane University.

*Ms. Jazy Zhang* joined our company as the chief financial officer in August 2011. Prior to joining us, Ms. Zhang was the chief financial officer of Shanghai Storm Entertainment, a venture capital invested pre-IPO online game company in China from November 2009. From 2005 to 2007, Ms. Zhang served as the director of accounting at Magma Design Automation, Inc. Prior to joining Magma Design Automation, Ms. Zhang held finance and accounting management positions at Nassda Corporation from 2004 to 2005, Brocade Communications, Inc. from 2001 to 2004, and

Tumbleweed Communications from 2000 to 2001, and worked at PricewaterhouseCoopers LLP in Los Angeles and San Jose, California from 1995 to 2000. Ms. Zhang is a U.S. certified public accountant and holds a master of business taxation from the University of Southern California and a bachelor of science in engineering from Shanghai Jiao Tong University.

*Mr. Shiliang Song* has been the chief technology officer of our company since our inception. Prior to joining us, Mr. Song was a senior software engineer of Top Group and IDN Telecommunication Co., Ltd from 2000 to 2002. From 2003 to 2004 Mr. Song was a principal programmer at Shanda Interactive Entertainment Limited. Mr. Song began serving as a supervisor of Giant Network's research and development center in October 2004. Mr. Song studied electronic materials and parts at the University of Electronic Science and Technology of China from 1996 to 2000.

*Ms. Min Tang* is the vice president of media and human resources of our company. Prior to joining us, Ms. Tang served as the assistant general manager, and later manager of administration and media at Shanghai Golden Partner Biotech Co., Ltd from 2004 to 2006, and the media manager of Shanghai Jiante Bio-Technology Co., Ltd from 2002 to 2004. From 1998 to 2000, Ms. Tang was the general manager of Shenzhen Bose Picture Designing Co., Ltd. Ms. Tang served as the vice general manager of Hong Kong Giant Technology Co., Ltd from 1993 to 1998. Ms. Tang graduated from Sichuan Normal University with a major in physics in 1991.

**Table of Contents**

*Mr. Yonghua Lu* is the vice president of sales and marketing of our company. Mr. Lu began to serve as a vice president of Giant Network in 2004. Prior to joining us, Mr. Lu was the director of administration and general manager of the Hangzhou branch of Shanghai Jiante Bio-Technology Co., Ltd from 1998 to 2004. From 1996 to 1998, he was a vice general manager of sales in Zhuhai Tiannian International Technology Co., Ltd. Mr. Lu was a manager of human resources, and later became a vice president of marketing of Zhuhai Giant Hi-Tech Co., Ltd from 1993 to 1996. He was an employee trainer of Hengyang Waver Machinery Factory from 1981 to 1993. Mr. Lu received a degree in journalism from Hunan TV University in 1988. He graduated from the China Europe International Business School in 2009 with an EMBA degree in business administration.

*Mr. Yongjun Fei* is the vice president of office administration, legal affairs and intellectual property rights of our company. Prior to joining us, Mr. Fei was the vice general manager of Shanghai Giant Biotech Co., Ltd. and Shanghai Golden Partner Biotech Co., Ltd from 1999 to 2007. From January to July 1999, Mr. Fei was the general manager of Zhuhai Kangqi Co., Ltd, and a marketing manager of Tongwei Shenzhen Electronic Co., Ltd from 1997 to 1998. Mr. Fei used to be the general manager of several branch companies of Zhuhai Giant Group from 1994 to 1997, and a professor at Tianjin University from 1990 to 1994. Mr. Fei received a bachelor's degree in precise instruments and technology from Tianjin University in 1990 and received his master's degree in business administration from the China Europe International Business School in 2004.

*Mr. Guoqiang Ding* has served as a vice president primarily in charge of project development since April 2010. Prior to joining us, Mr. Ding was a principal game designer in Shengpin Network Technology Co., Ltd from 2003 to 2004. From 2001 to 2002, Mr. Ding served as a principal game designer in Hongzhi Network Technology Co., Ltd. Mr. Ding graduated from Changzhou Institute of Technology with a degree in literature in July 2007.

*Mr. Cheng Peng* has served as a vice president of our company in charge of the ZT Online project division, the overseas operation center and the research institute since January 2011. Prior to joining us, Mr. Peng worked at Shanda Interactive Entertainment Limited as a project director in charge of several top games from 2008 to 2010. Prior to that, he served as a product manager of multiple game products from 2005 to 2007 at Shanda. Mr. Peng graduated from Chengde Petroleum College in July 2004 with a major in computer information management.

*Mr. Meng Wu* has been a vice president of our company in charge of project development, focusing on webgame planning and development, since February 2012. Prior to joining us, from 2007 to 2012 Mr. Wu served as president and a game producer of Dovo Technology, Inc., a webgame developer and operator in China, where he was responsible for project planning and game development. In 2006, Mr. Wu established Fanswo, a leading WEB2.0 community in China and served as chief executive officer of that company.

**B. Compensation****Compensation of Directors and Executive Officers**

In 2013, the aggregate cash compensation paid to our directors and executive officers listed in this annual report was RMB21.0 million (US\$3.5 million). In addition, an aggregate of 550,000 restricted ordinary shares of the Company were granted to our directors and officers in 2013. Our executives are also entitled to pension benefits under PRC law, which we are required to accrue for based on certain percentages of the executives' salaries in accordance with the relevant regulations. These benefits have been properly accrued for as of December 31, 2013.

We have entered into employment agreements with each of our executive officers that provide for severance payments upon termination of employment in certain circumstances. Under these agreements, if an executive officer terminates his or her employment based on one of several conditions, including a material reduction in the executive officer's

compensation or benefits, the officer will be entitled to a severance payment equal to half of his or her annual base salary. In addition, if we terminate the employment of any of our executive officers without cause, the executive officer is also entitled to a severance payment equal to half of his or her annual base salary.

Our board of directors determines remuneration to be paid to directors. The compensation committee assists our board of directors in reviewing and approving the compensation structure for directors. Our current service contracts with our outside directors do not provide them with any benefits upon termination.

### **Equity Incentive Plans**

In order to promote our success and to increase shareholder value by providing an additional means to attract, motivate, retain and reward selected directors, employees and other eligible persons, our board of directors adopted the Employee Share Option Scheme, or the 2006 Plan, in September 2007, and the 2007 Performance Incentive Plan, or the 2007 Plan, in October 2007. The 2006 Plan provided for the issuance of up to 16 million ordinary shares. In October 2007, however, our shareholders suspended the 2006 Plan and all unissued options authorized under the 2006 Plan were returned to the general share pool.

**Table of Contents**

The 2007 Plan initially provided for the issuance of up to 7.8 million ordinary shares, which amount was increased by our board of directors to 10.7 million ordinary shares in August 2010, and to 23.7 million ordinary shares in October 2011. In October 2011, our board of directors also approved the grant of up to 14 million restricted ordinary shares from the 23.7 million ordinary shares reserved for issuance to select employees and officers of the Company, and the reduction of the exercise price for approximately 1.1 million stock options previously granted under the 2007 Plan, to a new exercise price of US\$4.07, which was the closing price of our ADSs on October 28, 2011.

The tables set forth below summarize the outstanding stock options and restricted shares under the 2006 Plan and 2007 Plan as of December 31, 2013.

Exercise Price	Total		
	Outstanding Options	Vested Options	Unvested Options
US\$2.00	0	0	N/A
US\$4.07	690,300	645,300	45,000
<b>Total</b>	<b>690,300</b>	<b>645,300</b>	<b>45,000</b>

Exercise Price	Total		
	Restricted Shares Granted	Restricted Shares Excluding Cancelled	Restricted Shares
N/A	13,997,000	3,796,200	10,200,800

The 2007 Plan is administered by the administrator, which can be our board of directors or one or more committees appointed by the board of directors. Subject to the provisions of the 2007 Plan, the administrator is authorized and empowered to do all things necessary or desirable in connection with the authorization of awards and the administration of the 2007 Plan.

The table below sets forth both the restricted share and option grants made to our directors and executive officers pursuant to the 2006 Plan and 2007 Plan as of December 31, 2013.

Name	Number of		Exercise Price (/share)	Grant Date	Expiration Date
	Restricted Shares	Options			
Wei Liu		108,500	US\$ 2.00	October 1, 2006	September 30, 2012
		500,000	US\$ 2.00	May 15, 2007	September 30, 2013
	1,000,000			November 29, 2011	
Andrew Y. Yan (Director)		500,000	US\$ 4.07**	October 17, 2007	October 12, 2017
	50,000			November 29, 2011	
Jason Nanchun Jiang (Director)		50,000	US\$ 4.07**	October 17, 2007	October 12, 2017
	50,000			November 29, 2011	
Peter Andrew Schloss (Director)		50,000	US\$ 4.07**	October 17, 2007	October 12, 2017

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

	10,000	US\$ 4.07	January 14, 2011	January 14, 2021
	50,000		November 29, 2011	
Jazy Zhang	600,000		November 29, 2011	
	200,000		February 6, 2013	
	200,000		August 13, 2013	
Shiliang Song	750,000	**	October 1, 2006	September 30, 2012
	600,000	US\$ 2.00	May 15, 2007	September 30, 2013
	1,000,000		November 29, 2011	
Min Tang	400,000		November 29, 2011	
Xuefeng Ji	400,000	***	October 1, 2006	September 30, 2012
	100,000	US\$ 2.00	May 15, 2007	September 30, 2013
	2,000,000		November 29, 2011	
Guoqiang Ding	500,000	***	October 1, 2006	September 30, 2012
	200,000	US\$ 2.00	May 15, 2007	September 30, 2013
	1,000,000		November 29, 2011	
Cheng Peng	60,000		June 1, 2010	
	1,000,000		November 29, 2011	
Yongjun Fei	400,000		November 29, 2011	
Meng Wu	250,000		February 1, 2012	
	150,000		October 16, 2013	

\* The amount refers to the number of restricted shares granted to our directors and executive officers, one fifth of which will vest upon each anniversary of the grant date during the five year period following the grant date.

---

## **Table of Contents**

\*\* The exercise price of these options was originally US\$15.50, but our board of directors changed the exercise price to US\$6.36 in September 2010, and then to US\$4.07 in October 2011.

\*\*\* The exercise price of these options was originally RMB16. In October 2006, we reduced the exercise price to RMB0.02 with respect to 150,000 of these options here by Shiliang Song, 80,000 of these options here by Xuefeng Ji and 100,000 of these options here by Guoqiang Ding.

### **Effect of the Going Private Transaction on Outstanding Awards**

If the going private transaction described in Item 4. Information on the Company C. Organizational Structure Going Private Transaction is completed, at the effective time of the merger:

each issued and outstanding option to purchase ordinary shares granted under the share incentive plans will be cancelled and converted into the right to receive, as soon as practicable after the effective time of the merger, an amount equal to the product of (a) the total number of ordinary shares issuable under such option immediately prior to the effective time multiplied by (b) the excess of US\$12.00 over the exercise price payable per ordinary share under such option, in cash, without interest and net of any applicable withholding taxes; and

each restricted share awarded under the share incentive plans that is issued and outstanding (and with respect to which the restrictions have not lapsed) immediately prior to the effective time, or the company restricted shares, will be cancelled and converted into the right to receive, as soon as practicable after the effective time (and in any event no more than five business days after the effective time), an amount equal to US\$12.00, in cash, without interest and net of any applicable withholding taxes.

Notwithstanding the foregoing, we may enter into agreements with certain executive officers (other than Mr. Yuzhu Shi) and certain members of our senior management, collectively referred to as the deferred payment management participants, prior to the completion of the merger. Pursuant to such planned agreements, each deferred payment management participant would agree to a deferred payment arrangement with respect to cash payable to such deferred payment management participant with respect to his or her company restricted shares as contemplated in the Merger Agreement, such cash payment referred to as the company restricted share payment. The deferred payment arrangement will not change the company restricted share payment amount of US\$12.00, in cash, without interest and net of any applicable withholding taxes, payable in respect of each company restricted share as contemplated in the Merger Agreement, but will (i) effectively defer the company restricted share payment for each deferred payment management participant to a future date and (ii) subject such company restricted share payment to similar terms and conditions, including continued employment with the surviving corporation or its relevant subsidiary, as were applicable to the corresponding company restricted shares awarded under the share incentive plans without giving effect to the Merger. We are in the process of finalizing the deferred payment arrangements with the deferred payment management participants.

## **C. Board Practices**

### **Duties of Directors**

Under Cayman Islands law, our directors have a duty of loyalty, which requires them to act honestly and in good faith, with a view to our best interests. Our directors also have a duty to exercise the skill they actually possess and such care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their

duty of care to us, our directors must ensure compliance with our memorandum and articles of association, as amended and re-stated from time to time. A shareholder has the right to seek damages if a duty owed by our directors is breached.

The functions and powers of our board of directors include, among others:

convening shareholders annual general meetings and reporting its work to shareholders at such meetings;

declaring dividends and distributions;

appointing officers and determining their term of office;

exercising the borrowing powers of our company and mortgaging the property of our company; and

approving the transfer of shares of our company, including the registering of such shares in our share register.



## **Table of Contents**

### **Terms of Directors and Executive Officers**

Our officers are elected by and serve at the discretion of the board of directors. Under our articles of association, our directors are elected at general meetings and serve for a term of three years. Our directors' terms are staggered, such that approximately one third of our directors reach the end of their term of office each year. There are no limits on the number of terms a director may serve on our board. A director will be removed from office if, among other things, (i) the director gives notice in writing to us of his or her resignation; (ii) the director, without special leave of absence from the board, is absent from meetings of the board for six consecutive months; (iii) the director becomes bankrupt or makes any arrangement or composition with his or her creditors; (iv) the director dies or is found by our company to be or becomes of unsound mind; (v) the director is prohibited by law from being a director; or (vi) if our members by ordinary resolution resolve that the director should be removed pursuant to our articles of association.

Remuneration paid to our directors is determined by the board of directors, including benefits upon termination, if any.

### **Qualification**

There is no shareholding qualification for directors.

### **Board Committees**

Our board of directors has established an audit committee, a compensation committee and a corporate governance and nominating committee.

#### *Audit Committee*

Our audit committee consists of Peter Andrew Schloss, Jason Nanchun Jiang and Andrew Y. Yan. Mr. Schloss, who has accounting and financial management expertise, is both the chairman of our audit committee and an audit committee financial expert as defined in Item 401(h) of Regulation S-K under the Securities Act. Each member of our audit committee satisfies the independence requirements under Section 303A of the Corporate Governance Rules of the NYSE and Rule 10A-3 under the Exchange Act. The audit committee oversees our accounting and financial reporting processes and the audits of our financial statements. The audit committee is responsible for, among other things:

appointing our independent registered public accounting firm and pre-approving all auditing and non-auditing services permitted to be performed by our independent registered public accounting firm;

reviewing with our independent registered public accounting firm any audit problems or difficulties and management's response;

reviewing and approving all proposed related-party transactions;

reviewing and discussing the annual audited financial statements with management and our independent registered public accounting firm;

reviewing major issues as to the adequacy of our internal controls and any special audit steps adopted in light of material control deficiencies;

annually reviewing and reassessing our audit committee charter;

such other matters that are specifically delegated to our audit committee by our board of directors from time to time;

meeting separately and periodically with management and our independent registered public accounting firm; and

reporting regularly to the board of directors.

*Compensation Committee*

Our compensation committee consists of Peter Andrew Schloss, Jason Nanchun Jiang and Andrew Y. Yan, each of whom satisfy the independence standards of Section 303A of the Corporate Governance Rules of the New York Stock Exchange. Our compensation committee assists the board in reviewing and approving the compensation structure of our directors and executive officers, including all forms of compensation to be provided to our directors and executive officers. Members of the compensation committee are not prohibited from direct involvement in determining their own compensation. Our chief executive officer may not be present at any committee meeting during which her compensation is deliberated. The compensation committee is responsible for, among other things:

determining the compensation package for our executive officers;

reviewing and making recommendations to the board with respect to the compensation of our directors;

## **Table of Contents**

reviewing and approving corporate goals and objectives relevant to the compensation of our chief executive officer, evaluating the performance of our chief executive officer in light of those goals and objectives, and setting the compensation level of our chief executive officer based on this evaluation; and

reviewing periodically and making recommendations to the board regarding any long-term incentive compensation or equity compensation plans, annual bonuses, and employee pension and welfare benefit plans.

### *Corporate Governance and Nominating Committee*

Our corporate governance and nominating committee consists of Jason Nanchun Jiang, Peter Andrew Schloss and Andrew Y. Yan, each of whom satisfy the independence standards of Section 303A of the Corporate Governance Rules of the New York Stock Exchange. The corporate governance and nominating committee assists the board of directors in identifying individuals qualified to become our directors and in determining the composition of the board and its committees. The corporate governance and nominating committee is responsible for, among other things:

identifying and recommending to the board nominees for election or re-election to the board, or for appointment to fill any vacancy;

reviewing annually with the board the current composition of the board in light of the characteristics of independence, qualification, experience and availability;

identifying and recommending to the board which directors should serve as members of the board's committees;

developing and recommending to the board a set of corporate governance guidelines and principles; and

monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

### **Corporate Governance**

Our board of directors has adopted a code of ethics that is applicable to our senior executive and financial officers. In addition, our board of directors adopted a code of conduct that is applicable to all of our directors, officers and employees. Our code of ethics and our code of conduct are publicly available on our website.

In addition, our board of directors has adopted a set of corporate governance guidelines. Although these guidelines reflect certain guiding principles with respect to our board of director's structure, procedures and committees, they are not intended to change or interpret any law, or our amended and restated memorandum and articles of association.

### **Interested Transactions**

A director may vote with respect to any contract or transaction in which he or she is interested, provided that the nature of the director's interest in the contract or transaction is disclosed by him or her at or prior to its consideration by the board.

#### D. Employees

We had approximately 1,643 employees, 1,700 employees and 1,529 employees as of December 31, 2011, 2012 and 2013, respectively. Approximately 86% of our employees have earned at least a junior college degree. The following table shows the number of our employees by position as of December 31, 2013.

	<b>Number of Employees</b>	<b>Percentage of Total (%)</b>
Customer service	334	22%
Product development	835	55%
General and administration	171	11%
Technical and platform support	120	8%
Sales and marketing	69	4%
<b>Total</b>	<b>1,529</b>	<b>100%</b>

As of December 31, 2012, we dismissed all personnel in our sales liaison group, which at the end of 2011 consisted of approximately 420 people. Due to the continued growth of our game points sales through third party online payment systems and our direct partnership with internet cafés, sales liaison personnel's previous job functions have been eliminated.

**Table of Contents**

We enter into a standard three-year employment contract with most of our officers, managers and employees. These contracts include a covenant that prohibits the officer, manager or employee from engaging in any activities that compete with our business during their employment with us. In addition, we enter into an additional non-compete agreements with officers, managers and senior level employees, which generally prohibit them from engaging in activities that compete with our business for two years after their employment with us provided that we satisfy certain payment obligations.

We have developed a number of employee incentives aimed at motivating our employees and retaining talent. These include an employee incentive plan featuring stock options and restricted shares, opportunities for training and career advancement, and a flexible working environment. We also contribute to various employee benefit funds in accordance with relevant PRC laws and regulations, including housing, pension, medical and unemployment benefit plans. To encourage a cohesive and healthy workforce, we regularly organize sports contests and off-site events for our employees.

We recruit new employees by advertising on job-search websites and through cooperation with professional search companies. We actively recruit at universities and colleges to attract new graduates, and hold recruiting sessions in large cities to attract experienced professionals. In addition, we encourage our current employees to refer to us qualified applicants for employment opportunities at our company. Referring employees typically receive a bonus payment for each hired referral.

Our employees who are PRC citizens are members of a labor union that represents employees with respect to labor disputes and other employee matters. The labor union does not, however, represent employees for the purpose of collective bargaining. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes or any difficulty in recruiting staff for our operations.

**E. Share Ownership**

The following table sets forth information with respect to the beneficial ownership, within the meaning of Rule 13d-3 under the Exchange Act, of our ordinary shares, as of April 10, 2014, the most recent practicable date, by:

each of our directors and executive officers who beneficially own our ordinary shares; and

each person known to us to own beneficially more than 5% of our ordinary shares.

Beneficial ownership of our ordinary shares consists of voting power and/or investment power with respect to our ordinary shares. Except as indicated below, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all ordinary shares shown as beneficially owned by them. The percentage of beneficial ownership set forth in the table is based on 240,638,522 ordinary shares outstanding as of April 10, 2014.

Name	Ordinary Shares Beneficially Owned	
	Number	Percent
<b>Directors and Executive Officers</b>		

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Yuzhu Shi <sup>(1)</sup>	106,778,540	44.4%
Wei Liu	*	*
Xuefeng Ji	*	*
Andrew Y. Yan	*	*
Jason Nanchun Jiang	*	*
Peter Andrew Schloss	*	*
Jazy Zhang	*	*
Shiliang Song	*	*
Yonghua Lu	*	*
Min Tang	*	*
Yongjun Fei	*	*
Guoqiang Ding	*	*
Cheng Peng	*	*
Meng Wu	*	*
<b>Other 5% Shareholders</b>		
Citi (Nominees) Limited**	153,369,939	63.7%

\* Upon exercise of options currently exercisable or vested within 60 days after the date of this annual report, would beneficially own less than 1% of our ordinary shares.

---

## **Table of Contents**

\*\* These shares include the shares repurchased by the Company under the authorized share repurchase programs for the period from December 24, 2007 through December 31, 2013.

- (1) Includes (i) 102,000,000 ordinary shares held by Union Sky Holding Group Limited, a British Virgin Islands company owned by Yuzhu Shi, and (ii) 1,890,687 ordinary shares and 2,887,853 ADSs held by Jing Shi, Yuzhu Shi's daughter, on behalf of Yuzhu Shi, through Vogel Holding Group Limited.

None of our shareholders has different voting rights from other shareholders. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company other than the going private transaction as disclosed in Item 4. Information on the Company C. Organizational Structure Going Private Transaction.

## **ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

### **A. Major Shareholders**

Please refer to Item 6.E, Directors, Senior Management and Employees Share Ownership .

### **B. Related Party Transactions**

#### **Contractual Arrangements with Giant Network and Its Shareholders**

PRC laws and regulations restrict foreign equity ownership of companies that are engaged in China's online game industry. To comply with these PRC laws and regulations, we operate our online games in China through a series of contractual arrangements with Giant Network, a variable interest entity that is 80% owned by our chairman Yuzhu Shi, and the shareholders of Giant Network. For a description of these contractual arrangements, see Item 4.C, Information on the Company Organizational Structure .

#### **Contractual Arrangements Regarding the Reorganization of Our Game Development Studios**

In 2009, in connection with our Win@Giant initiative, we began reorganizing our game development studios by establishing various subsidiaries that are 51% owned by us and 49% owned by the key members of the relevant development team. Each reorganized studio is only focused on producing and supporting internally developed games, which we believe gives them greater incentive to make their games commercially successful. As a result of this reorganization, and through these contractual arrangements, ZT Online 2 is supported by Jujia Network, World of Xianxia is supported by Juhuo Network and some of our other internally developed games are supported by these and other of our 51% owned studios. For a description of these contractual arrangements, see Item 4.C, Information on the Company Organizational Structure .

#### **Equity Interests Transfer from Zhengduo Information to Giant Network**

Pursuant to the Online Game Measures issued by the MOC in June 2010, all domestic online games must be registered with the MOC within 30 days after their launch, while all imported online games are subject to a content review procedure and must be approved by the MOC prior to their launch. A game is classified as a domestic game when the copyright is owned by a domestic company, but if the copyright is owned by a foreign-invested enterprise then the game will be classified as an imported game and subject to content review. As a result of these restrictions, we reorganized four game development studios (mainly webpage development studios) from foreign-invested enterprises to domestic companies in order to reduce regulatory delays for their future game launches. Accordingly, in February 2012 Zhengduo Information transferred to Giant Network, in exchange for a purchase price equivalent to the capital investment made by Zhengduo Information, its entire 51% interest in Juhe Network, its entire 40.8% interest in Shanghai Juxian Network Technology Co., Ltd., or Juxian Network, its entire 30% interest in Shanghai Tonghua

Technology Co., Ltd., or Tonghua, and its entire 42% interest in Juxi Network Technology Co., Ltd. or Juxi Network. In March 2013, Giant Network sold its interest in Juxi Network and is therefore no longer a shareholder of Juxi Network.

#### **Loan Agreement with Tonghua**

In March 2012, Zhengduo Information entered into a loan agreement with Tonghua in the amount of RMB6.0 million. In April 2013 and February 2014, Zhengduo Information entered into two additional loan agreements with Tonghua in the amount of RMB6.0 million (US\$1.0 million) and RMB3.72 million (US\$0.6 million), respectively. Zhengduo Information granted these interest-free loans to Tonghua to be used for Tonghua's game development expenses. The time period for the loans are not specified in the agreements, but the loans are to be repaid when Tonghua receives profits from its operations that are equivalent to the amount of the loan agreement.



## **Table of Contents**

### **Transfer of Investment in the Sunshine Insurance Group Corporation, Ltd.**

In April 2011, we committed to invest RMB958.8 million in Sunshine Insurance Group Corporation, Ltd., a privately held insurance company. However, due to investor sentiment, regulatory and other considerations, we unwound this investment commitment in August 2011 by transferring our obligation to Union Sky Holding Group, Ltd, a company wholly-owned by our chairman Mr. Yuzhu Shi, for a purchase price equal to the full amount of the investment commitment plus an amount for interest accrued during the period prior to the transfer.

### **Investment in CMBC Convertible Bond**

In March 2013, we purchased a convertible bond issued by China Minsheng Banking Corp., Ltd., or the CMBC bond, for RMB35.2 million, which may be converted into the bank's A-shares that are traded on the Shanghai Stock Exchange. In May 2013, the investment was sold for a consideration of RMB38.9 million.

### **Transactions with Shanghai Jiante Bio-Technology Co., Ltd.**

We lease our Songjiang District facility, consisting of approximately 7,500 square meters of office space and 91 staff apartments, from Shanghai Jiante, a related party that is controlled by our chairman Mr. Yuzhu Shi. The monthly rent and property management fee for our Songjiang District facility during the six months of 2010 in which we rented the facility, was RMB530,000, which was a reduced rental rate due to the fact that the facilities and grounds were not yet fully operational. In 2011, we contracted with an unrelated third party for property management services. In addition, the monthly rent increased to RMB1,000,000 due to the fact that the remaining construction work on the facilities was completed at the beginning of 2011. In 2012 and 2013, the monthly rent remained unchanged at RMB1,000,000 (US\$165,188).

### **Equity Interests Transfer Agreement from Giant Investment Co., Ltd. and Shanthai Jiante to Zhengtu Information**

In anticipation of long-term growth for our product development and technical and platform support teams, we decided to build additional office buildings in the Songjiang Phase II Area. The State-Owned Construction Land Use Rights for the relevant parcels in the Songjiang Phase II Area were initially recorded in the name of Giant Jiante (Shanghai) Real Estate Co., Ltd., or Jiante Real Estate, and the Songjiang Phase II Area was the sole property of Jiante Real Estate. The registered capital of Jiante Real Estate is RMB35.0 million, of which Giant Investment Co., Ltd. accounted for 95% and Shanghai Jiante accounted for 5%. In August 2013, Zhengtu Information, Giant Investment and Shanghai Jiante entered into an equity interests transfer agreement, under which Zhengtu Information agreed to purchase, and Giant Investment and Shanghai Jiante agreed to sell, 100% of the equity interests of Jiante Real Estate at a price of RMB16.0 million (US\$2.6 million). This purchase price was based on a valuation report assessment provided by a professional valuation company, Shanghai Xinmin Asset Valuation Co., Ltd. and reflected the total net asset value of Jiante Real Estate as of the date of the equity interest transfer agreement.

### **Software Intellectual Property Transfer Agreement between Beijing Giant Zhengtu and Giant Network**

Pursuant to the software intellectual property agreement dated September 1, 2013 between Beijing Giant Zhengtu and Giant Network, Beijing Giant Zhengtu, the registered holder of the software intellectual property of King of King III V2.0, agreed to transfer all its intellectual property rights in the King of King III V2.0 to Giant Network for a consideration of approximately RMB 11.7 million (US\$1.9 million).

### **Investment in Minsheng Royal Baoteng Asset Custody Plan**

In August and September 2013, in order to ensure the safety of our capital and improve the applicable capital yield, Zhengtu Information subscribed to the Minsheng Baoteng Asset Custody Plan, or the Baoteng Plan, recommended by China Minsheng Banking Corp., Ltd., or CMBC, a related party in which our chairman, Mr. Yuzhu Shi, served as a director, with a total subscription price of RMB952.0 million. The lock-up period of the Baoteng Plan is one year from the date of subscription and the estimated annualized rate of return is 6.0%. Zhengtu Information terminated the Baoteng Plan in the first quarter of 2014. As the Baoteng Plan was terminated before its maturity, we were subject to an annualized early termination fee of approximately 1.20% of the subscription amount.

On January 28, 2014, Zhengju Information separately subscribed the Baoteng Plan with a subscription price of RMB6.0 million. The lock-up period shall end on August 19, 2014 and the annualized rate of return is 6.8%. Mr. Yuzhu Shi resigned from his office as a director of CMBC on March 25, 2014.

---

**Table of Contents**

**Employment Agreements**

See Item 6.B, Directors, Senior Management and Employees Compensation Employment Agreements.

**Share Options**

See Item 6.B, Directors, Senior Management and Employees Compensation Equity Incentive Plans.

**C. Interests of Experts and Counsel**

Not applicable.

**ITEM 8. FINANCIAL INFORMATION**

**A. Consolidated statements and other financial information.**

We have appended consolidated financial statements filed as part of this annual report. See Item 18. Financial Statements.

**Legal Proceedings**

We may from time to time become a party to various legal or administrative proceedings arising in the ordinary course of our business.

On or about March 28, 2014, we became aware that a complaint had been filed by an alleged holder of our ADSs against us, members of our board or directors, Giant Investment Limited and Giant Merger Limited in the United States District Court for the Southern District of New York in connection with the proposed going private transaction, or the Proposed Merger, contemplated by the agreement and plan of merger dated March 17, 2014. The lawsuit is a purported class action brought on behalf of all holders of ADSs and is captioned *Tripp v. Giant Interactive Group Inc., et al* (case no. 14 CV 2177). The representative plaintiff alleges, among other things, that each of our directors breached their fiduciary duties in connection with the Proposed Merger, which plaintiff alleges do not appropriately value our company, were the result of an inadequate process overseen by conflicted directors and include preclusive deal protection devices. The lawsuit also claims that we, Giant Investment Limited and Giant Merger Limited aided and abetted these violations. The complaint purports to seek, among other things, an injunction against the consummation of the Proposed Merger and rescission in the event that the Proposed Merger is consummated prior to the entry of the court's final judgment, an award of unspecified damages, costs and expenses, including attorneys' and experts' fees and expenses, and such other equitable relief that the court deems just and proper. On or about April 14, 2014, we became aware that another class action complaint captioned *Palkon v. Giant Interactive Group Inc., et al* (case no. 14 CV 2556) was filed on behalf of all holders of ADSs in the same court against us, our directors, Giant Investment Limited and Giant Merger Limited alleging that each of our directors breached fiduciary duties by not appropriately valuing our Company in connection with the proposed going private transaction and that we, Giant Investment Limited and Giant Merger Limited aided and abetted these alleged violations. On or about April 22, 2014, we became aware that a third class action complaint captioned *Sutherland, et al. v. Giant Interactive Group Inc., et al* (case no. 14 CV 2826) was filed on behalf of all holders of ADSs in the same court against us, our directors, Giant Investment Limited, Giant Merger Limited, Baring Private Equity Asia and Hony Capital Fund V, L.P., alleging that the proxy statement filed by us in connection with the proposed going private transaction is materially false and misleading and therefore violates Section 14(a) of the Securities Exchange Act of 1934. We and our board of directors believe that the claims in these three complaints are without merit and intend to defend against them vigorously.

One of the conditions to the closing of the Proposed Merger is that no final order by a court or other governmental entity shall be in effect that prohibits the consummation of the Proposed Merger or that makes the consummation of the merger illegal. As such, if the representative plaintiff is successful in obtaining an injunction prohibiting the defendants from completing the Proposed Merger on the agreed-upon terms and such injunction has not been reversed and is non-appealable, then such injunction may prevent the Proposed Merger from becoming effective, or from becoming effective within the expected timeframe. The outcome of this lawsuit is uncertain. An adverse judgment for monetary damages could have an adverse effect on our operations and liquidity. A preliminary injunction could delay or jeopardize the completion of the Proposed Merger, and an adverse judgment granting permanent injunctive relief could indefinitely enjoin completion of the Proposed Merger.

We are currently not aware of any other legal proceeding, investigation or claim which, in the opinion of our management, is likely to have a material adverse effect on our business, financial condition or results of operations.

**Table of Contents****Dividend Policy**

The table below sets forth information with respect to cash dividends that we have paid to our shareholders out of our listed company's net distributable profits, which are determined using an equity method basis of accounting for the standalone listed company financial statements, during the three-year period ending December 31, 2013.

<b>Date Declared by The Board of Directors</b>	<b>Date Paid</b>	<b>Total Amount</b>
February 21, 2011	March 30 and April 8, 2011	RMB270.3 million
August 8, 2011	September 9, 2011	RMB4,539.9 million
February 24, 2012	March 29, 2012 and April 5, 2012	RMB446.3 million
February 22, 2013	July 2 and 3, 2013	RMB629.7 million
August 5, 2013	December 16 and 23, 2013	RMB343.0 million

Commencing in 2013, we had intend to pay regular cash dividends on a semi-annual basis. Under this policy, dividends would have been paid at the discretion of our board of directors. When considering whether to pay a dividend, and the amount of such dividend, if any, our board of directors would consider a variety of factors, including our operations and earnings, capital requirements and surplus, general financial conditions, shareholders' interests and contractual restrictions. Our ability to pay dividends is generally dependent upon our receipt of dividends from Zhengtu Information and Zhengduo Information, our wholly owned subsidiaries in China. In order for Zhengtu Information and Zhengduo Information to pay dividends to us, however, they must comply with the requirements of PRC law. For additional information regarding the PRC rules and regulations applicable to the payment of dividends, see Item 10. Additional Information Exchange Controls Regulation of Foreign Currency Exchange and Dividend Distribution Dividend Distribution.

Holders of ADSs will be entitled to receive dividends, subject to the terms of the depositary agreement, to the same extent as holders of our ordinary shares, less the fees and expenses payable thereunder. Cash dividends will be paid in U.S. dollars.

Under the terms of the merger agreement dated March 17, 2014, entered into between us, Giant Investment Limited and Giant Merger Limited, we are not permitted to pay any dividends or repurchase any shares pending consummation of the merger. As a result, our board of directors has suspended our previously announced dividend policy.

**B. Significant Changes**

Since the date of our audited consolidated financial statements included in this annual report, we entered into a definitive agreement and plan of merger, or the Merger Agreement, on March 17, 2014 with Giant Investment Limited and Giant Merger Limited pursuant to which Giant Investment Limited, a company owned by our chairman Mr. Shi, an affiliate of Baring Private Equity Asia and an affiliate of Hony Capital Fund V, L.P., will acquire all of our outstanding ordinary shares for cash consideration equal to US\$12.00 per ordinary share or per ADS. If completed, the merger will result in us becoming a privately-held company and our ADSs will no longer be listed on the NYSE.

In addition, we entered into an agreement to sell all of our limited partnership interest in Yunfeng E-Commerce Funds, which held all of our interest in the ordinary shares of Alibaba Group Holding Limited, to Tiger Global

Mauritius Fund for approximately US\$199.1 million. The sale was completed on February 14, 2014.

**Table of Contents****ITEM 9. THE OFFER AND LISTING.****A. Offering and listing details.****Price Range of Our ADSs**

Our ADSs are listed for trading on the New York Stock Exchange under the symbol **GA**. The following table sets forth the monthly high and low trading prices of our ADSs on the New York Stock Exchange for the periods indicated:

	<b>High</b>	<b>Low</b>
<b>Annual</b>		
2009	9.57	5.31
2010	8.25	6.03
2011	9.45	3.02
2012	5.66	3.91
2013	11.47	5.50
<b>Quarterly</b>		
First Quarter, 2012	5.20	3.91
Second Quarter, 2012	5.66	4.42
Third Quarter, 2012	5.28	4.20
Fourth Quarter, 2012	5.60	4.95
First Quarter, 2013	6.61	5.50
Second Quarter, 2013	8.64	6.45
Third Quarter, 2013	9.50	7.33
Fourth Quarter, 2013	11.47	8.15
First Quarter, 2014	11.63	10.18
<b>Monthly</b>		
October, 2013	9.60	8.15
November, 2013	11.44	8.18
December, 2013	11.47	10.92
January, 2014	11.31	10.18
February, 2014	11.55	10.93
March, 2014	11.63	11.10
April (through April 25, 2014)	11.79	11.54

On April 25, 2014, the closing sale price of our ADSs as reported on the New York Stock Exchange was US\$11.74 per ADS.

**B. Plan of Distribution**

Not applicable.

**C. Markets**

See Item 9.A above.

**D. Selling Shareholders**

Not applicable.

**E. Dilution**

Not applicable.

**F. Expenses of the Issue**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION.**

**A. Share capital**

Not applicable.



## **Table of Contents**

### **B. Memorandum and Articles of Association**

We incorporate by reference into this annual report the description of our amended and restated memorandum of association contained in our F-1 registration statement (File No. 333-146681) originally filed with the U.S. Securities and Exchange Commission, or the SEC, on October 26, 2007, as amended. Our shareholders adopted our amended and restated memorandum and articles of association by a special resolution on October 26, 2007.

### **C. Material Contracts**

On March 17, 2014, we entered into a definitive agreement and plan of merger, or the Merger Agreement, with Giant Investment Limited and Giant Merger Limited, a wholly owned subsidiary of Giant Investment Limited, pursuant to which Giant Investment Limited, a company owned by our chairman Mr. Shi, an affiliate of Baring Private Equity Asia and an affiliate of Hony Capital Fund V, L.P., will acquire all of our outstanding ordinary shares for cash consideration equal to US\$12.00 per ordinary share or per ADS. The merger, which is currently expected to close during the second half of 2014, is subject to customary closing conditions, including the approval by an affirmative vote of our shareholders representing at least two-thirds of the shares present and voting in person or by proxy as a single class at our shareholders meeting, which will be convened to consider the authorization and approval of the Merger Agreement and the transactions contemplated by the Merger Agreement, including the Proposed Merger, and the other closing conditions specified in the Merger Agreement.

On February 1, 2014, we entered into an agreement to sell all of our limited partnership interest in Yunfeng E-Commerce Funds to Tiger Global Mauritius Fund for approximately US\$199.1 million. The sale was completed on February 12, 2014.

In connection with the secondary offering of 12,650,000 ADSs by some of our shareholder in June 2013, we entered into an underwriting agreement with Morgan Stanley on June 5, 2013, pursuant to which Morgan Stanley acted as the underwriter and agreed to purchase all of the 12,650,000 ADSs offered, representing 12,650,000 of our ordinary shares.

Other than the aforementioned contracts, we have not entered into any material contracts other than in the ordinary course of business and other than those described in Item 4, Information on the Company and in Item 7, Major Shareholders and Related Party Transactions or elsewhere in this annual report on Form 20-F.

### **D. Exchange Controls**

#### **Regulation of Foreign Currency Exchange and Dividend Distribution**

##### ***Foreign Currency Exchange.***

Foreign currency exchange regulation in China is primarily governed by the following rules:

Foreign Exchange Administration Rules (1996), as amended in August 2008, or the Exchange Rules; and

Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules.



## **Table of Contents**

Pursuant to the Exchange Rules, the Renminbi is freely convertible for foreign exchange transactions such as trade, service-related and unilateral transfers, but is not freely convertible for direct investment, loans, investment in securities or other capital account transactions outside China unless the prior approval of the State Administration of Foreign Exchange, or SAFE, is obtained. In addition, enterprises incorporated in China with investments by or in cooperation with foreign enterprises, individuals or entities, or foreign-invested enterprises, may transact in foreign exchange without the approval of SAFE for trade and service-related foreign exchange transactions by providing commercial documents evidencing these transactions. Under the Administration Rules, foreign-invested enterprises that need foreign exchange for the distribution of profits to their shareholders may effect payment from their foreign exchange accounts or purchase and pay foreign exchange rates at the designated foreign exchange banks to their foreign shareholders by producing board resolutions for such profit distribution. Based on their needs, foreign-invested enterprises are permitted to open foreign exchange settlement accounts for current account receipts and payments of foreign exchange along with specialized accounts for capital account receipts and payments of foreign exchange, in each case at certain designated foreign exchange banks.

On August 29, 2008, SAFE promulgated a notice, Circular 142, regulating the conversion by a foreign-invested company of foreign currency into Renminbi by restricting how the converted Renminbi may be used. The notice requires that the registered capital of a foreign-invested company settled in Renminbi converted from foreign currencies may only be used for purposes within the business scope approved by the applicable governmental authority and may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the registered capital of a foreign-invested company settled in Renminbi converted from foreign currencies. The use of such Renminbi capital may not be changed without SAFE's approval, and may not in any case be used to repay Renminbi loans if the proceeds of such loans have not been used. Furthermore, on November 9, 2010, SAFE promulgated the Notice Relating to Strengthening the Administration of Foreign Exchange Businesses, which tightens regulation of the settlement of net proceeds from overseas offerings, such as our offering, and requires (i) that the settlement of net proceeds must be consistent with the uses stated in the prospectus for the offering, and (ii) the submission of relevant board resolutions for the portion of proceeds that fall outside the uses stated in the prospectus.

### ***Dividend Distribution.***

The principal regulations governing distribution of dividends of wholly foreign-owned enterprises include:

The Wholly Foreign-Owned Enterprise Law (1986), as amended in 2000; and

Implementation Rules of the Wholly Foreign-Owned Enterprise Law (1990), as amended in 2001.

Under these regulations, wholly foreign-owned enterprises in China may pay dividends only out of their after-tax profits, after deducting losses for prior years, determined in accordance with PRC accounting standards and regulations and the company's articles of association. In addition, wholly foreign-owned enterprises in China are required to allocate at least 10% of their respective after-tax profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends.

### **Regulation of Foreign Exchange in Certain Onshore and Offshore Transactions**

On October 21, 2005, SAFE issued the Notice on Issues Relating to the Administration of Foreign Exchange in Fundraising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or Notice 75, which became effective as of November 1, 2005.

According to Notice 75:

prior to establishing or assuming control of an offshore company for the purpose of financing that offshore company with assets or equity interests in an onshore enterprise in China, each PRC resident, whether a natural or legal person, must complete the overseas investment foreign exchange registration procedures with the relevant local SAFE branch;

an amendment to the registration with the local SAFE branch is required to be filed by any PRC resident that directly or indirectly holds interests in that offshore company upon either (1) the injection of equity interests or assets of an onshore enterprise to the offshore company, or (2) any overseas fund raising by such offshore company after the injection mentioned in (1) hereabove;

an amendment to the registration with the local SAFE branch is also required to be filed by such PRC resident when there is any material change in the capital of the offshore company that does not involve reverse investment, such as (1) an increase or decrease in its capital, (2) a transfer or swap of shares, (3) a merger or division, (4) a long term equity or debt investment, or (5) the creation of any security interests over the relevant assets located in China.

## **Table of Contents**

Under the relevant rules, failure to comply with the registration procedures set forth in Notice 75 may result in restrictions being imposed on the foreign exchange activities of the relevant onshore company, including the payment of dividends and other distributions to its offshore parent or affiliate and the capital inflow from the offshore entity, and may also subject relevant PRC residents to penalties under the relevant foreign exchange administration regulations.

## **E. Taxation**

### **Cayman Islands Taxation**

The Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty or withholding tax applicable to us or to any holder of our ADSs and ordinary shares. There are no other taxes likely to be material to us levied by the government of the Cayman Islands except for stamp duties, which may be applicable on instruments executed in, or after execution brought within the jurisdiction of the Cayman Islands. No stamp duty is payable in the Cayman Islands on transfers of shares of Cayman Islands companies, except those which hold interests in land in the Cayman Islands. The Cayman Islands is not party to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

Pursuant to Section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, we have obtained an undertaking from the Governor-in-Cabinet:

that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciation shall apply to us or our operations; and

that the aforesaid tax or any tax in the nature of estate duty or inheritance tax shall not be payable on our shares, debentures or other obligations.

The undertaking for us is for a period of twenty years from December 9, 2008.

### **People's Republic of China Taxation**

In accordance with the PRC Enterprise Income Tax Laws, or the EIT Law, enterprises established under the laws of foreign countries or regions and whose place of effective management is located within the PRC territory are considered PRC resident enterprises, subject to PRC income tax at the rate of 25% on worldwide income. The definition of place of effective management shall refer to an establishment that exercises, in substance, overall management and control over, among other things, the production and business, personnel, accounting and properties of an enterprise. The Company, if considered a PRC tax residence enterprise, would be subject to PRC enterprise income tax at the rate of 25% on its worldwide income. Based on the assessment of facts and circumstances available at December 31, 2013, the company is more likely than not a non-PRC tax resident enterprise. Accordingly, the company has not accrued for PRC enterprise income tax for 2013.

Additionally, if the company is considered to be PRC tax residence enterprise, the EIT Law would impose a 10% income tax on dividends payable to our non-PRC shareholders and, while less clear, with respect to gains derived by our non-PRC shareholders from disposition of our shares or ADSs, if such gains are determined to have been derived from sources within China. The EIT Law and its implementing rules are unclear as to how to determine the sources of

such dividends or gains.

---

**Table of Contents**

If we are not deemed to be a PRC resident enterprise, then dividends payable to our non-PRC shareholders and gains from disposition of our shares of ADSs by our non-PRC shareholders will not be subject to PRC income tax withholding. Under the current laws of China, the profits of a foreign-invested enterprise that are distributed to its immediate holding company outside the PRC are subject to a withholding tax rate of 10%. A lower withholding tax rate is applied if there is a tax treaty or arrangement between the PRC and the jurisdiction of the foreign holding company. For example, holding companies in Hong Kong that own more than 25% of the equity interest in a PRC company are subject to a 5% withholding tax rate if the Hong Kong holding companies are regarded as the beneficial owners of such dividends. Accordingly, dividends that were previously paid by Zhengtu Information to Eddia International were subject to a 10% withholding tax, and dividends paid by our PRC subsidiaries to Giant HK are subject to a 5% withholding tax, provided that Giant HK is treated as the beneficiary owner of the dividends. In addition, following the reorganization of Zhengtu Information that we completed in May 2013, our entire equity interest in Zhengtu Information previously held by Eddia International and Giant HK is now held by Giant HK. Accordingly, any dividends paid by Zhengtu Information to Giant HK from retained earnings accumulated after the reorganization are subject to a 5% withholding tax. See Risk Factors Risks Related to the Regulation of Our Business The PRC EIT Law will affect tax exemptions on the dividends we receive and we may not be able to obtain certain treaty benefits on such dividends.

As a result, we accrued a one-time withholding tax in the amount of RMB259.4 million associated with the repatriation of cash for the special dividend paid by Zhengtu Information to Eddia International during the third quarter 2011. In addition, we accrued a withholding tax in the amount of RMB32.3 million associated with a dividend to be paid by Zhengduo Information with respect to 2012 earnings. In 2013, we accrued a withholding tax in the amount of RMB212.0 million (US\$35.0 million) with a dividend to be paid by our PRC subsidiaries.

**U.S. Federal Income Taxation**

This discussion describes certain material U.S. federal income tax consequences to U.S. Holders (as defined below) of the purchase, ownership and disposition of our ADSs and ordinary shares. This discussion does not address any aspect of U.S. federal gift or estate, Medicare tax, or the state, local or non-U.S. tax consequences of an investment in our ADSs and ordinary shares. This discussion applies only to U.S. Holders that hold the ADSs or ordinary shares as capital assets (generally, property held for investment) and does not apply to U.S. Holders who are a member of a class of holders subject to special rules, such as:

dealers in securities or currencies;

traders in securities that elect to use a mark-to-market method of accounting for securities holdings;

banks or certain financial institutions;

insurance companies;

tax-exempt organizations;

partnerships or other entities treated as partnerships or other pass-through entities for U.S. federal income tax purposes or persons holding ADSs or ordinary shares through any such entities;

regulated investments companies or real estate investment trusts;

persons that hold ADSs or ordinary shares as part of a hedge, straddle, constructive sale, conversion transaction or other integrated investment;

persons whose functional currency for tax purposes is not the U.S. dollar;

persons liable for alternative minimum tax; or

persons who actually or constructively own 10% or more of the total combined voting power of all classes of our shares entitled to vote (including ADSs or ordinary shares).

This discussion is based on the U.S. Internal Revenue Code of 1986, as amended, which we refer to in this discussion as the Code, its legislative history, existing and proposed regulations promulgated thereunder, published rulings and court decisions, all as of the date hereof. These laws are subject to change, possibly on a retroactive basis. In addition, this discussion relies on our assumptions regarding the value of our ADSs and ordinary shares and the nature of our business over time.



---

**Table of Contents**

**Prospective purchasers are urged to consult their own tax advisors concerning the particular U.S. federal income tax consequences to them of the purchase, ownership and disposition of our ADSs and ordinary shares, as well as the consequences to them arising under the laws of any other taxing jurisdiction.**

For purposes of the U.S. federal income tax discussion below, U.S. Holder means a beneficial owner of our ADSs or ordinary shares that is:

an individual citizen or resident of the United States for U.S. federal income tax purposes;

a corporation, or other entity taxable as a corporation, that was created or organized in or under the laws of the United States or any state thereof or the District of Columbia;

an estate the income of which is subject to U.S. federal income tax regardless of its source; or

a trust if (a) a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (b) the trust has a valid election in effect to be treated as a U.S. person.

For U.S. federal income tax purposes, income earned through a U.S. or non-U.S. partnership or other flow-through entity is attributed to its owners. Accordingly, if a partnership or other flow-through entity holds ADSs or ordinary shares, the tax treatment of the holder will generally depend on the status of the partner or other owner and the activities of the partnership or other flow-through entity.

**Dividends on ADSs and Ordinary Shares**

Subject to the Passive Foreign Investment Company discussion below, if we make distributions to U.S. Holder, the gross amount of any distributions with respect to their ADSs and ordinary shares (including the amount of any taxes withheld therefrom) will generally be includible in their gross income on the day they actually or constructively receive such income as dividend income if the distributions are made from our current or accumulated earnings and profits, calculated according to U.S. federal income tax principles. We, however, do not intend to calculate earnings and profits in accordance with U.S. federal income tax principles. Accordingly, distributions paid on our ADSs or ordinary shares, if any, will be treated as dividend distributions for U.S. federal income tax purposes.

With respect to non-corporate U.S. Holders, certain dividends received from a qualified foreign corporation may be subject to reduced rate of taxation. A non-U.S. corporation is treated as a qualified foreign corporation with respect to dividends from that corporation on shares (or ADSs backed by such shares) that are readily tradable on an established securities market in the United States. U.S. Treasury Department guidance indicates that our ADSs, which are listed on the NYSE, are readily tradable on an established securities market in the United States. However, our expectation is that our ADSs will no longer be listed in the NYSE beginning the second half of 2014. U.S. Holders should consult their own tax advisors as to the rate of tax that will apply to them with respect to dividend distributions, if any, they receive from us.

Corporations will not be entitled to claim a dividends-received deduction with respect to distributions made by us. Dividends generally will constitute foreign source passive income for purposes of the U.S. foreign tax credit rules.

U.S. Holders should consult their own advisor as to their ability, and the various limitations on their ability, to claim foreign tax credits in connection with the receipt of dividends.

### **Sales and Other Dispositions of ADSs or Ordinary Shares**

Subject to the **Passive Foreign Investment Company** discussion below, when U.S. Holders sell or otherwise dispose of their ADSs or ordinary shares, they will generally recognize capital gain or loss in an amount equal to the difference between the amount realized on the sale or other disposition and their adjusted tax basis in the ADSs or ordinary shares. Any such gain or losses that they recognize will be treated as U.S. source income for foreign tax credit limitation purposes. A U.S. Holder's adjusted tax basis will generally equal the amount the U.S. Holder paid for the ADSs or ordinary shares. Any gain or loss a U.S. Holder recognizes will be long-term capital gain or loss if the U.S. Holder's holding period in our ADSs or ordinary shares is more than one year at the time of disposition. If a U.S. Holder is a non-corporate U.S. Holder, including an individual, any such long-term capital gain will be taxed at preferential rates. U.S. Holder's ability to deduct capital losses will be subject to various limitations.

---

**Table of Contents****Passive Foreign Investment Company**

In general, we will be classified as a passive foreign investment company, or PFIC, in any taxable year if either: (a) the average quarterly value of our gross assets that produce passive income or are held for the production of passive income is at least 50% of the average quarterly value of our total gross assets, or (b) 75% or more of our gross income for the taxable year is passive income (such as certain dividends, interest or royalties). For purposes of the above tests, we will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, at least 25% (by value) of the stock. For purposes of the first test: (a) any cash and cash invested in short-term, interest-bearing, debt instruments, or bank deposits that are readily convertible into cash will generally count as producing passive income or held for the production of passive income, and (b) the total value of our assets is calculated based on our market capitalization.

We believe that we were not PFIC for U.S. federal income tax purposes for our taxable year ended December 31, 2013. However the application of the PFIC rules is subject to uncertainty in several respects, and we must make a separate determination after the close of each taxable year as to whether we were a PFIC for such year. As such, although we intend to conduct our business activities in a manner to reduce the risk of our classification as a PFIC in the future, as we currently hold, and expect to continue to hold, a substantial amount of cash and other passive assets, there can be no assurance that we will not be classified as a PFIC for 2014 or any future taxable year.

If we were a PFIC for any taxable year during which U.S. Holders held ADSs or ordinary shares, certain adverse U.S. federal income tax rules would apply. Such U.S. Holders would generally be subject to additional taxes and interest charges on certain excess distributions we make and on any gain realized on the disposition or deemed disposition of their ADSs or ordinary shares, regardless of whether we continue to be a PFIC in the year in which they receive an excess distribution or dispose of or are deemed to dispose of their ADSs or ordinary shares. Distributions in respect of their ADSs or ordinary shares during a taxable year would generally constitute excess distributions if, in aggregate, they exceed 125% of the average amount of distributions with respect to their ADSs or ordinary shares over the three preceding taxable years or, if shorter, the portion of their holding period before such taxable year.

To compute the tax on excess distributions or any gain, (a) the excess distribution or the gain would be allocated ratably to each day in their holding period, (b) the amount allocated to the current year and any tax year prior to the first taxable year in which we were a PFIC would be taxed as ordinary income in the current year, (c) the amount allocated to other taxable years would be taxable at the highest applicable marginal rate in effect for that year, and (d) an interest charge at the rate for underpayment of taxes for any period described under (c) above would be imposed on the resulting tax liability on the portion of the excess distribution or gain that is allocated to such period. In addition, if we were a PFIC, no distribution that U.S. Holders receive from us would qualify for taxation at the reduced rate discussed in the Dividends on ADSs or ordinary shares section above.

Under certain attribution rules, if we are a PFIC, U.S. Holders will be deemed to own their proportionate share of lower-tier PFICs, and will therefore be subject to U.S. federal income tax on (a) a distribution on the shares of a lower-tier PFIC and (b) a disposition of shares of a lower-tier PFIC, both as if they directly held the shares of such lower-tier PFIC.

If a U.S. Holder makes a mark-to-market election with respect to the ADSs, such holder will include as ordinary income the excess, if any, of the fair market value of the ADSs at the end of each taxable year over their adjusted basis, and will be permitted an ordinary loss in respect of the excess, if any, of the adjusted basis of the ADSs over their fair market value at the end of the taxable year, but only to the extent of the net amount of previously included income as a result of the mark-to-market election. Any gain recognized on the sale or other disposition of the securities will be treated as ordinary income. The mark-to-market election is available only for marketable stock,

which is stock that is traded in other than de minimis quantities on at least 15 days during each calendar quarter on a qualified exchange or other market, as defined in the applicable Treasury regulations. Our ADSs may not be marketable stock because they will no longer be listed on the NYSE during the second half of 2014. In addition, the mark-to-market election will not be available for any lower tier PFIC that is deemed owned pursuant to the attribution rules discussed above. U.S. Holders should consult their tax advisors as to the availability and desirability of a mark-to-market election, as well as the impact of such election on interests in any lower-tier PFICs.

## **Table of Contents**

Alternatively, a U.S. Holder of stock in a PFIC may make a qualified electing fund election with respect to such PFIC to elect out of the tax treatment discussed above. A U.S. Holder that makes a valid qualified electing fund election with respect to a PFIC will include in gross income for a taxable year such holder's pro rata share of the corporation's earnings and profits for the taxable year. However, the qualified electing fund election is available only if the PFIC provides such U.S. Holder with certain information regarding its earnings and profits as required under applicable U.S. Treasury regulations, and we do not intend to prepare or provide the information that would entitle U.S. Holders to make a qualified electing fund election.

Unless otherwise provided by the U.S. Treasury, each U.S. Holder of a PFIC is required to file an annual report containing such information as the U.S. Treasury may require. U.S. holders should consult their own tax advisors as to the application of any information reporting requirements to them resulting from our status as a PFIC.

## **U.S. Information Reporting and Backup Withholding Rules**

In general, dividend payments with respect to the ADSs and ordinary shares and the proceeds received on the sale or other disposition of ADSs and ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service, or the IRS, and to backup withholding (currently imposed at a rate of 28%). Backup withholding will not apply, however, if U.S. Holders provide a taxpayer identification number, certify as to no loss of exemption from backup withholding and otherwise comply with the applicable backup withholding rules. To establish their status as an exempt person, they will generally be required to provide certification on IRS Form W-9. Any amounts withheld from payments to U.S. Holders under the backup withholding rules that exceed their U.S. federal income tax liability will be allowed as a refund or a credit against their U.S. federal income tax liability, provided that they timely furnish the required information to the IRS. Certain individuals holding ADSs and ordinary shares other than in an account at a U.S. financial institution may be subject to additional information reporting requirements.

PROSPECTIVE PURCHASERS OF OUR ADSS AND ORDINARY SHARES ARE ENCOURAGED TO CONSULT THEIR OWN TAX ADVISOR REGARDING THE APPLICATION OF THE U.S. FEDERAL INCOME TAX LAWS TO THEIR PARTICULAR SITUATIONS AS WELL AS ANY TAX CONSEQUENCES RESULTING FROM PURCHASING, HOLDING OR DISPOSING OF OUR ADSS AND ORDINARY SHARES, INCLUDING THE APPLICABILITY AND EFFECT OF THE TAX LAWS OF ANY STATE, LOCAL OR NON-U.S. JURISDICTION AND INCLUDING ESTATE, GIFT AND INHERITANCE LAWS.

## **F. Dividends and Paying Agents**

Not applicable.

## **G. Statement by Experts**

Not applicable.

## **H. Documents on Display**

We previously filed with the U.S. Securities and Exchange Commission, or the SEC, our registration statement on Form F-1.

We have filed this annual report on Form 20-F with the SEC under the Securities Exchange Act of 1934. With respect to each such document filed as an exhibit to this annual report, reference is made to the exhibit for a more complete description of the matter involved.

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

We are subject to the informational requirements of the Exchange Act and file reports and other information with the SEC. Reports and other information which we filed with the SEC, including this annual report on Form 20-F, may be inspected and copied at the SEC's public reference room at 100 F Street, N.E., Washington D.C. 20549.

---

**Table of Contents**

You can also obtain copies of this annual report on Form 20-F by mail from the SEC's Public Reference Section, 100 F Street, N.E., Washington D.C. 20549, at prescribed rates. In addition, copies of this material may be obtained from the SEC's website at <http://www.sec.gov>. The SEC's telephone number is 1-800-SEC-0330.

**I. Subsidiaries Information**

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

**Quantitative and Qualitative Disclosures about Market Risk**

***Interest Rate Risk***

Our exposure to interest rate risk relates to interest rates on our deposits in money market funds and time deposits. We have not used any derivative financial instruments to manage our interest rate risk exposure. Historically, we have not been exposed to material risks due to changes in interest rates on any deposits in money market funds; however, future interest rates on our deposits in money market funds may decrease due to changes in market interest rates. We are currently not engaged in any interest rate hedging activities.

We had RMB2,809.7 million (US\$464.1 million) in fixed-income investments as of December 31, 2013, with a weighted average duration of approximately 0.42 years. A hypothetical one percentage point (100 basis-point) increase in interest rates would have resulted in a decrease of approximately RMB11.9 million (US\$2 million) in the fair value of our fixed-income investments at December 31, 2013.

***Foreign Currency Exchange Rate Risk***

Beginning in July 2005, the Renminbi has fluctuated within a narrow and managed band against a basket of certain foreign currencies. The cumulative depreciation of the U.S. dollar against the Renminbi from July 2005 to December 2013 was approximately 27%. While the international reaction to the Renminbi appreciation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the U.S. dollar. Most of our revenues and costs are denominated in Renminbi, while a portion of our cash, cash equivalents, short-term financial assets, investment in equity investees and available-for-sale securities held by us are denominated in U.S. dollars, the aggregate amount of which was US\$159 million as of December 31, 2013. Our exposure to foreign exchange risk primarily relates to those financial assets denominated in U.S. dollars. A hypothetical 10% decrease in the exchange rate of the U.S. dollar against the Renminbi would have resulted in a decrease of RMB97 million (US\$16 million) in the value of our US dollar-denominated financial assets at December 31, 2013. We have not hedged exposures denominated in foreign currencies using any derivative financial instruments. Any further significant revaluation of the Renminbi against the U.S. dollar may materially affect our revenues, earnings and financial position, and the value of, and any dividends payable on, our ADS in U.S. dollars.

***Inflation***

In recent years, China has not experienced significant inflation, and thus inflation has not had a material impact on our results of operations. According to the National Bureau of Statistics of China, the change in the Consumer Price Index in China was 5.4%, 2.6% and 2.6% in 2011, 2012 and 2013, respectively.





**Table of Contents****ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.****D. American Depositary Shares*****Fees Payable by ADS Holders***

Citibank, N.A., the depository of our ADS program (one ADS represents one common share), which is located at 388 Greenwich Street, 14/F, New York, collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. Depository fees payable in connection with distributions of cash or securities to ADS holders and the depository service fee are charged by the depository to the holders of record of ADSs as of the applicable ADS record date. In the case of cash distributions, the depository fees are generally deducted from the cash being distributed. In the case of distributions other than cash (e.g., stock dividends, rights, etc.), the depository charges the applicable fee to the ADS record date holders concurrent with the distribution. In the case of ADSs registered in the name of the investor (whether certificated or in DRS), the depository sends invoices to the applicable record date ADS holders. In the case of ADSs held in brokerage and custodian accounts via the Depository Trust Company, or DTC, the depository generally collects its fees through the settlement systems provided by DTC (whose nominee is the registered holder of the ADSs held in DTC) from the brokers and custodians holding ADSs in their DTC accounts.

In the event of refusal to pay the depository fees the depository may, under the terms of the deposit agreement, refuse the requested service until payment is received or may set off the amount of the depository fees from any distribution to be made to the ADS holder.

**Fee to be paid by persons depositing or withdrawing shares**

	<b>Services</b>
US\$5.00 per 100 ADSs	Issuance of ADSs.
US\$5.00 per 100 ADS	Cancellation of ADSs.
US\$0.02 per ADS	Distribution of cash dividends.
US\$5.00 per 100 ADS	Distribution of ADSs pursuant to share dividends or other free share distributions
US\$0.02 per ADS	Depository service fee.
As necessary	Expenses of the depository, such as cable, telex, fax transmissions and delivery expenses
As necessary	Any charges incurred by the depository in connection with regulatory requirements applicable to the shares, deposited securities, ADSs or ADRs.
As necessary	Any charges incurred by the depository or its agents for servicing the deposited securities

***Fees Payable by the Depository to Us***

From January 1, 2013 to December 31, 2013, we received from the depository a reimbursement of US\$2.5 million (after tax) for certain expenses related to the maintenance of the ADR program, including our annual stock exchange listing fees and our expenses incurred in connection with investor relations programs.



**Table of Contents**

**PART II.**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES.**

None of these events occurred in any of the years ended December 31, 2011, 2012 and 2013.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS.**

The rights of securities holders and use of proceeds have not been materially modified.

**ITEM 15. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and chief financial officer, undertook an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934), as of the end of the period covered by this report, as required by Rules 13a-15(b) and 15d-15(b). Pursuant to this evaluation, our management, including our chief executive officer and chief financial officer, concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective.

**Management's Annual Report on Internal Control Over Financial Reporting.**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended, for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that a company's receipts and expenditures are being made only in accordance with authorizations of a company's management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of a company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As required by Section 404 and related rules as promulgated by the Securities and Exchange Commission, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013 using criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

Based on this assessment, using the criteria referenced above, management concluded that our internal control over financial reporting was effective as of December 31, 2013.

Our independent registered public accounting firm, Ernst & Young Hua Ming LLP, has issued an attestation report on the Company's internal control over financial reporting as of December 31, 2013, as stated in their report included herein.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the year ended December 31, 2013 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders of Giant Interactive Group Inc.

We have audited Giant Interactive Group Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Giant Interactive Group Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Giant Interactive Group Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Giant Interactive Group Inc. as of December 31, 2012 and 2013, and the related consolidated statements of comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013 of Giant Interactive Group Inc. and our report dated April 29, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young Hua Ming LLP

Shanghai, People's Republic of China  
April 29, 2014

**Table of Contents****ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT.**

Our audit committee consists of Peter Andrew Schloss, Jason Nanchun Jiang and Andrew Y. Yan. Mr. Schloss, who has accounting and financial management expertise, is both the chairman of our audit committee and an audit committee financial expert as defined in Item 401(h) of Regulation S-K under the Securities Act. Each member of our audit committee satisfies the independence requirements under Section 303A of the Corporate Governance Rules of the NYSE and Rule 10A-3 under the Exchange Act.

**ITEM 16B. CODE OF ETHICS.**

Our board of directors has adopted a code of ethics that is applicable to our senior executive and financial officers. In addition, our board of directors adopted a code of conduct that is applicable to all of our directors, officers and employees. Our code of ethics and our code of conduct are publicly available on our website at [www.ga-me.com](http://www.ga-me.com). We will post any amendments to, or waivers from, our Code of Ethics on our website.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Ernst & Young Hua Ming LLP, or Ernst & Young, our independent registered public accounting firm, for the periods indicated. We did not pay any other fees to Ernst & Young during the periods indicated below.

	<b>For the Year Ended December 31,</b>	
	<b>2012</b>	<b>2013</b>
	<b>(In thousands of RMB)</b>	
Audit fees <sup>(1)</sup>	7,500	7,500
Audit-related fees <sup>(2)</sup>	900	1,000
Tax fees <sup>(3)</sup>	65	430
All other fees <sup>(4)</sup>		

- (1) Audit fees include the aggregate fees billed for professional services rendered by Ernst & Young for the audit of our annual consolidated financial statements, as well as for services rendered associated with the audit of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002.
- (2) Audit-related fees represent the aggregate of fees billed for professional services rendered by Ernst & Young for assurance and related services that are not reported under audit fees.
- (3) Tax fees represent the aggregated fees billed for professional services rendered by Ernst & Young for tax planning.
- (4) All other fees represent any fees other than audit fees, audit-related fees and tax fees.

The policy of our audit committee is to pre-approve all audit and non-audit services provided by Ernst & Young. The audit services, audit-related services, tax services and other services associated with the fees set forth above were approved by our audit committee prior to the commencement of services.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.**

None.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.**

In September 2011, our board of directors approved a share repurchase plan with a term of one year pursuant to which we were authorized to repurchase up to US\$50.0 million worth of our ADSs prior to September 30, 2012. In August 2012, our board of directors extended the term of this new share repurchase plan for an additional year, thereby authorizing us to repurchase an amount of our ADS worth up to the remaining balance of the US\$50.0 million authorized in September 2011. We did not, however, repurchase any of our shares in 2013 and this share repurchase plan expired in September.

**ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT.**

Not applicable.



**Table of Contents**

**ITEM 16G. CORPORATE GOVERNANCE.**

**Differences Between Our Current Corporate Governance Practices and the NYSE Corporate Governance Requirements Applicable to Domestic US Companies**

Our American Depositary Shares are listed on the NYSE. As such, we are subject to corporate governance requirements imposed by the NYSE. Under Section 303A of the NYSE's Listed Company Manual, NYSE-listed non-U.S. companies such as ourselves may, in general, follow their home country corporate governance practices in lieu of some of the NYSE corporate governance requirements. A NYSE-listed non-U.S. company is simply required to provide a general summary of the significant differences to its U.S. investors either on the company website or in its annual report distributed to its U.S. investors.

We are committed to a high standard of corporate governance. As such, we endeavor to comply with most of the NYSE corporate governance practices, with the current exception that (i) we are not required by our charter documents, including our amended and restated memorandum of association and articles of association, or applicable law, to obtain shareholder approval for our adoption of, or material revisions to, our equity-compensation plans where our directors consider it in the best interests of the company to do so and when the issue price of shares issued pursuant to such plans is otherwise fair; and (ii) the majority of our board of directors is not comprised of independent directors. In this case, however, our practice is in compliance with the laws of the Cayman Islands.

**ITEM 16H. MINE SAFETY DISCLOSURE.**

Not applicable.

**Table of Contents****PART III.****ITEM 17. FINANCIAL STATEMENTS.**

We have elected to provide financial statements pursuant to Item 18.

**ITEM 18. FINANCIAL STATEMENTS.**

Our consolidated financial statements are included at the end of this annual report.

**ITEM 19. EXHIBITS.**

<b>Exhibit Number</b>	<b>Description of Document</b>
1.1	Memorandum and Articles of Association of Giant Interactive Group Inc. (incorporated by reference to Exhibit 3.1 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
2.1	Specimen Certificate for Common Shares of Giant Interactive Group Inc. (incorporated by reference to Exhibit 4.2 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
2.2	Form of American Depositary Receipt of Giant Interactive Group Inc. (incorporated by reference to Exhibit 4.1 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
2.3	Form of Deposit Agreement among the Giant Interactive Group Inc., Citibank, N.A., and holders and beneficial owners of American Depositary Shares issued thereunder (incorporated by reference to Exhibit 4.3 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
4.1	Employee Share Option Scheme (incorporated by reference to Exhibit 10.1 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
4.2	Forms of option grant agreements for the Employee Share Option Scheme (incorporated by reference to Exhibit 10.2 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
4.3	2007 Performance Incentive Plan (incorporated by reference to Exhibit 10.3 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
4.4	Forms of option grant agreement and SAR grant agreement under the 2007 Performance Incentive Plan (incorporated by reference to Exhibit 10.4 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
4.5	Form of Indemnification Agreement with the directors of Giant Interactive Group Inc. (incorporated by reference to Exhibit 10.5 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).

- 4.6 Form of Employment Agreement for Executive Officers of Giant Interactive Group and Employment Agreement of Yuzhu Shi (incorporated by reference to Exhibit 10.6 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.7 Form of Irrevocable Powers of Attorney of all the recorded shareholders of Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.), namely Yuliang Feng, Haixiao Lin, Wei Liu, Chen Cheng, Lu Zhang, Tao Yue, Fabing Qu, Yonggui Wang, Kai Chen and Shanghai Lanlin Bio-Technology Co., Ltd., dated September 7, 2006 and Irrevocable Powers of Attorney of Lu Zhang (incorporated by reference to Exhibit 10.7 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.8 Purchase Option and Cooperation Agreement among Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.) recorded shareholders of Shanghai Giant Network Technology Co., Ltd., namely Yuliang Feng, Haixiao Lin, Wei Liu, Chen Cheng, Lu Zhang, Tao Yue, Fabing Qu, Yonggui Wang, Kai Chen and Shanghai Lanlin Bio-Technology Co., Ltd, and Shanghai Zhengtu Information Technology Co., Ltd. dated September 7, 2006 (incorporated by reference to Exhibit 10.8 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).

---

**Table of Contents**

- 4.9 Share Pledge Agreement among Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.) recorded shareholders of Shanghai Giant Network Technology Co., Ltd., namely Yuliang Feng, Haixiao Lin, Wei Liu, Chen Cheng, Lu Zhang, Tao Yue, Fabing Qu, Yonggui Wang, Kai Chen and Shanghai Lanlin Bio-Technology Co., Ltd, and Shanghai Zhengtu Information Technology Co., Ltd. dated September 7, 2006 (incorporated by reference to Exhibit 10.9 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.10 Online Game Software Sales and Licensing Agreement between Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.) and Shanghai Zhengtu Information Technology Co., Ltd. dated September 6, 2006 (incorporated by reference to Exhibit 10.10 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.11 Exclusive Technical Consulting and Service Agreement between Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.) and Shanghai Zhengtu Information Technology Co., Ltd. dated September 7, 2006 (incorporated by reference to Exhibit 10.11 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.12 Supplementary Agreement among Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.), recorded shareholders of Shanghai Giant Network Technology Co., Ltd., namely Yuliang Feng, Haixiao Lin, Wei Liu, Chen Cheng, Lu Zhang, Tao Yue, Fabing Qu, Yonggui Wang, Kai Chen and Shanghai Lanlin Bio-Technology Co., Ltd, Shanghai Zhengtu Information Technology Co., Ltd., and Yuzhu Shi (incorporated by reference to Exhibit 10.12 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.13 Supplementary Agreement among Shanghai Giant Network Technology Co., Ltd. (a/k/a Shanghai Zhengtu Network Technology Co., Ltd.), recorded shareholders of Shanghai Giant Network Technology Co., Ltd., namely Yuliang Feng, Haixiao Lin, Wei Liu, Chen Cheng, Lu Zhang, Tao Yue, Fabing Qu, Yonggui Wang, Kai Chen and Shanghai Lanlin Bio-Technology Co., Ltd, Shanghai Zhengtu Information Technology Co., Ltd. and Yuzhu Shi dated August 27, 2007 (incorporated by reference to Exhibit 10.13 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.14 Subscription Agreement between Giant Interactive Group Inc. and Standard Chartered Private Equity Limited (incorporated by reference to Exhibit 10.14 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.15 Registration Rights Agreement between Giant Interactive Group Inc. and Standard Chartered Private Equity Limited (incorporated by reference to Exhibit 10.15 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007).
- 4.16 Translation of Office Lease and Property Management Contract between Shanghai Zhengtu Information Technology Co., Ltd. and Shanghai Jiante Biotechnology Co., Ltd. (incorporated by reference to Exhibit 4.16 from our annual report on Form 20-F for the year ended December 31, 2010, as amended, initially filed with the Commission on June 17, 2011).
- 4.17 Translation of Office Lease Contract between Shanghai Zhengtu Information Technology Co., Ltd. and Shanghai Jiante Bio-Technology Co., Ltd. (incorporated by reference to Exhibit 4.17 from our annual report on Form 20-F for the year ended December 31, 2010, as amended, initially filed with the Commission on June 17, 2011).
- 4.18 Translation of ZT Online 2 User Platform Software Sales and Licensing Agreement between Shanghai Jujia Network Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated August 25, 2011

## Edgar Filing: Giant Interactive Group Inc. - Form 20-F

(initially filed with the Commission on April 23, 2012).

- 4.19 Translation of ZT Online 2 Game Software Distribution and License Agreement between Shanghai Jujia Network Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated August 27, 2011, as amended by a Supplement dated June 20, 2011 (incorporated by reference to Exhibit 4.18 from our annual report on Form 20-F for the year ended December 31, 2011, as amended, initially filed with the Commission on April 23, 2012).
- 4.20 Translation of Giant Online User Platform Software Distribution and License Agreement between Shanghai Juhuo Network Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated June 21, 2011 (incorporated by reference to Exhibit 4.20 from our annual report on Form 20-F for the year ended December 31, 2011, initially filed with the Commission on April 23, 2012).
- 4.21 Sunshine Insurance Investment Transfer Agreement between Union Sky Holding Group, Ltd. and Shanghai Giant Network Technology Co., Ltd. dated August 8, 2011 (incorporated by reference to Exhibit 4.21 from our annual report on Form 20-F for the year ended December 31, 2011, initially filed with the Commission on April 23, 2012).

---

**Table of Contents**

- 4.22 Translation of Supplementary Agreement to the Exclusive Technical Consulting and Service Agreement dated September 7, 2006, between Shanghai Zhengtu Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated January 5, 2012 (incorporated by reference to Exhibit 4.22 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.23 Translation of ZT Online 2 Exclusive Technical Consulting and Service Agreement between Shanghai Zhengju Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated January 5, 2012 (incorporated by reference to Exhibit 4.23 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.24 Translation of Supplementary Agreement No.1 to the ZT Online 2 Exclusive Technical Consulting and Service Agreement between Shanghai Zhengju Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated January 6, 2012 (incorporated by reference to Exhibit 4.24 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.25 Translation of Loan Agreement between Shanghai Zhengduo Information Technology Co., Ltd. and Shanghai Tonghua Network Technology Co., Ltd. dated March 27, 2012 (incorporated by reference to Exhibit 4.25 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.26 Translation of XT Online Game Software Sales and Licensing Agreement between Hangzhou Snow Wolf Software Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated August 13, 2009 (incorporated by reference to Exhibit 4.26 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.27 Translation of Supplementary Agreement No.1 to XT Online Game Software Sales and Licensing Agreement between Hangzhou Snow Wolf Software Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated December 23, 2009 (incorporated by reference to Exhibit 4.27 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.28 Translation of Translation of Supplementary Agreement No.2 to XT Online Game Software Sales and Licensing Agreement between Shanghai Zhengtu Information Technology, Shanghai Giant Network Technology Co., Ltd. and Hangzhou Snow Wolf Software Co., Ltd. dated December 3, 2012 (incorporated by reference to Exhibit 4.28 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.29 Translation of Supplementary Agreement No.3 to XT Online Game Software Sales and Licensing Agreement between Hangzhou Snow Wolf Software Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated March 7, 2013 (incorporated by reference to Exhibit 4.29 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.30 Translation of World of Xianxia Game Software Sales and Licensing Agreement between Shanghai Zhengju Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated March 27, 2012 (incorporated by reference to Exhibit 4.30 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.31 Translation of King of King III Game Software Sales and Licensing Agreement between Beijing Giant Zhengtu Network Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated October 30, 2012 (incorporated by reference to Exhibit 4.31 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

- 4.32 Translation of Elsword and Allods Online Game Software Sales and Licensing Agreement between Shanghai Zhengju Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated April 1, 2012 (incorporated by reference to Exhibit 4.32 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.33 Translation of Equity Interest Transfer Agreement on Tonghua Network between Shanghai Zhengduo Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated February 6, 2012 (incorporated by reference to Exhibit 4.33 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.34 Translation of Equity Interest Transfer Agreement on Juxian Network between Shanghai Zhengduo Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated February 10, 2012 (incorporated by reference to Exhibit 4.34 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).

**Table of Contents**

- 4.35 Translation of Equity Interest Transfer Agreement on Juhe Network between Shanghai Zhengduo Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated February 13, 2012 (incorporated by reference to Exhibit 4.35 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.36 Translation of Equity Interest Transfer Agreement on Juxi Network between Shanghai Zhengduo Information Technology Co., Ltd. and Shanghai Giant Network Technology Co., Ltd. dated March 20, 2012 (incorporated by reference to Exhibit 4.36 from our annual report on Form 20-F for the year ended December 31, 2012, initially filed with the Commission on April 18, 2013).
- 4.37\* Translation of Office Lease and Property Management Contract between Shanghai Jiante Biotechnology Co., Ltd. A and Shanghai Zhengtu Information Technology Co., Ltd dated January 1, 2013.
- 4.38\* Translation of Loan Agreement between Shanghai Zhengduo Information Technology Co., Ltd and Shanghai Tonghua Network Technology Co., Ltd dated April 12, 2013.
- 4.39\* Translation of Convertible Bond Purchase Form between Shanghai Giant Network Technology Co., Ltd and China Minsheng Banking Co., Ltd. dated March 15, 2013.
- 4.40\* Translation of Supplementary Agreement between Shanghai Zhengju Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated April 20, 2013.
- 4.41\* Translation of Supplementary Agreement to the Exclusive Technical Consulting and Service Agreement between Shanghai Zhengtu Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd. dated April 25, 2013.
- 4.42\* Translation of Exclusive Technical Consulting & Service Agreement between Shanghai Zhengju Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated April 25, 2013.
- 4.43\* Translation of Supplementary Agreement to the ZT Online 2 Platform Software Distribution and License Agreement between Shanghai Jujia Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated June 25, 2013.
- 4.44\* Translation of Supplementary Agreement between Shanghai Juhuo Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated June, 2013.
- 4.45\* Translation of Equity Interest Transfer Agreement between Giant Investment Co., Ltd, Shanghai Jiante Bio-technology Co., Ltd and Shanghai Zhengtu Information Technology Co., Ltd dated August 8, 2013.
- 4.46\* Translation of Contract for Technology Transfer between Shanghai Giant Network Technology Co., Ltd and Beijing Giant Zhengtu Network Technology Co., Ltd dated September 1, 2013.
- 4.47\* Translation of Supplementary Agreement between Beijing Giant Zhengtu Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated September 1, 2013.
- 4.48\* Translation of Supplementary Agreement to the Exclusive Technical Consulting and Service Agreement between Shanghai Zhengtu Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd. dated December 5, 2013.
- 4.49\* Translation of Technical Consulting & Service Agreement between Shanghai Jujia Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated December 5, 2013.
- 4.50\* Translation of Platform Software License Agreement between Shanghai Juhuo Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated December 10, 2013.
- 4.51\*



Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Translation of Supplementary Agreement No.2 between Shanghai Juhuo Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated December 10, 2013.

4.52\* Translation of Supplementary Agreement No.3 between Shanghai Juhuo Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated December 10, 2013.

4.53\* Translation of Supplementary Agreement to the Exclusive Technical Consulting and Service Agreement between Shanghai Zhengtu Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd. dated January 2, 2014.

4.54\* Translation of Technical Consulting & Service Agreement between Shanghai Juhuo Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated January 2, 2014.

**Table of Contents**

4.55*	Translation of Supplementary Agreement to the Online Game Distribution and License Agreement between Shanghai Zhengju Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated January 5, 2014.
4.56*	Translation of Supplementary Agreement to the ZT Online 2 Game Software Distribution and License Agreement between Shanghai Zhengju Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated January 5, 2014.
4.57*	Translation of Purchase Terms for Minsheng Royal Asset Management * Minsheng Baoteng [A]-[2013]-[006]Special Asset Management Project between Shanghai Zhengju Information Technology Co., Ltd and Minsheng Royal Asset Management Co., Ltd dated January 28, 2014.
4.58*#	Interest Purchase Agreement between Giant Interactive Group Inc. and Tiger Global Mauritius Fund dated February 1, 2014.
4.59*	Translation of Loan Agreement between Shanghai Zhengduo Information Technology Co., Ltd and Shanghai Tonghua Network Technology Co., Ltd dated February 13, 2014.
4.60*	Translation of Equity Pledge Agreement between Shanghai Lanlin Bio-Technology Co., Ltd, Shanghai Zhengtu Network Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated March 18, 2014.
4.61*	Translation of Supplementary Agreement No.2 to the Exclusive Technical Consulting and Service Agreement between Shanghai Zhengtu Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd. dated March 18, 2014.
4.62*	Translation of Supplementary Agreement No.4 to the Exclusive Technical Consulting and Service Agreement between Shanghai Zhengtu Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd. dated March 18, 2014.
4.63*	Translation of Exclusive Asset Purchase Option Agreement between Shanghai Lanlin Bio-technology Co., Ltd, Shanghai Zhengtu Information Technology Co., Ltd and Shanghai Giant Network Technology Co., Ltd dated March 18, 2014.
8.1*	List of Subsidiaries
11.1	Code of Business Conduct and Ethics (incorporated by reference to Exhibit 99.1 from our F-1 registration statement (File No. 333-146681), as amended, initially filed with the Commission on October 31, 2007)
12.1*	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2*	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1*	CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2*	CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
23.1*	Consent of Grandall Law Firm (Shanghai)
23.2*	Consent of Independent Registered Public Accounting Firm
23.3*	Consent of Jones Lang LaSalle Sallmanns
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed with this annual report

# Confidential treatment has been requested for certain confidential provisions of this exhibit pursuant to Rule 246-2 under the Exchange Act. These confidential provisions will be filed separately with the Commission.

**Table of Contents**

**SIGNATURE**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: April 29, 2014

**GIANT INTERACTIVE GROUP INC.**

Name: /s/ JAZY ZHANG  
**Jazy Zhang**  
Title: **Chief Financial Officer**

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	Page
<b>Financial Statements</b>	
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets as of December 31, 2012 and 2013</u>	F-3 - F-4
<u>Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2011, 2012 and 2013</u>	F-5
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2011, 2012 and 2013</u>	F-6 - F-7
<u>Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2011, 2012 and 2013</u>	F-8 - F-9
<u>Notes to the Consolidated Financial Statements</u>	F-10 - F-63

F-1

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of

Giant Interactive Group Inc.

We have audited the accompanying consolidated balance sheets of Giant Interactive Group Inc. (the Company) as of December 31, 2012 and 2013, and the related consolidated statements of comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Giant Interactive Group Inc. at December 31, 2012 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Giant Interactive Group Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated April 29, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young Hua Ming LLP

Shanghai, The People's Republic of China

April 29, 2014

Table of Contents

**GIANT INTERACTIVE GROUP INC.**  
**CONSOLIDATED BALANCE SHEETS**

		December 31,		
	Note	2012 RMB	2013 RMB	US\$
<b>ASSETS</b>				
<b>Current assets:</b>				
Cash and cash equivalents	2	1,943,061,530	1,021,371,762	168,718,596
Restricted cash	2		10,101,867	1,668,710
Short-term investments	4	739,314,900	2,799,686,050	462,475,189
Accounts receivable (net of allowance of RMB4,131,311 and RMB3,938,700 (US\$650,627) for 2012 and 2013, respectively)		12,106,819	15,647,868	2,584,844
Prepayments and other current assets	5	236,446,037	285,237,701	47,117,912
Due from related parties	20	7,370,022	659,190	108,890
Inventories		333,195		
Deferred tax assets, net	15	157,885,822	147,310,764	24,334,005
<b>Total current assets</b>		<b>3,096,518,325</b>	<b>4,280,015,202</b>	<b>707,008,146</b>
<b>Non-current assets:</b>				
Property and equipment, net	6	340,242,374	355,801,443	58,774,211
Intangible assets, net	7	32,799,853	35,462,653	5,858,013
Land use right	3		48,370,323	7,990,208
Due from research and development entity partners		7,637,000	7,000,000	1,156,318
Due from a related party	20		5,662,621	935,398
Goodwill	8	99,316,001	99,316,001	16,405,835
Long-term investments	9	426,087,585	437,636,564	72,292,410
Available-for-sale security	10	78,740,916	74,772,662	12,351,564
Held-to-maturity securities	11	190,000,000	10,000,000	1,651,882
Deferred tax assets, net	15	25,345,455	11,135,275	1,839,416
Other assets		25,541,335	131,250	21,681
<b>Total non-current assets:</b>		<b>1,225,710,519</b>	<b>1,085,288,792</b>	<b>179,276,936</b>
<b>Total assets</b>		<b>4,322,228,844</b>	<b>5,365,303,994</b>	<b>886,285,082</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>				
<b>Current liabilities:</b>				
Short-term loan	12		613,323,717	101,313,860
Payables and accrued expenses (including payables and	13	238,594,085	211,321,494	34,907,824

accrued expenses of Shanghai Giant Network Technology Co., Ltd. and its consolidated entities ( VIE and its consolidated entities ) without recourse to the Company of RMB63,103,923 and RMB68,497,136 (US\$11,314,921) as of December 31, 2012 and 2013, respectively)				
Advances from distributors (including advances from distributors of VIE and its consolidated entities without recourse to the Company of RMB93,468,209 and RMB70,317,903 (US\$11,615,690) as of December 31, 2012 and 2013, respectively)		93,468,209	70,471,207	11,641,015
Due to a related party (including due to a related party of VIE and its consolidated entities without recourse to the Company of nil and RMB2,000,041 (US\$330,383) as of December 31, 2012 and 2013, respectively)	20	598,953	2,677,106	442,226
Deferred revenue (including deferred revenue of VIE and its consolidated entities without recourse to the Company of RMB470,279,509 and RMB347,524,943 (US\$57,407,031) as of December 31, 2012 and 2013, respectively)		486,024,501	365,783,894	60,423,195
Tax payable (including tax payable of VIE and its consolidated entities without recourse to the Company of RMB4,371,971 and RMB22,209,243 (US\$3,668,706) as of December 31, 2012 and 2013, respectively)		48,121,958	65,107,352	10,754,968
Unrecognized tax benefits (including unrecognized tax benefits of VIE and its consolidated entities without recourse to the Company of RMB6,418,702 and RMB6,418,702 (US\$1,060,294) as of December 31, 2012 and 2013, respectively)	15	47,579,967	47,579,967	7,859,651
Deferred tax liabilities (including deferred tax liabilities of VIE and its consolidated entities without recourse to the Company of RMB2,500,250 and nil as of December 31, 2012 and 2013, respectively)	15	112,282,639	336,719,532	55,622,104
<b>Total current liabilities</b>		1,026,670,312	1,712,984,269	282,964,843
<b>Non-current liabilities:</b>				
Long-term loan			2,928,995	483,836
Deferred tax liabilities	15	32,311,676		
<b>Total liabilities</b>		1,058,981,988	1,715,913,264	283,448,679

*The accompanying notes are an integral part of the consolidated financial statements.*



**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**  
**CONSOLIDATED BALANCE SHEETS**

	Note	2012 RMB	December 31, 2013 RMB	US\$
<b>Commitments and contingencies</b>	24			
<b>Shareholders equity</b>				
Ordinary shares (par value US\$0.0000002 per share; 500,000,000 shares authorized; 273,110,626 shares issued and 239,252,672 shares outstanding as of December 31, 2012; 273,110,626 shares issued and 240,499,872 shares outstanding as of December 31, 2013)		430	430	71
Additional paid-in capital		4,456,659,188	4,530,173,387	748,331,332
Statutory reserves	23	48,596,713	51,135,968	8,447,060
Accumulated other comprehensive loss	18	(368,723,831)	(373,265,071)	(61,658,997)
Retained earnings		1,087,615,133	1,337,146,037	220,880,790
Treasury stock	21	(2,006,420,168)	(1,959,804,269)	(323,736,602)
<b>Total Giant Interactive Group Inc. s equity</b>		3,217,727,465	3,585,386,482	592,263,654
<b>Noncontrolling interests</b>		45,519,391	64,004,248	10,572,749
<b>Total shareholders equity</b>		3,263,246,856	3,649,390,730	602,836,403
<b>Total liabilities and shareholders equity</b>		4,322,228,844	5,365,303,994	886,285,082

*The accompanying notes are an integral part of the consolidated financial statements.*

Table of Contents**GIANT INTERACTIVE GROUP INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

		For the year ended December 31,			
	Note	2011	2012	2013	US\$
		RMB	RMB	RMB	
<b>Net revenue:</b>					
Online games		1,701,343,096	2,074,950,188	2,309,280,670	381,465,991
Licensing revenues		54,537,719	52,186,105	41,901,953	6,921,710
Other revenue, net		36,336,494	24,758,274	4,287,962	708,321
<b>Total net revenue</b>		<b>1,792,217,309</b>	<b>2,151,894,567</b>	<b>2,355,470,585</b>	<b>389,096,022</b>
Cost of services		(257,246,446)	(288,361,076)	(298,660,231)	(49,335,156)
<b>Gross profit</b>		<b>1,534,970,863</b>	<b>1,863,533,491</b>	<b>2,056,810,354</b>	<b>339,760,866</b>
<b>Operating (expenses) income</b>					
Research and product development		(230,209,370)	(326,792,503)	(320,981,132)	(53,022,306)
Sales and marketing		(169,981,540)	(146,452,268)	(175,768,566)	(29,034,899)
General and administrative		(103,727,165)	(148,708,274)	(135,747,942)	(22,423,963)
Government financial incentives	14	47,746,000	63,644,000	44,766,000	7,394,816
<b>Total operating expenses</b>		<b>(456,172,075)</b>	<b>(558,309,045)</b>	<b>(587,731,640)</b>	<b>(97,086,352)</b>
<b>Income from operations</b>		<b>1,078,798,788</b>	<b>1,305,224,446</b>	<b>1,469,078,714</b>	<b>242,674,514</b>
Interest income		141,587,341	105,833,413	128,619,486	21,246,425
Investment income (loss)		3,047,619	(243,626,993)	8,231,124	1,359,685
Other income, net		43,558,342	34,844,307	32,861,183	5,428,281
Income before income tax expenses		1,266,992,090	1,202,275,173	1,638,790,507	270,708,905
Income tax expenses	15	(352,378,221)	(124,203,884)	(296,622,358)	(48,998,523)
Share of losses of equity investees		(8,218,001)	(6,117,163)	(6,388,717)	(1,055,341)
<b>Net income</b>		<b>906,395,868</b>	<b>1,071,954,126</b>	<b>1,335,779,432</b>	<b>220,655,041</b>
Net income attributable to noncontrolling interests		(26,428,994)	(78,234,120)	(82,811,504)	(13,679,486)
<b>Net income attributable to the Company's shareholders</b>		<b>879,966,874</b>	<b>993,720,006</b>	<b>1,252,967,928</b>	<b>206,975,555</b>

**Other comprehensive income (loss),  
net of tax**

Foreign currency translation	(84,727,808)	2,735,104	(2,926,501)	(483,424)
Unrealized holding gains (losses)	(15,997,558)	29,770,851	(1,614,739)	(266,736)

<b>Total other comprehensive income (loss), net of tax</b>	<b>(100,725,366)</b>	<b>32,505,955</b>	<b>(4,541,240)</b>	<b>(750,160)</b>
--	----------------------	-------------------	--------------------	------------------

<b>Comprehensive income</b>	<b>779,241,508</b>	<b>1,026,225,961</b>	<b>1,248,426,688</b>	<b>206,225,395</b>
-----------------------------	--------------------	----------------------	----------------------	--------------------

**Comprehensive income attributable to  
noncontrolling interests**

<b>Comprehensive income attributable to the Company's shareholders</b>	<b>779,241,508</b>	<b>1,026,225,961</b>	<b>1,248,426,688</b>	<b>206,225,395</b>
--	--------------------	----------------------	----------------------	--------------------

**Earnings per share:** 16

Basic	3.79	4.20	5.23	0.86
Diluted	3.79	4.13	5.08	0.84

**Weighted average ordinary shares:**

Basic	232,004,879	236,796,818	239,652,597	239,652,597
Diluted	232,004,879	240,821,127	246,835,259	246,835,259

*The accompanying notes are an integral part of the consolidated financial statements.*

**Table of Contents****GIANT INTERACTIVE GROUP INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the year ended December 31,

	2011	2012	2013	
	RMB	RMB	RMB	US\$
<b>Cash flows from operating activities:</b>				
Net income	906,395,868	1,071,954,126	1,335,779,432	220,655,041
Adjustments for:				
Deferred taxes	83,932,389	(4,859,603)	218,898,411	36,159,442
Share-based compensation expense	29,335,181	119,892,890	67,798,091	11,199,447
Provision for (recovery of) doubtful accounts	(1,877,904)	56,149	1,069,574	176,681
Depreciation of property and equipment	60,877,662	60,669,884	49,458,028	8,169,884
Amortization of intangible assets, land use right and other assets	19,607,751	16,950,387	25,660,701	4,238,846
Loss from disposal of property and equipment	2,034,664	6,614,286	4,169,615	688,771
Impairment of intangible assets		13,066,057	20,100,000	3,320,283
Gain on disposal of long-term investment		(310,120)		
Impairment of long-term investment		3,211,404		
Loss from revaluation of a long-term investment upon reacquisition		303,581		
Other-than-temporary impairment of an available-for-sale security		240,725,709		
Gain on deconsolidation of a subsidiary	(4,993,146)		(4,519,737)	(746,607)
Share of loss of an equity investee	8,218,001	6,117,163	6,388,717	1,055,341
Changes in assets and liabilities:				
(Increase) decrease in accounts receivable	(2,014,362)	2,604,900	(662,717)	(109,473)
(Increase) decrease in prepayments and other current assets	18,024,537	(102,934,410)	(79,240,659)	(13,089,625)
(Increase) decrease in due from related parties	(3,320,543)	(4,155,893)	(5,750,000)	(949,832)
Decrease in due from research-and-development entity partners	3,146,600			
Decrease (increase) in inventories	116,934	(16,176)	333,195	55,040
Decrease (increase) in land use right			(48,786,881)	(8,059,018)
Decrease (increase) in other assets		53,692,457	3,645,417	602,180
(Decrease) increase in payables and accrued expenses	15,133,759	26,718,801	14,616,563	2,414,484
(Decrease) increase in advances from distributors	6,820,714	11,140,540	(22,997,002)	(3,798,834)
Increase in due to a related party	782,830	58,608	2,000,041	330,383
(Decrease) increase in deferred revenue	86,409,383	(43,179,884)	(119,153,831)	(19,682,811)
Increase in income tax payable	16,369,200	9,560,801	18,048,493	2,981,399

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Increase in unrecognized tax benefits	29,692,724	3,128,445		
<b>Net cash provided by operating activities</b>	<b>1,274,692,242</b>	<b>1,491,010,102</b>	<b>1,486,855,451</b>	<b>245,611,022</b>
<b>Cash flows from investing activities:</b>				
Purchase of short-term investments	(3,733,267,990)	(758,558,950)	(2,839,876,023)	(469,114,099)
Maturity of short-term investments	6,047,547,330	938,967,485	873,798,862	144,341,289
Purchase of property and equipment	(244,571,881)	(61,844,999)	(71,241,205)	(11,768,209)
Proceeds from disposal of property and equipment	223,580	234,750	439,880	72,663
Capitalized product development costs and intangible assets	(11,002,249)	(17,150,657)	(33,529,473)	(5,538,674)
Proceeds from disposal of intangible assets	25,000,000			
Purchase of long-term investments	(326,050,000)	(12,950,000)	(17,590,144)	(2,905,685)
Proceeds from disposal of long-term investments		20,805,359		
Proceeds from disposal of an available-for-sale investment			888,600	146,786
Purchase of held-to-maturity securities	(100,000,000)	(100,000,000)	(10,000,000)	(1,651,882)
Proceeds from disposal of held-to-maturity securities		10,000,000	90,000,000	14,866,941
Proceeds from disposal of a subsidiary	(4,608,901)	28,625,000	(17,584,606)	(2,904,770)
Acquisition of a subsidiary, net of cash acquired		(20,231,462)	(28,613,897)	(4,726,679)
<b>Net cash (used in) provided by investing activities</b>	<b>1,653,269,889</b>	<b>27,896,526</b>	<b>(2,053,308,006)</b>	<b>(339,182,319)</b>
<b>Cash flows from financing activities:</b>				
Proceeds from (payments for) exercise of share options	138,511,514	(613,958)	27,722,330	4,579,403
Proceeds from a short-term loan			621,119,907	102,601,699
Proceeds from a long-term loan			2,928,995	483,836
Restricted cash			(10,101,867)	(1,668,710)
Dividends to shareholders	(4,810,164,772)	(446,302,773)	(972,700,107)	(160,678,611)
Dividends to noncontrolling interests	(12,250,000)	(93,100,000)	(59,045,000)	(9,753,539)
Repurchase of shares	(22,960,759)	(22,862,890)		
Capital contribution from noncontrolling interests	937,000	35,642,700	30,682,505	5,068,389
Capital distribution to noncontrolling interests	(3,554,500)	(172,500)		
<b>Net cash used in financing activities</b>	<b>(4,709,481,517)</b>	<b>(527,409,421)</b>	<b>(359,393,237)</b>	<b>(59,367,533)</b>
Effect of exchange rate changes on cash and cash equivalents	(45,095,908)	1,243,295	4,156,024	686,527
<b>Net (decrease) increase in cash and cash</b>	<b>(1,826,615,294)</b>	<b>992,740,502</b>	<b>(921,689,768)</b>	<b>(152,252,303)</b>

**equivalents**

Cash and cash equivalents at the beginning of year	2,776,936,322	950,321,028	1,943,061,530	320,970,899
Cash and cash equivalents at the end of year	950,321,028	1,943,061,530	1,021,371,762	168,718,596

*The accompanying notes are an integral part of the consolidated financial statements.*

Table of Contents**GIANT INTERACTIVE GROUP INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)**

	<b>For the year ended December 31,</b>			
	<b>2011</b>	<b>2012</b>	<b>2013</b>	
	RMB	RMB	RMB	US\$
<b>Supplemental disclosures:</b>				
Income tax paid	(109,454,531)	(117,401,021)	(60,633,264)	(10,015,902)
Withholding income tax paid in association with the repatriation of cash for a special dividend	(111,357,239)			
Tax benefit realized from stock options	6,731,453	14,313,452	9,709,357	1,603,872
Interest received	153,658,020	103,514,928	71,610,810	11,829,263

*The accompanying notes are an integral part of the consolidated financial statements.*

Table of Contents

## GIANT INTERACTIVE GROUP INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Number of Ordinary shares	Ordinary shares RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated other comprehensive loss RMB	Retained earnings RMB	Treasury stock RMB	Total Giant Interactive Group Inc. equity RMB	Noncon inter RM
28,019,412	417	6,087,534,887	43,890,273	(300,504,420)	2,738,731,300	(2,176,792,033)	6,392,860,424	14,78
	13							13
					879,966,874		879,966,874	26,42
								83
								(2,15
								(1,85
								(12,25
				(84,727,808)			(84,727,808)	
				(15,997,558)			(15,997,558)	
8,148,519		99,668,141			(47,960,922)	77,228,476	128,935,695	
			(32,958,749)		32,958,749			
			3,194,295		(3,194,295)			



		(1,599,254)							(1,599,254)
		29,335,181							29,335,181
(932,972)						(22,960,759)			(22,960,759)
		(1,864,676,429)			(2,945,488,343)				(4,810,164,772)
35,234,959	430	4,350,262,526	14,125,819	(401,229,786)	655,013,363	(2,122,524,316)	2,495,648,036	25,700,000	20,700,000
					993,720,006		993,720,006	78,200,000	
									(3,000,000)
									13,900,000
									(93,100,000)
					2,735,104				2,735,104
					(39,364,932)				(39,364,932)
					69,135,783				69,135,783
4,829,650		(28,524,745)			(80,344,569)	138,967,038			30,097,724
			34,470,894		(34,470,894)				
		14,871,384							14,871,384

(72,451)

(72,451)

120,122,474

120,122,474

(811,937)

(22,862,890)

(22,862,890)

(446,302,773)

(446,302,773)

*The accompanying notes are an integral part of the consolidated financial statements.*

F-8

Table of Contents

## GIANT INTERACTIVE GROUP INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (CONT'D)

Number of Ordinary shares	Ordinary shares RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated other comprehensive loss RMB	Retained earnings RMB	Treasury stock RMB	Total Giant Interactive Group Inc. equity RMB	Noncontrolling interests RMB
239,252,672	430	4,456,659,188	48,596,713	(368,723,831)	1,087,615,133	(2,006,420,168)	3,217,727,465	45,519,111
					1,252,967,928		1,252,967,928	82,811,111
		7,210,110					7,210,110	23,472,111
		11,014,467					11,014,467	(14,764,111)
								(13,989,111)
								(59,045,111)
				(2,926,501)			(2,926,501)	
				(1,614,739)			(1,614,739)	
1,247,200		(12,508,469)			(28,197,662)	46,615,899	5,909,768	
			2,539,255		(2,539,255)			
		67,798,091					67,798,091	
					(972,700,107)		(972,700,107)	

240,499,872	430	4,530,173,387	51,135,968	(373,265,071)	1,337,146,037	(1,959,804,269)	3,585,386,482	64,004
-------------	-----	---------------	------------	---------------	---------------	-----------------	---------------	--------

240,499,872	71	748,331,332	8,447,060	(61,658,997)	220,880,790	(323,736,602)	592,263,654	10,572
-------------	----	-------------	-----------	--------------	-------------	---------------	-------------	--------

*The accompanying notes are an integral part of the consolidated financial statements.*

F-9

**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****1. ORGANIZATION AND NATURE OF OPERATIONS**

The accompanying consolidated financial statements include the financial statements of Giant Interactive Group Inc. (the Company or Giant Interactive), its subsidiaries, Shanghai Giant Network Technology Co., Ltd. (Giant Network or the VIE) and its consolidated entities, collectively referred to as the Group.

Giant Interactive was incorporated in the Cayman Islands on July 26, 2006 and became the holding company of the Group.

The Group is mainly engaged in the development and operation of online games in the People's Republic of China (the PRC). The Group primarily develops and operates online games through its PRC subsidiaries and Giant Network.

Details of the Company's subsidiaries, VIE and its consolidated entities as of December 31, 2013 are as follows:

Entities	Date of incorporation/ establishment	Place of incorporation/ establishment	Percentage of shareholding/ ownership	Principal activities
<b>Subsidiaries:</b>				
Eddia International Group Limited (Eddia International)	July 26, 2006	British Virgin Islands (BVI)	100.00%	Investment holding
Shanghai Zhengtu Information Technology Co., Ltd. (Zhengtu Information)	September 6, 2006	PRC	100.00%	Online game development and maintenance
Giant Interactive (HK) Limited (Giant HK)	December 22, 2008	Hong Kong	100.00%	Oversea online game licensing, development, and operation
Zhuhai Zhengtu Information Technology Co., Ltd. (Zhuhai Zhengtu)	February 19, 2009	PRC	100.00%	Online game research and development
Hangzhou Snow Wolf Software Co., Ltd. (Snow Wolf Software)	Acquired on May 18, 2009	PRC	40.76%	Online game research and development
Shanghai Zhengduo Information Technology Co., Ltd. (Zhengduo Information)	July 8, 2009	PRC	100.00%	Online game development and maintenance
	October 20, 2009	PRC	51.00%	

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Shanghai Jujia Network Technology Co., Ltd. ( Jujia Network )				Online game research and development
Shanghai Juhuo Network Technology Co., Ltd. ( Juhuo Network )	November 4, 2009	PRC	51.00%	Online game research and development
Shanghai Zhengju Information Technology Co., Ltd. ( Zhengju Information )	April 28, 2010	PRC	100.00%	Online game development and maintenance
Shanghai Juquan Network Technology Co., Ltd. ( Juquan Network )	May 19, 2010	PRC	51.00%	Online game research and development
Shanghai Jujia Network Technology Co., Ltd. (II) ( Jujia Network II )	October 10, 2012	PRC	70.00%	Online game research and development
Beijing Giant Zhengtu Network Technology Co., Ltd. ( Beijing Giant Zhengtu )	Acquired on October 17, 2012	PRC	100.00%	Online game research and development
Shanghai Juhuan Network Technology Co., Ltd. ( Juhuan Network )	October 24, 2012	PRC	51.00%	Online game research and development
Shanghai Juxiao Real Estate Co., Ltd. ( Juxiao Estate )	Acquired on August 8, 2013	PRC	100.00%	Real Estate Development
Shanghai Juyan Network Technology Co., Ltd. ( Juyan Network )	Acquired on November 15, 2013	PRC	100.00%	Online game research and development

F-10

**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****1. ORGANIZATION AND NATURE OF OPERATIONS (CONT D)**

Entities	Date of incorporation/ establishment	Place of incorporation/ establishment	Percentage of shareholding/ ownership	Principal activities
<b><u>Variable Interest Entity (the VIE )</u></b>				
Giant Network	November 14, 2004	PRC		Internet content provider
<b><u>Held directly by Giant Network:</u></b>				
Shanghai Juhe Network Technology Co., Ltd. ( Juhe Network )	November 4, 2009	PRC	51.00%	Online game research and development
Shanghai Juxin Network Technology Co., Ltd. ( Juxin Network )	October 9, 2010	PRC	51.00%	Online game research and development
Beijing Julun Network Information Technology Co., Ltd. ( Julun Network )	Acquired on November 19, 2010	PRC	100.00%	Online game research and development
Shanghai Jujia Network Technology Co., Ltd. (III) ( Jujia Network III )	October 10, 2012	PRC	51.00%	Online game research and development
Shanghai Juzi Information Technology Co., Ltd. ( Juzi Information )	October 10, 2012	PRC	51.00%	Online game research and development
Beijing Haishen Network Technology Co., Ltd. ( Beijing Haishen Network )	August 26, 2013	PRC	51.00%	Online game research and development

In September 2006, in contemplation of an initial public offering, the Group completed a reorganization (the Reorganization ) which was necessary to comply with PRC laws and regulations that restrict foreign ownership of a company that provides internet content services, which includes operating online games.

As part of the Reorganization, Mr. Yuzhu Shi, his immediate family and the other eighteen individual shareholders of Giant Network through their respective BVI holding companies, established the Company and Eddia International. Mr. Yuzhu Shi and his immediate family, through their BVI holding companies, Union Sky Holding Co., Ltd. and Vogel Holding Group Limited, were the controlling shareholders of the Company since incorporation. Subsequently, on September 6, 2006, Eddia International established Zhengtu Information, a wholly-owned foreign enterprise, which

entered into a series of agreements with Giant Network. Pursuant to these agreements, Giant Network transferred most of its employees and operating assets to Zhengtu Information, except for certain assets and licenses that an online game operator must own to be an internet license holder. In return, Zhengtu Information exclusively provides certain technical and consulting services and software licenses to Giant Network in exchange for fees, which can be adjusted at the Company's discretion, through its direct ownership interest in Zhengtu Information as well as provide financial support to Giant Network, as necessary. As a result of these agreements, the Company is considered the primary beneficiary of Giant Network through Zhengtu Information (Note 2) and accordingly, Giant Network's results of operation and financial condition are consolidated in the financial statements of the Company.

F-11



**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION AND NATURE OF OPERATIONS (CONT'D)**

On June 14, 2012, Giant Network purchased 51% equity interest of Juhe Network from Zhengduo Information, wholly owned by Giant HK, at a consideration of RMB765,000. As a result, Juhe Network changed from a subsidiary of the Company, a foreign-invested enterprise, into a subsidiary of the VIE, a PRC company with the aim of reducing regulatory delays for Juhe Network's future game launches, as a domestic company. As of December 31, 2012 and 2013, the net liabilities of Juhe Network were RMB5,689,845 and RMB6,704 (US\$1,107), respectively. During the years ended December 31, 2011, 2012 and 2013, its revenue was RMB194,660, RMB195,734, and RMB5,384 (US\$889), respectively, while its net loss was RMB235,749, and RMB6,120,600 for the years ended December 31, 2011 and 2012, respectively, and its net income was RMB5,683,142 (US\$938,788) for the year ended December 31, 2013. Both Zhengduo Information and Zhengtu Information are wholly owned by the Company while Zhengtu Information controls Giant Network as its primary beneficiary. Hence, the transfer of Juhe Network from Zhengduo Information to Giant Network was accounted for as a common control transaction in accordance with Financial Accounting Standards Codification (ASC) Subtopic 805-50 (ASC 805-50), Business Combination: Related Issues as both Zhengduo Information and Giant Network are commonly controlled by the Company. The common control transaction had no impact to the Company's consolidated financial statements for the year ended December 31, 2012.

On October 10, 2012, Zhengduo Information, along with two other non-controlling shareholders invested RMB5,000,000 to establish Jujia Network II and obtained 70% equity interests of Jujia Network II.

On October 10, 2012, Giant Network, along with two other non-controlling shareholders invested RMB2,000,000 to establish Shanghai Jujia Network III, and obtained 51% equity interest of Jujia Network III.

On October 10, 2012, Giant Network along with another non-controlling individual invested RMB1,000,000 to establish Juzi Information and obtained 51% equity interest of Juzi Information.

On October 17, 2012, Zhengtu Information reacquired 51% equity interest of Beijing Giant Zhengtu at a consideration of RMB57,250,000 from Huayi Brothers Media Corporation (Huayi). As a result, together with the 34% equity interest previously held by Giant Network, the Group owns 85% equity interest in Beijing Giant Zhengtu and Beijing Giant Zhengtu changed from an investment in equity investee to a subsidiary of the Group (Note 3). On November 15, 2013, Zhengtu Information acquired 100% equity interest of Juyan Network which holds the remaining 15% equity interest in Beijing Giant Zhengtu, at a consideration of RMB30,000 (US\$4,956).

On October 24, 2012, Zhengduo Information, along with another individual and a non-controlling shareholder invested RMB5,000,000 to establish Juhuan Network and obtained 51% equity interests of Juhuan Network.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION AND NATURE OF OPERATIONS (CONT D)**

On June 10, 2013, Zhengtu Information along with another noncontrolling shareholder injected additional capital of RMB2,000,000 (US\$330,376) and RMB1,241,005 (US\$204,999) respectively, into Snow Wolf Software. After the capital injection, Zhengtu Information's equity interest in the Snow Wolf Software was diluted from 51.07% to 40.76%. According to the investment agreement, the additional capital injected by Zhengtu Information and the noncontrolling shareholder provided no voting rights. Thus, Zhengtu Information continues to hold 51.07% voting rights as before the capital injection and retains control over Snow Wolf Software.

On August 8, 2013, Zhengtu Information acquired 100% equity interest in Juxiao Estate, a company controlled by Mr. Shi Yuzhu, at a consideration of RMB16,000,000 (US\$2,643,012), based on the fair value of Juxiao Estate equity interest on the acquisition date (Note 3).

On August 26, 2013, Giant Network along with four third party individuals established Beijing Haishen Network. Giant Network invested capital of RMB2,000,000 (US\$330,376) and holds 51% equity interest in Beijing Haishen Network.

On August 30, 2013, the Group closed a subsidiary, Chengdu Jufan Network Technology Co., Ltd ( Chengdu Jufan ), given a change in the Group's development strategy. As a result, the Group deconsolidated Chengdu Jufan in August 2013. No gain or loss resulted from the deconsolidation.

On December 27, 2013, the Group entered into a share transfer agreement with Shanghai Juzheng Network Technology Co., Ltd. ( Juzheng Network ), a noncontrolling shareholder of Glorious Mission Network Technology Co., Ltd. ( Glorious Mission Network , formerly known as Wuxi Giant Network Technology Co., Ltd.), to transfer its 26.12% equity interest in Glorious Mission Network to Juzheng Network for a total consideration of RMB9,500,000 (US\$1,569,288). After the share transfer, the Group's investment in Glorious Mission Network was reduced from 45.12% to 19%. The Group recognized a gain on the deconsolidation of RMB4,519,737 (US\$746,607), representing the difference between the sum of the consideration received, the fair value of the 19% equity interest in Glorious Mission Network plus the carrying amount of the noncontrolling interest in the Glorious Mission Network and the carrying amount of the Glorious Mission Network's assets and liabilities. The 19% equity interest retained is accounted for using the cost method and classified as a long-term investment as the Group does not exert any influence over the operation and financial decisions of Glorious Mission Network. The gain on the deconsolidation of Glorious Mission Network was recorded as an investment income in the consolidated statements of comprehensive income. The transaction did not constitute a related party transaction and Wuxi Network would not be a related party since the deconsolidation.

The fair value of the 19% equity interest in Glorious Mission Network was determined by management with the assistance of an independent third party valuation firm using an income approach. As Glorious Mission Network is a private entity, the fair value measurement was based on significant inputs that were not observable in the market and thus represented a Level 3 measurement as defined in ASC 820 ( ASC 820 ), Fair Value Measurement. The fair value estimate was based on (i) the discount rate of 21.5%, (ii) long-term sustainable growth rate of 3%, (iii) financial

multiples of companies in the same industry as Glorious Mission Network and (iv) adjustments due to lack of marketability that market participants would consider when estimating the fair value of Glorious Mission Network as a private entity.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***1) Basis of presentation and use of estimates***

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( US GAAP ).

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of its assets and liabilities, disclosures of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions reflected in the Company's consolidated financial statements include, but are not limited to, revenue recognition, allowance of doubtful accounts, assessing the initial valuation of investments and the subsequent other-than-temporary declines in fair value, estimating the useful lives of long-lived assets and intangible assets, assessing the initial valuation of assets acquired and liabilities assumed in a business combination and the subsequent impairment assessment of long-lived assets, intangible assets and related goodwill, share-based compensation expenses, deferred tax assets and related valuation allowance and income tax uncertainties. Management bases the estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could materially differ from these estimates.

***2) Consolidation***

The consolidated financial statements include the financial statements of the Company, its subsidiaries, the VIE and its consolidated entities for which a subsidiary of the Company, Zhengtu Information, is the primary beneficiary. All transactions and balances between the Company, its subsidiaries, the VIE and its consolidated entities have been eliminated upon consolidation. Results of acquired subsidiaries are consolidated.

The attribution of net income and other comprehensive income or loss items, if any, are allocable to the Company and its noncontrolling interests based on their respective ownership percentages of the entities to which these underlying items are derived from.

The Group has adopted ASC 810-10 ( ASC 810-10 ), Consolidation: Overall. ASC 810-10 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**2) Consolidation (Cont d)**

PRC laws and regulations restrict foreign ownership to operate online games. In order to comply with these foreign ownership restrictions, the Company operates its online games in China through Giant Network, a variable interest entity, which is 75% owned by Mr. Yuzhu Shi, who is also a principal shareholder of the Company.

Giant Network holds a value-added telecommunications business operating license to provide internet content distribution services in PRC, an internet publishing license to operate and distribute games through the internet, and an approval from government to provide online discussion forum services. In addition, Giant Network also owns facilities including an office building, computers, equipment and servers that are recognized in the Company's consolidated financial statements and hires operational and marketing employees for its daily operation. Through online games, software sales, and licensing agreements entered into with other PRC subsidiaries of the Company, Giant Network operates certain of the Group's games exclusively in PRC, such as ZT Online and ZT Online 2, in return for fees.

Zhengtu Information has the unilateral right to control Giant Network, including its financial interests, through the following contractual arrangements which have been entered into amongst Zhengtu Information, Giant Network and its equity holders:

*Online Games Software Sales and Licensing Agreements*

Pursuant to the Online Games Software Sales and Licensing Agreements between Zhengtu Information, Jujia Network, Juhuo Network, Snow Wolf Software, Zhengju Information and Giant Network, Zhengtu Information, Jujia Network, Juhuo Network, Snow Wolf Software and Zhengju Information license their online game software to Giant Network in return for an upfront fees and royalty fees charged at fixed rates ranging from 24% to 65% of the game revenues derived from four game series, on a monthly basis. In addition, such royalty fee rates are effectively adjustable at the sole discretion of Zhengtu Information, Jujia Network, Juhuo Network, Snow Wolf Software and Zhengju Information. For the agreements with Zhengtu Information, Snow Wolf Software, and Zhengju Information, they have indefinite terms and can only be terminated if both parties mutually agree in writing. For the agreements with Jujia Network and Juhuo Network, they have a term of two years and will be terminated if both parties mutually agree in writing.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**2) Consolidation (Cont d)**

*Exclusive Technical Consulting and Service Agreements*

Pursuant to the Exclusive Technical Consulting and Service Agreement between Zhengtu Information and Giant Network, Zhengtu Information is to provide exclusive technical and consulting services in return for fees computed based on the total operating expenses incurred by Zhengtu Information plus a reasonable markup. The initial term of this agreement is expected to expire on September 6, 2016 and is renewable at the sole discretion of Zhengtu Information. Pursuant to this agreement, in the event that either party to such agreement (i) breaches its obligations thereunder in full or in part and fails to cure such breach effectively and in a timely manner, which leads to a material damage to the non-breaching party; (ii) materially fails to perform its undertakings under this agreement; or (iii) any of the representations given by such party is untrue, in each case the non-breaching party shall have the right to terminate this agreement. Notwithstanding the above, if Giant Network wishes to terminate this agreement before the expiration of its term, it shall serve a written notice to Zhengtu Information six-months prior to the expiration of the agreement and obtain Zhengtu Information's consent, and shall be liable for a penalty of RMB20,000,000 and compensation to Zhengtu Information for all of its losses resulting from such early termination.

A similar Exclusive Technical Consulting and Service Agreement was signed between Zhengju Information and Giant Network in 2012 with identical terms as described above. The term of this agreement is ten years which is expected to expire on January 5, 2022 and cannot be early terminated unless both parties mutually agree in writing.

During the years ended December 31, 2011, 2012 and 2013, total fees charged under the agreements above totaled approximately RMB1,474,000,000, RMB1,776,000,000, and RMB1,777,000,000 (US\$294,000,000), respectively, which represented substantially all of Giant Network's operating profits for the years presented.

*Power of Attorney*

Pursuant to the Purchase Option and Cooperation Agreement, each of the equity holders of Giant Network signed an irrevocable Power of Attorney to grant Zhengtu Information's designee, Mr. Yuzhu Shi, the power to exercise all the voting rights of such entity holders in shareholders' meeting, including but not limited to deciding to sale or transfer of all or part of such entity holders' equity interests in, and appointing and selecting directors, general managers and other senior management of Giant Network. The initial agreement has a term of ten years and can automatically extend for another ten years if Zhengtu Information doesn't raise an objection.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**2) Consolidation (Cont d)**

*Purchase Option and Cooperation Agreement*

Pursuant to the Purchase Option and Cooperation Agreement and its supplementary agreements amongst Zhengtu Information and the equity holders of Giant Network, the equity holders of Giant Network granted Zhengtu Information or its designated party, an exclusive irrevocable option to purchase all or part of their equity interests, when and to the extent permitted under the PRC law, at an amount equal to RMB10,000,000 or the lowest price permitted by the PRC law. Giant Network cannot declare any profit distributions or grant loans in any forms without the prior written consent of Zhengtu Information. All funds received by the equity holders of Giant Network or their designees (including but not limited to dividends and loans) must be remitted in full to Zhengtu Information and Giant Network, respectively. If Giant Network or its equity holders commit a material breach of the Purchase Option and Cooperation Agreement or its supplementary agreements and fail to cure or remedy such breach, Zhengtu Information reserves the right to either terminate the agreement and demand the breaching party for compensation for all damages and losses, or to enforce the further performance of the agreement in addition to the claim for all damages and losses against the breaching party.

*Share Pledge Agreement*

Pursuant to the Share Pledge Agreement between Zhengtu Information and the equity holders of Giant Network, the equity holders of Giant Network have contemporaneously pledged all their equity interests in Giant Network to secure the payment obligations of Giant Network under the VIE agreements. This agreement is valid as long as the other VIE agreements are effective.

*Letter of Financial Support*

Pursuant to Letter of Financial Support, Zhengtu Information agreed to provide unlimited financial support to Giant Network during its operation and agreed to forego the right to seek repayment in the event that Giant Network is unable to repay such funding.

As of December 31, 2013, the share capital and accumulated gain of Giant Network was RMB10,000,000 (US\$1,651,882) and RMB92,673,054 (US\$15,308,498), respectively, as compared to share capital and accumulated loss of RMB10,000,000 and RMB54,957,718, respectively, as of December 31, 2012.

Despite the lack of technical majority ownership, there exists a parent-subsidary relationship between the Company and Giant Network through the irrevocable Power of Attorney, whereby the equity holders of Giant Network has effectively assigned all of their voting rights underlying their equity interest in Giant Network to Zhengtu Information. In addition, through the other aforementioned agreements, the Company demonstrates its ability and intention to

continue to exercise the ability to absorb substantially all of the profits and all of the expected losses of Giant Network through Zhengtu Information. Thus the Company is also considered the primary beneficiary of Giant Network through Zhengtu Information. Accordingly, Giant Network and its consolidated entities' results are consolidated in the Company's financial statements under ASC 810-10.

F-17



**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**2) Consolidation (Cont d)**

In the opinion of management and the Company's PRC counsel, Grandall Law Firm (Shanghai), (i) the ownership structure of the Company and Giant Network, through Zhengtu Information, are in compliance with existing PRC laws and regulations, and (ii) the contractual arrangements with Giant Network and its shareholder are valid, binding, enforceable and will not result in any violation of PRC laws or regulations currently in effect.

Even though the equity holders of Giant Network also hold equity interests in the Company, they may fail or cause Giant Network to fail to perform the obligations under the VIE agreements. The Company may have to incur substantial costs and expend efforts to enforce the Company's rights under these agreements, where it has to rely on legal remedies under the PRC law.

However, there are substantial uncertainties regarding the interpretation and application of current and future PRC laws and regulations. Accordingly, the Company cannot be assured that the PRC regulatory authorities will not ultimately take a contrary view to its opinion. If the current ownership structure of the Company and its contractual arrangements with Giant Network, through Zhengtu Information, are prospectively found to be in violation of any existing or future PRC laws and regulations, the Company may be required to restructure its ownership structure and operations in the PRC to comply with the new PRC laws and regulations. The restructuring of its organization structure to comply with new PRC laws and regulations may cause the Company to lose control of its VIE, thus resulting in its deconsolidation. In the opinion of management, the likelihood of such events provoking deconsolidation in respect of the Company's current ownership structure or the contractual arrangements with Giant Network is remote based on current facts and circumstances.

There are no pledges or collateralization of Giant Network and its consolidated entities' assets which may only be used to settle Giant Network and its consolidated entities' obligations during the periods presented. For the periods presented, creditors of Giant Network and its consolidated entities do not have recourse to the general credit of the Company, who is also considered the primary beneficiary of Giant Network through Zhengtu Information, and as such, these amounts have been parenthetically presented on the face of the Company's consolidated balance sheets. The Company has not provided any financial or other support that it was not previously contractually required to provide to Giant Network during the periods presented.

**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)****2) Consolidation (Cont d)**

The following table represents the carrying amounts of the assets and liabilities of Giant Network and its consolidated entities, including the intercompany payables to the Company's PRC subsidiaries for accrued service and license fees of RMB1,278,972,129 and RMB1,694,938,756 (US\$ 279,983,936) as of December 31, 2012 and 2013, respectively:

	2012 RMB	2013 RMB	2013 US\$
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	274,141,083	320,894,854	53,008,054
Accounts receivable	6,555,391	3,494,393	577,233
Prepayments and other current assets	37,563,773	31,571,092	5,215,173
Due from a related parties	1,019,128,949	1,359,271,355	224,535,632
Inventories	333,195		
Deferred tax assets, net	143,002,725	115,097,258	19,012,713
<b>Total current assets</b>	<b>1,480,725,116</b>	<b>1,830,328,952</b>	<b>302,348,805</b>
Non-current assets:			
Property and equipment, net	312,791,693	313,983,683	51,866,409
Intangible assets, net	5,914,981	20,520,060	3,389,672
Due from research and development entity partners	637,000		
Goodwill	15,170,511	15,170,511	2,505,990
Long-term investments	59,808,310	70,072,423	11,575,140
Deferred tax assets, net	1,502,617	1,675,755	276,815
Other assets	1,100,000	62,291,667	10,289,850
<b>Total non-current assets</b>	<b>396,925,112</b>	<b>483,714,099</b>	<b>79,903,876</b>
<b>Total assets</b>	<b>1,877,650,228</b>	<b>2,314,043,051</b>	<b>382,252,681</b>

**LIABILITIES**

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

<b>Current liabilities:</b>			
Payables and accrued expenses	63,103,923	68,497,136	11,314,921
Advances from distributors	93,468,209	70,317,903	11,615,690
Due to a related parties	1,298,030,769	1,723,137,717	284,642,073
Deferred revenue	470,279,509	347,524,943	57,407,031
Tax payable	4,371,971	22,209,243	3,668,706
Unrecognized tax benefit	6,418,702	6,418,702	1,060,294
Deferred tax liabilities	2,500,250		
<b>Total current liabilities</b>	<b>1,938,173,333</b>	<b>2,238,105,644</b>	<b>369,708,715</b>
<b>Total liabilities</b>	<b>1,938,173,333</b>	<b>2,238,105,644</b>	<b>369,708,715</b>

F-19

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)****2) Consolidation (Cont d)**

The following table represents the breakdown of contribution by Giant Network and its consolidated entities as well as the Company and other entities within the Group to the Group's total net income and total comprehensive income. The amounts presented below are calculated before deducting intercompany service and license fees payables from the VIE and its consolidated entities to the other PRC subsidiaries of the Company.

	For year ended December 31,			
	2011	2012	2013	2013
	RMB	RMB	RMB	US\$
<b>Net income (loss) attributable to the Company's shareholders</b>				
Giant Network and its consolidated entities	1,515,790,079	1,778,254,022	1,908,831,536	315,316,505
The Company and other entities within the Group	(635,823,205)	(784,534,016)	(655,863,608)	(108,340,950)
	879,966,874	993,720,006	1,252,967,928	206,975,555
<b>Other comprehensive income (loss)</b>				
Giant Network and its consolidated entities				
The Company and other entities within the Group	(100,725,366)	32,505,955	(4,541,240)	(750,160)
	(100,725,366)	32,505,955	(4,541,240)	(750,160)
<b>Comprehensive income</b>	779,241,508	1,026,225,961	1,248,426,688	206,225,395

In addition, Giant Network and its consolidated entities accounted for approximately RMB1,342,000,000, RMB1,789,500,000 and RMB 1,780,300,000 (US\$ 294,085,000) net increase in cash and cash equivalents in 2011, 2012 and 2013, respectively. However, a substantial amount of the cash and cash equivalents generated by the VIE was subsequently transferred to the other PRC subsidiaries of the Company to pay for the intercompany service and license fees.

**3) *Foreign currency translation and transactions***

The Company's, its BVI and Hong Kong subsidiary's functional currency is the United States dollars ( US\$ ). The functional currency of the Company's PRC subsidiaries, Giant Network and its consolidated entities, is the Chinese Renminbi ( RMB ), based on the criteria of ASC subtopic 830-10 ( ASC 830-10 ), Foreign Currency Matters: Overall. The Company uses the RMB as its reporting currency. The Company uses the average exchange rate for the year and the exchange rate at the balance sheet date to translate its operating results and financial position, respectively. Translation differences are recorded in accumulated other comprehensive loss, a component of shareholders' equity.

Transactions denominated in foreign currencies are translated into the functional currency at the exchange rates prevailing on the transaction dates. Assets and liabilities denominated in foreign currencies are remeasured into the functional currency at the exchange rates prevailing at the balance sheet date. The resulting realized and unrealized exchange gains and losses are included in the consolidated statements of operations and comprehensive income.

---

Table of Contents

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**4) Convenience translation**

Amounts in US\$ are presented for the convenience of the reader and are translated at the noon buying rate of US\$1.00 to RMB6.0537 on December 31, 2013 in the City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. No representation is made that the RMB amounts could have been, or could be, converted into US\$ at such rate.

**5) Cash and cash equivalents and restricted cash**

Cash and cash equivalents represent cash on hand, demand deposits and money market fund placed with banks or other financial institutions. All highly liquid investments with a stated maturity of 90 days or less from the date of purchase are classified as cash equivalents. All highly liquid investments with stated maturities of greater than 90 days but less than one year, are mainly fixed rate time foreign deposits that are classified as short-term investments which are stated at their approximate fair value.

Restricted cash represents an USD deposit in bank to be used for the payments of bank charges of an outstanding short-term bank loan (Note 12).

**6) Investments**

The Group accounts for its investments in accordance to ASC subtopic 320-10 ( ASC 320-10 ), Investments-Debt and Equity Securities: Overall. ASC 320-10 classifies the investments in debt securities as trading , held-to-maturity or available-for-sale , whose classification determines the respective accounting methods stipulated by the accounting standard for financial instruments.

Trading securities

The securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities. Unrealized holding gains and losses for trading securities are included in earnings. The Group had no securities that were bought and held principally for the purpose of selling them in the near term to which would be classified as trading securities as of December 31, 2012 and 2013.

Held- to- maturity securities

The securities that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and are stated at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Interest income from the held-to-maturity securities is recognized when earned. Premiums and discounts, if any, are amortized or accreted over the life of the related security as an adjustment to interest income using the

effective-interest method. For individual securities classified as held-to-maturity securities, the Group evaluates whether a decline in fair value below the amortized cost basis is other-than-temporary using estimated fair values of the pledged collaterals or financial guarantees. If the Group concludes that it does not intend or is not required to sell an impaired debt security before the recovery of its amortized cost basis, the impairment is considered temporary and the held-to-maturity security continue to be recognized at the amortized cost.

Table of Contents

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**6) Investments (Cont d)**

Held- to- maturity securities (Cont d)

When the Group intends to sell an impaired debt security or it is more likely than not that it will be required to sell prior to recovery of its amortized cost basis, an other-than-temporary impairment loss equal to the entire excess of the debt security's amortized cost basis over its fair value is recognized at the balance sheet date.

Available-for-sale security

Investments not classified as trading or as held-to-maturity are classified as available-for-sale securities. Available-for-sale securities are reported at fair value, with unrealized gains and losses recorded in other comprehensive income (loss). Gains or losses are charged to earnings during the period in which gains or losses are realized. An impairment loss on available-for-sale debt securities would be recognized in the earnings when the decline in value is determined to be other-than-temporary.

The Group has designated its investment in convertible redeemable preferred shares ( the Preferred Shares ) of Five One Network Development Co., Ltd. ( 51.com ) as available-for-sale in accordance with ASC 320-10. Such available-for-sale investment is reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive loss in shareholders' equity. Realized gains or losses are charged to earnings during the period in which the gain or loss is realized. If the Group determines a decline in fair value is other-than-temporary, the cost basis of the individual security is written down to its estimated fair value. The new cost basis will not be adjusted for subsequent recoveries in fair value. Determination of whether declines in value are other-than-temporary requires significant judgment. The Group recorded an other-than-temporary impairment of RMB240,725,709 for the year ended December 31, 2012. No impairment was recorded for the years ended December 31, 2011 and 2013.

Dividend and interest income, including amortization of the premium and discount arising at acquisition, for all categories of investments in securities are included in earnings. Any realized gains or losses on the sale of the investments are determined on a specific identification method, and such gains and losses are included in earnings.



**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

**7) *Long-term investments***

In accordance with ASC 325-20 ( ASC 325-20 ), Investments-Other: Cost Method Investments, for investments in an investee over which the Group does not have significant influence, the Group carries the investment at cost and only adjusts for other-than-temporary declines in fair value and distributions of earnings that exceed the Company's share of earnings since its investment. Management regularly evaluates the impairment of its cost method investments based on the performance and financial position of the investee as well as other evidence of estimated market values. Such evaluation includes, but is not limited to, reviewing the investee's cash position, projected and historical financial performance, cash flow forecasts and current and future financing needs. An impairment loss is recognized in the consolidated statements of comprehensive income equal to the excess of the investment's cost over its estimated fair value at the balance sheet date of the reporting period for which the assessment is made. The fair value would then become the new cost basis of investment. The impairment charge was nil for the years ended December 31, 2011, 2012 and 2013.

**8) *Investment in equity investees***

For investments in an investee over which the Group can exercise significant influence but does not own a majority equity interest or control are accounted for using the equity method of accounting in accordance with ASC 323-10 ( ASC 323-10 ), Investments-Equity Method and Joint Ventures.

Under the equity method, the Group initially records its investment at cost and prospectively recognizes its proportionate share of each equity investee's net income or loss into its consolidated statements of comprehensive income. The difference between the cost of the equity investee and the amount of the underlying equity in the net assets of the equity investee is recognized as equity method goodwill included in equity method investment on the consolidated balance sheets. The Group evaluates the equity method investments for impairment under ASC 323-10. An impairment loss on the equity method investments is recognized in the consolidated statements of comprehensive income when the decline in value is determined to be other-than-temporary. The impairment charge was nil, RMB3,211,404 and nil for the years ended December 31, 2011, 2012 and 2013, respectively.

The Group holds equity investments in Shanghai Tonghua Network Technology Co., Ltd. ( Tonghua Network ) with 30% equity interest and Shanghai Juxian Network Technology Co., Ltd. ( Juxian Network ) with 40.8% equity interest. The carrying amounts of these investments were reduced to nil as of December 2012. The Group continued to record equity pick up of losses from Tonghua Network for the years ended December 31, 2012 and 2013 in accordance with ASC 323-10 as the Group provided additional financial support to Tonghua Network during the years ended December 31, 2012 and 2013.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)****9) Property and equipment**

Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the following estimated useful lives:

Computer equipment	5 years
Leasehold improvements	Over the shorter of the lease terms or the estimated useful lives of the assets
Furniture and fixtures	5 years
Motor vehicles	5 years
Property	42 years

Fixed assets have an estimated residual equal to 5% of the original cost.

Repair and maintenance costs are charged to expense as incurred, whereas the cost of renewals and betterments that extend the useful life of a fixed asset are capitalized as an addition to the related asset. Retirements, sales and disposals of assets are recorded by removing the cost and accumulated depreciation from the asset and accumulated depreciation accounts with any gain or loss reflected in the consolidated statements of comprehensive income.

**10) Intangible assets**

The Group recognizes costs to develop its online game products to be licensed for sale in accordance with ASC subtopic 985, Software. Online game product development costs consist primarily of payroll, depreciation and other overhead expenses incurred by the Group to develop, maintain, monitor and manage the Group's online gaming products. Costs incurred for the development of online game products prior to the establishment of technological feasibility are expensed when incurred and are included in product development expenses. Once an online game product has reached technological feasibility, all subsequent online game product development costs are capitalized until the product is available for marketing. Technological feasibility is evaluated on a product-by-product basis, but typically encompasses both technical design and game design documentation and only occurs when the online games have a proven ability to operate in an online game environment.

Intangible assets are stated at cost less accumulated amortization. Amortization is computed using the straight-line method over the following estimated useful lives:

Online game product development costs	4 years
Software	3 and 10 years

License fee

Over the shorter of the license  
terms or  
the estimated licensed game lives

F-24

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***10) Intangible assets (Cont d)***

The Group recognizes website and internally used software development costs in accordance with ASC subtopic 350-40 ( ASC 350-40 ), Intangibles – Goodwill and Other: Internal-Use Software. As such, the Group expenses all costs that are incurred in connection with the planning and implementation phases of development and costs that are associated with repair or maintenance of the existing websites and software. Costs incurred in the development phase are capitalized and amortized over their estimated expected life. Since the inception of the Group, the amount of costs qualifying for capitalization has been insignificant and as a result those costs have been expensed as incurred. For the years ended December 31, 2011, 2012, and 2013, the Group capitalized approximately RMB4,800,000, RMB7,450,000, and nil of the online game development costs, respectively.

***11) Land use right***

The land use right represents the amounts paid and relevant costs incurred for the right to use land in the PRC and it is recorded at purchase cost less accumulated amortization. Amortization is provided on a straight-line basis over the terms of the land use rights agreement, which is 50 years. For a land use right obtained through a business or asset acquisition, amortization is recorded on a straight-line basis over its respective remaining estimated useful live.

***12) Impairment of long-lived assets and intangible assets***

Long-lived assets, including intangible assets, are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with ASC subtopic 360-10 ( ASC 360-10 ), Property, Plant and Equipment: Overall. When such events occur, the Group assesses the recoverability of the long lived assets by comparing the carrying amounts to the estimated future undiscounted cash flows associated with the related assets. If the future net undiscounted cash flows are less than the carrying amount of the assets, the assets are considered impaired and an expense is recognized equal to the amount required to reduce the carrying amount of the assets to their then estimated fair value. Fair value is generally determined by discounting the cash flows expected to be generated by the assets, when the market prices are not readily available for the long-lived assets.

The impairment loss of nil, RMB13,066,057 and RMB20,100,000 (US\$3,320,283) was recognized for the years ended December 31, 2011, 2012 and 2013, respectively.

***13) Goodwill***

Goodwill represents the excess of the purchase price over the estimated fair value of net tangible and identifiable intangible assets acquired. The Group's goodwill outstanding at December 31, 2013 was related to the Group's acquisition of three subsidiaries. In accordance with the provisions of ASC subtopic 350 ( ASC 350 ), Goodwill and Other Intangible Assets, goodwill amounts are not amortized, but rather are tested for impairment at least annually or more frequently if there are indicators of impairment present.

F-25

Table of Contents

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***13) Goodwill (Cont d)***

In accordance with ASC 350, the Group has assigned and assessed goodwill for impairment at the reporting unit level. A reporting unit is an operating segment or one level below the operating segment. The Group has determined that it has one reporting unit, which is also its only reportable segment.

The performance of the impairment test involves a two-step process. The first step of the impairment test involves comparing the fair value of the reporting unit with its carrying amount, including goodwill. Fair value is primarily determined by computing the future discounted cash flows expected to be generated by the reporting unit. If the carrying value exceeds the fair value, goodwill may be impaired. If this occurs, the Group performs the second step of the goodwill impairment test to determine the amount of impairment loss. The fair value of the reporting unit is allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of the reporting unit goodwill. If the carrying amount of the goodwill is greater than its implied fair value, the excess is recognized as an impairment loss. The annual goodwill impairment test is performed on December 31 of each year.

In accordance with Accounting Standards Update No. 2011-08 ( ASU 2011-08 ), Testing Goodwill for Impairment, issued by the Financial Accounting Standards Board ( FASB ), the Group has the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative test. If the Group believes, as a result of the qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The qualitative assessment included an in-depth analysis of factors, including general economic conditions, industry and market conditions, financial factors (such as revenue growth) and the price of the Company's ADS, as well as other drivers of a fair value analysis.

No impairment loss was recognized for the years ended December 31, 2011, 2012 and 2013.

***14) Fair value of financial instruments***

Financial instruments of the Group primarily comprise of cash and cash equivalents, restricted cash, short-term investments, accounts receivable, certain other assets and liabilities, available-for-sale security, held-to-maturity securities, a short-term loan and a long-term loan. As of December 31, 2012, and 2013, the carrying values of these financial instruments, other than available-for-sale security, held-to-maturity securities and long-term loan, approximated their fair values due to their generally short maturities (Note 25). The carrying value of the long-term loan approximated its fair value given the interest rate on the loan approximated prevailing market interest rate.



---

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***15) Revenue recognition***

**Online game revenue**

The Group currently provides online game services in the PRC and recognizes revenue in accordance to the criteria of ASC subtopic 605 ( ASC 605 ), Revenue Recognition, when persuasive evidence of an arrangement exists, the service has been rendered, the sales price is fixed or determinable, and collectability is reasonably assured.

The Group operates Massively Multiplayer Online Role-Playing Games ( MMORPG ) under a free-to-play model. Under this model, players can access the games free of charge but may purchase game points for in-game premium features.

The Group sells prepaid cards, in physical or virtual forms, for its in-game premium features to distributors who in turn sell the prepaid cards to end customers. The prepaid game cards provide customers with a pre-specified number of game points for consumption. All prepaid cards sold to distributors require upfront advance cash payments. The Group also sells game points through online sales directly to end customers using their credit or debit cards, which is generally settled by the banks within one to two days. Proceeds from the sale of prepaid game cards from distributors and online sale of game points are initially recognized as advances from distributors. These prepaid fees are reclassified to deferred revenue upon the end users' online registration and conversion of the game points into the respective user accounts.

The Group's end users are required to activate the prepaid game cards by using access codes and passwords to transfer the value of those cards to game points in their personal user accounts. The Group does not recognize revenue for game cards which are sold but not yet converted into game points and used by customers to purchase premium features as the Group is required to provide future services, in the form of in-game premium features, related to those cards or points. Deferred revenue is recognized as revenue over the estimated lifespan of the premium features purchased or as the premium features purchased with the game points are consumed. In-game premium features include virtual services and consumable virtual items and permanent virtual items. In terms of virtual services and consumable virtual items, revenue is recognized either ratably or upon consumption depending on whether services and items be recognized as time-based or usage-based. In terms of permanent virtual items, revenue is recognized over the estimated lifespan which is determined on the basis of historical player usage patterns and playing behaviors. When the estimated lifespan of certain permanent virtual items is unable to be reliably determined on the basis of historical paying player patterns or behaviors, the related revenues would be recognized over the estimated game lifespan. Future usage patterns may differ from the historical usage patterns on which the Group's revenue recognition policy is based. The Group is committed to continually monitoring its actual operational statistics and usage patterns of its online games and to comparing these actual statistics with its original estimates and to refining these estimates and assumptions when they materially differ from the actual statistics.





---

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***15) Revenue recognition (Cont d)***

**Online game revenue (Cont d)**

The Group sells prepaid game cards at a discount to its distributors. The Group accounts for such discounts in accordance with ASC subtopic 605-15 ( ASC 605-15 ), Revenue: Product. Such discounts are initially accounted for as a reduction of advances from distributors. As a result, deferred revenue will only include the value of activated discounted and undiscounted prepaid cards and game points, which are subsequently recognized as revenue on a weighted average basis when the Group provides future services in the form of premium features.

**Licensing revenue**

The Group also licenses various kinds of its games to overseas third parties in Vietnam, Thailand, Russia, United States, South Korea, Taiwan, Hong Kong and Macao in 2013. The royalty income is determined based on an agreed upon percentage of game points consumed by the players with accounts registered with the game vendors, net of applicable withholding taxes, which becomes fixed or determinable at the time actual usage occurs. The related royalty income is recognized on a monthly basis, as the game vendors confirm their sales activities for the period.

The Group's VIE is subject to a 5% business tax and related surcharges on the revenues earned from the sale of game points that are deducted from online game revenue. The Company's subsidiary, Giant HK, is also subject to overseas withholding taxes and related surcharges on royalty income that are deducted from licensing revenue. Such business tax and related surcharges for the years ended December 31, 2011, 2012 and 2013 were RMB111,185,658, RMB125,496,870 and RMB131,260,725 (US\$21,682,727), respectively.

The Group does not defer any costs associated with the sale of its prepaid cards or game points.

***16) Cost of services***

Cost of services consists primarily of payroll, depreciation and amortization, maintenance and rental of computer equipment, production costs for prepaid game cards and other overhead expenses directly attributable to the provision of the Group's online game services.

Cost of services also includes a 6% VAT (5% business tax for the year ended December 31, 2011), and 3% (net) VAT and related surcharges on technical and consulting fees and royalty fees charged by the Company's PRC subsidiaries to Giant Network. Such business tax, VAT and related surcharges for the years ended December 31, 2011, 2012 and

2013 were RMB72,804,988, RMB83,559,952 and RMB86,954,956 (US\$14,363,935), respectively.

***17) Advertising expenses***

Advertising costs are expensed when incurred as sales and marketing expenses and amounted to approximately RMB105,308,000, RMB93,425,000, and RMB128,282,000 (US\$21,191,000) for the years ended December 31, 2011, 2012 and 2013, respectively.

---

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***18) Research and product development expenses***

Costs incurred for the development of online game products prior to the establishment of technological feasibility and costs incurred for maintenance after the online game products are available for marketing are expensed when incurred and are included in research and product development expenses.

***19) Comprehensive income***

Comprehensive income is defined as the changes in equity of the Group during a period from transactions and other events and circumstances excluding transactions resulting from investments by owners and distributions to owners. Among other disclosures, ASC topic 220 ( ASC 220 ), Comprehensive Income, requires that all items that are required to be recognized under current accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. For each of the periods presented, the Group's comprehensive income includes net income, foreign currency translation adjustments and unrealized holding gains (losses) and is presented in the consolidated statements of comprehensive income.

***20) Share-based compensation***

The Group's employees participate in the Company's 2006 and 2007 stock incentive plans including share options and restricted shares, which is more fully described in Note 17. The Group accounts for its share-based payments pursuant to ASC subtopic 718-10 ( ASC 718-10 ), Compensation - Stock Compensation: Overall. According to ASC 718-10, all grants of share options and restricted shares to employees are recognized in the consolidated financial statements based on their grant date fair values. The Company's share options and restricted shares are subject to graded vesting provisions. Fair value of share options is determined by management with the assistance of an independent third party valuation firm, using a binomial option pricing model derived by management. Fair value of restricted shares is determined by management using the closing price of the unrestricted share as of the valuation date minus the present value of the expected dividends during the vesting period. The Group has elected to recognize compensation expense using the accelerated method for all share options and restricted shares with service conditions that have a graded vesting schedule.

ASC 718-10 requires forfeitures to be estimated at the time of grant and revised, if necessary, in the subsequent year if actual forfeitures differ from initial estimates. Share-based compensation expense is recorded net of estimated forfeitures such that expense is recorded only for those share-based awards that are expected to vest. Forfeiture rate is estimated based on historical and future expectation of employee turnover rate and adjusted to reflect future change in circumstances and facts, if any.

The Group records share-based compensation expense for awards granted to non-employees in exchange for services at fair value in accordance with the provisions of ASC subtopic 505-50 ( ASC 505-50 ), Equity: Equity Based Payment

to Non-Employees. For the awards granted to non-employees, the Group records compensation expense equal to the fair value of the share options and restricted shares at the service performance date. The fair value of the unvested share options and restricted shares is recalculated at each reporting date as the service agreements signed with the non-employees do not include significant disincentive for non-performance. There were no share options or restricted shares issued to non-employees during the years ended December 31, 2011, 2012, and 2013.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***20) Share-based compensation (Cont d)***

A change in any of the terms or conditions of share options and restricted shares shall be accounted for as a modification of the plan. Therefore, the Group calculates incremental compensation cost of a modification as the excess of the fair value of the modified awards over the fair value of the awards immediately before its terms are modified, measured based on the share price and other pertinent factors at the modification date. For vested share options and restricted shares, the Group would recognize incremental compensation cost in the period the modification occurs and for unvested share options and restricted shares, the Group would recognize, over the remaining requisite service period, the sum of the incremental compensation cost and the remaining unrecognized compensation cost for the original award on the modification date.

***21) Leases***

Leases are classified at the inception date as either a capital lease or an operating lease. For the lessee, a lease is a capital lease if any of the following conditions exist: a) ownership is transferred to the lessee by the end of the lease term, b) there is a bargain purchase option, c) the lease term is at least 75% of the property's estimated remaining economic life or d) the present value of the minimum lease payments at the beginning of the lease term is 90% or more of the fair value of the leased property to the lessor at the inception date. A capital lease is accounted for as if there was an acquisition of an asset and an incurrence of an obligation at the inception of the lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. The Group has no capital leases for any of the years stated herein.

***22) Income taxes***

The Group follows the liability method in accounting for income taxes in accordance to ASC subtopic 740-10 ( ASC 740-10 ), Income Taxes: Overall. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect in the year in which the differences are expected to reverse. The Group records a valuation allowance to offset deferred tax assets if, based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of the deferred tax assets will not be realized.

***23) Accounting for uncertain income tax positions***

The Group applies the provisions of ASC 740-10 to account for uncertainties in income taxes. ASC 740-10 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold a tax position is required to

meet before being recognized in the financial statements. The Group has elected to classify interest and penalties related to an uncertain tax position, if and when required, as part of income tax expense in the consolidated statements of comprehensive income.

---

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***24) Earnings per share***

Earnings per share are calculated in accordance with ASC subtopic 260-10 ( ASC 260-10 ), Earnings Per Share: Overall. Basic earnings per share is computed by dividing net income attributable to holders of ordinary shares by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are computed using the weighted average number of shares and dilutive equivalent shares outstanding during the period. Dilutive equivalent shares consist of ordinary shares issuable upon the exercise of share options granted, with an exercise price less than the average fair market value for such period, using the treasury stock method. Dilutive equivalent shares are excluded from the computation of diluted earnings per share if their effects would be anti-dilutive.

***25) Financial incentives***

Government financial incentives are recognized where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with, if any. When the grant relates to an expense item, it is recognized in the consolidated statements of comprehensive income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, it is recognized as deferred income and released to the consolidated statements of comprehensive income in proportion to the depreciation of the related assets. Government financial incentives are recognized as income upon receipt when there are no conditions or continuing performance obligations of the Group attached to any of the governmental financial incentives received.

***26) Share repurchase program***

In September 2011, the Board of Directors approved a new share repurchase plan ( Share Repurchase Plan 4 ), authorizing the Group to repurchase up to US\$50,000,000 of its ADSs for the effective period from September 2011 to September 2012. As of December 31, 2011, the Group repurchased 932,972 ADSs under this plan for a total consideration of US\$3,600,000.

In September 2012, the Board of Directors approved a twelve-month extension for Share Repurchase Plan 4 up to September 2013. As of December 31, 2012, the Group repurchased 1,744,909 ADSs under this plan for a total consideration of US\$7,200,000. There were no repurchases made during 2013.

There was no additional repurchase plan approved during the year ended December 31, 2013.

The Group accounted for share repurchase as treasury stock at cost in accordance to ASC Subtopic 505-30 ( ASC 505-30 ), Treasury Stock, which is shown separately in the shareholders' equity as the Group has not yet decided on the ultimate disposition of the ADSs acquired. When the Group decides to retire the treasury stock or use the treasury stock to settle the exercise of share options and restricted shares (Note 21), the difference between the issuance price and the repurchase price is charged to retained earnings.





---

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

***27) Segment reporting***

The Group follows ASC subtopic 280 ( ASC 280 ), Segment Reporting. The Group's chief operating decision-maker, who has been identified as the chief executive officer, reviews the consolidated results when making decisions about allocating resources and assessing performance of the Group as a whole and hence, the Group has only one reportable segment. The Group operates and manages its business as a single segment through the provision of online gaming services. As the Group's long-lived assets are substantially all located in the PRC and substantially all the Group's revenues are derived from within the PRC, no geographical segments are presented.

***28) Concentration of risk***

**Credit risk**

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash and cash equivalents, restricted cash, accounts receivable, short-term investments, available-for-sale security, held-to-maturity securities, and amounts due from related parties and research and development entity partners. As of December 31, 2012 and 2013, substantially all of the Group's cash and cash equivalents and short-term fixed rate time deposits were held by major Chinese financial institutions located in the PRC and Hong Kong. Historically, deposits in Chinese banks are secured due to the state policy on protecting depositors' interests. However, China promulgated a new Bankruptcy Law in August 2006 that has come into effect on June 1, 2007, which contains a separate article expressly stating that the State Council promulgates implementation measures for the bankruptcy of Chinese banks based on the Bankruptcy Law when necessary. Under the new Bankruptcy Law, a Chinese bank can go into bankruptcy. In addition, since China's accession to the World Trade Organization, foreign banks have been gradually permitted to operate in China and have been significant competitors against Chinese banks in many aspects, especially since the opening of the Renminbi business to foreign banks in late 2006. Therefore, the risk of bankruptcy of those Chinese banks in which the Group has deposits has increased. In the event of bankruptcy of one of the banks which holds the Group's deposits, it is unlikely to claim its deposits back in full since it is unlikely to be classified as a secured creditor based on PRC laws. Since the global financial crisis began during the third quarter of 2008, the risk of bankruptcy of those banks in which the Group has deposits or investments has increased significantly. In the event of bankruptcy of one of these financial institutions, it may be unlikely to claim its deposits or investments back in full. The Group continues to monitor the financial strength of these financial institutions.

Accounts receivable are typically unsecured and derived from revenue earned from customers in both the PRC and the overseas, which are exposed to credit risk. The risk is mitigated by credit evaluations the Group performs on its customers and its ongoing monitoring process of outstanding balances. The Group maintains reserves for estimated credit losses, which have generally been within its expectations.

Amounts due from related parties and research and development entity partners are typically unsecured, interest free and without any fixed term of repayment. Any negative events or deterioration in financial well-being with respect to

the Group's related parties and research and development entity partners may cause material loss to the Group and have a material effect on the Group's financial condition and results of operations.

Table of Contents

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT D)**

*28) Concentration of risk (Cont d)*

Credit risk (Cont d)

The Group's available-for-sale security, 51.com is reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive loss in shareholders' equity (Note 10). The time deposit in Bank of Ningbo bears a fixed yield of 3.75% with a maturity term of two years. Two short-term investment securities in China Merchant Bank which bear fixed yields of 4.8% and 5% per annum, respectively, with maturity terms of six months and one year, respectively. One short-term investment security in Minsheng Royal Asset Management which bears a yield of return of 6% per annum with a maturity term of one year. Any negative events or deterioration in financial well-being with respect to the counterparties of the above investments may cause material losses to the Group and have a material effect on the Group's financial condition and results of operations.

Business and economic risk

The Group participates in a highly technical industry and believes that changes in any of the following areas could have a material adverse effect on the Group's future financial position, results of operations or cash flows: changes in the overall demand for services; competitive pressures from other online gaming companies; advances and new trends in new technologies and industry standards; changes in bandwidth suppliers; changes in certain strategic relationships or distributor relationships; regulatory considerations; and risks associated with the Group's ability to attract and retain employees necessary to support its growth.

More than 80% of the Group's revenues for the year ended December 31, 2011, 2012 and 2013 were primarily derived from a single online game series. No individual distributor or end-user customer accounted for more than 10% of advances from distributors or net revenues, respectively, for the years ended December 31, 2011, 2012 and 2013.

The Group's operations could be adversely affected by significant political, economic and social uncertainties in the PRC. Although the PRC government has been pursuing economic reform policies for more than 20 years, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered, especially in the event of a change in leadership, social or political disruption or unforeseen circumstances affecting the PRC political, economic and social conditions. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**

***28) Concentration of risk (Cont'd)***

**Currency convertibility risk**

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

**Foreign currency exchange rate risk**

From July 21, 2005, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. On June 19, 2010, the People's Bank of China announced the end of the RMB's de facto peg to U.S. dollar, a policy which was instituted in late 2008 in the face of the global financial crisis, to further reform the RMB exchange rate regime and to enhance the RMB's exchange rate flexibility. On March 15, 2014, the People's Bank of China announced the widening of the daily trading band for RMB against US\$. The depreciation of the U.S. dollar against RMB was approximately 4.6%, 1.0%, and 2.8% in 2011, 2012 and 2013, respectively. Any significant revaluation of RMB may materially and adversely affect the Group's cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, the ADS in U.S. dollars. As a result, the appreciation of RMB against the U.S. dollar has resulted in foreign currency translation losses when translating the assets of the Group from the U.S. dollar into RMB.

***29) Dividends***

Dividends of the Group are recognized when declared. Relevant laws and regulations permit payments of dividends by the PRC subsidiaries and affiliated companies only out of their retained earnings, if any, as determined in accordance with respective accounting standards and regulations.

***30) Recent accounting pronouncements***

In July 2013, the FASB issued ASU No. 2013-11 ( ASU 2013-11 ), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which concludes an

unrecognized tax benefit should be presented as a reduction of a deferred tax asset when settlement in this manner is available under the tax law. The amendments are effective for reporting periods beginning after December 15, 2013. Early adoption is permitted. The Group does not expect the adoption of ASU 2013-11 will have a significant effect on its consolidated financial statements.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****3. ACQUISITIONS**

On October 17, 2012, the Group reacquired 51% equity interest of Beijing Giant Zhengtu from Huayi. Beijing Giant Zhengtu was previously sold to Huayi in December 2010 for a consideration of RMB57,250,000 (the reacquisition). Prior to the reacquisition, the Group owned 34% equity interest of Beijing Giant Zhengtu and accounted it as an equity investee. After the reacquisition, the Group had a total of 85% equity interest of Beijing Giant Zhengtu and Beijing Giant Zhengtu became a consolidated subsidiary of the Group. The Group reacquired Beijing Giant Zhengtu principally for the knowledge and expertise of its research and development employees as well as potential value associated with its developed game. The reacquisition met the definition of a business acquisition in accordance with ASC 805-10 (ASC 805-10), Business Combination.

The acquisition date fair value of the consideration pursuant to the application of the acquisition method was as follows:

	<b>RMB</b>
Cash	57,250,000
34% previously owned equity interests	31,572,322
15% noncontrolling interest	13,928,966
	102,751,288

The acquisition date fair value of the previously owned equity interest of 34% was included in the measurement of the consideration transferred and a loss of RMB303,581 was recognized as a result of re-measuring upon reacquisition which was recorded as a debit to other income in the consolidated statements of comprehensive income. The fair value of the previously owned equity interest and noncontrolling interest was determined by management with the assistance of an independent third party valuation firm using an income approach. As Beijing Giant Zhengtu is a private entity, the fair value measurement was based on significant inputs that were not observable in the market and thus represented a Level 3 measurement as defined in ASC 820. The fair value estimate was based on (i) a discount rate of 13.7%, (ii) long-term sustainable growth rate of 3%, (iii) financial multiples of companies in the same industry as Beijing Giant Zhengtu and (iv) adjustment due to the lack of marketability that market participants would consider when estimating the fair value of Beijing Giant Zhengtu as a private entity.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****3. ACQUISITIONS (CONT'D)**

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as at the date of acquisition:

	<b>RMB</b>
Current assets	10,553,021
Property and equipment, net	16,390
Online game software	15,833,333
Total identifiable assets acquired	26,402,744
Accounts and other payables	77,581
Accrued liabilities	687,916
Total liabilities assumed	765,497
Net identifiable assets acquired	25,637,247
Goodwill	77,114,041
Net assets acquired	102,751,288

The fair value of the online game software was determined by management with the assistance of an independent third party valuation firm using an income approach, which involves applying an appropriate discount rate to estimated cash flow that will be derived from the online game in the future. The online game software is subject to a useful life of 5 years and amortization expense recorded for the year ended December 31, 2012 since acquisition was RMB834,167. The goodwill recognized was attributable to expected synergies and knowledge and expertise from the workforce of Beijing Giant Zhengtu. None of the goodwill was expected to be deductible for income tax purpose.

Consolidated revenue and net income of Beijing Giant Zhengtu that was recorded during the period from October 17, 2012 through December 31, 2012 was RMB816,474 and RMB1,659,266, respectively. Pro forma results of operation for this acquisition were not presented because the effects of the acquisition were not material to the Company's consolidated financial results.

On August 8, 2013, the Group entered into a share transfer agreement with related parties, Giant Investment Co., Ltd. ( Giant Investment ) and Shanghai Jiante Biotechnology Co., Ltd. ( Jiante Biotechnology ), to acquire 100% equity



interest in Juxiao Estate for cash consideration of RMB16,000,000 (US\$2,643,012). Juxiao Estate holds the land use right to a lot adjacent to the Group's existing office space for the construction of additional office space (Note 20). The purchase consideration approximated fair value of Juxiao Estate's net assets. The acquisition was completed and the Group took effective control of Juxiao Estate on August 8, 2013. The acquisition of Juxiao Estate did not meet the definition of a business acquisition in accordance with ASC 805-10 and was accounted for as an asset acquisition.

The acquired land use right is recorded at purchase cost less accumulated amortization. Amortization is provided on a straight-line basis over the life of the land use right agreement, which is 48.25 years. As of December 31, 2013, the land use right had a net book value of RMB48,370,323 (US\$7,990,208). The Group recognized amortization expense of RMB416,558 (US\$68,810) for the year ended December 2013.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4. SHORT-TERM INVESTMENTS**

Short-term investments consisted of the following as of December 31, 2012 and 2013:

	<b>2012</b>	<b>December 31,</b>	
	<b>RMB</b>	<b>2013</b>	<b>2013</b>
		<b>RMB</b>	<b>US\$</b>
- Fixed rate time deposits	139,314,900	250,486,050	41,377,347
- Investment contracts			
- Huaneng Trust <sup>(1), (2)</sup>	600,000,000		
- China Merchant Bank <sup>(3), (4)</sup>		1,597,200,000	263,838,645
- Minsheng Baoteng Plan <sup>(5)</sup>		952,000,000	157,259,197
Total short-term investments	739,314,900	2,799,686,050	462,475,189

- (1) In April 2012, the Group made an investment of RMB300,000,000, with a maturity term of one year, in Huaneng Guicheng Trust ( Huaneng Trust ), which was used to fund Ningbo Poly Real Estate Co., Ltd. ( Ningbo Poly ), a real estate development company with operations throughout the PRC. The short-term investment, after deducting management fees charged by the Huaneng Trust, was expected to yield a net return to the Group of 8.5%. The principal and interest of the investment were guaranteed by Poly HK Co. Ltd., a company listed on the Hong Kong Stock Exchange and Poly Real Estate Group Limited, a subsidiary of Poly HK Co., Ltd. Proceeds with respect to this investment were received by the Group on April 9, 2013.
- (2) In June 2012, the Group made another investment in Huaneng Trust of RMB300,000,000, with a maturity term of one year, which was used to fund a short-term loan provided to China Enterprise, a commercial and residential real estate development company with operations throughout the PRC. The short-term investment, after deducting management fees charged by Huaneng Trust, was expected to yield a net return to the Group of 8.3%. The principal and interest of the investment loan were guaranteed by a regional real estate company in Shanghai. Proceeds with respect to this investment were received by the Group on the maturity date, June 20, 2013.
- (3) In June 2013, the Group made an investment with China Merchant Bank, Shanghai Branch, in the amount of RMB800,000,000 (US\$132,150,586), as a pledge for the loan obtained from China Merchant Bank, Hong Kong Branch (Note 12). This short-term investment has a maturity term of one year and is expected to yield a return of 5% to the Group.
- (4) In August and September 2013, the Group made investments with China Merchant Bank in the aggregate amount of RMB797,200,000 (US\$131,688,059). The investments have maturity terms of six months and are expected to yield a return of 4.8% to the Group.
- (5) In August and September 2013, the Group made investments in the Minsheng Baoteng Plan with Minsheng Royal Asset Management in the aggregate amount of RMB952,000,000 (US\$157,259,197). The short-term investments have maturity terms of one year and are expected to yield a return of 6% to the Group.

There were no impairment indicators associated with these investments as of December 31, 2012 and 2013.

F-37

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4. SHORT-TERM INVESTMENTS (CONT D)**

The Group recorded interest income on the short-term investments amounting to RMB102,202,930, RMB86,194,786 and RMB83,705,315 (US\$13,827,133) for the years ended December 31, 2011, 2012 and 2013, respectively, in the consolidated statements of comprehensive income.

**5. PREPAYMENTS AND OTHER CURRENT ASSETS**

Prepayments and other current assets consisted of the following:

	<b>2012</b>	<b>December 31,</b>	
	<b>RMB</b>	<b>2013</b>	
		<b>RMB</b>	<b>US\$</b>
Prepaid expenses	9,625,806	10,287,700	1,699,407
Staff advances	5,072,831	4,506,613	744,440
VAT refundable <sup>(1)</sup>	115,015,077	160,011,443	26,432,007
Interest receivable	5,263,501	65,917,594	10,888,811
Receivable from a shareholder of Glorious Mission Network (Note 1)		9,500,000	1,569,288
Share-based awards exercise receivables <sup>(2)</sup>	42,971,091	4,134,689	683,002
Receivable from the sale of a land use right <sup>(3)</sup>	34,040,054		
Others	24,457,677	30,879,662	5,100,957
<b>Total</b>	<b>236,446,037</b>	<b>285,237,701</b>	<b>47,117,912</b>

(1) VAT refundable related to the 14% VAT refunds to certain subsidiaries of the Company that qualify for the software company tax incentive. Such tax incentive is typically received within one year from declaration to the tax bureau.

(2) Starting from 2008, the Group uses a third party broker to facilitate the cashless exercise of share options and restricted shares by employees. The balances as of December 31, 2012 and 2013 represented the amounts due from the third party broker to the Group upon the exercise of options and restricted shares on behalf of the Group's employees.

(3) In May 2012, the Zhuhai Land and Resources Bureau (the Zhuhai Bureau) decided to retrieve a parcel of land sold to the Group in 2009 for RMB85,100,136. The Group received RMB51,060,082 from the Zhuhai Bureau during the year ended December 31, 2012 and the remaining balance of RMB34,040,054 was received in full in

May 2013.

F-38

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****6. PROPERTY AND EQUIPMENT**

Property and equipment and their related accumulated depreciation as of December 31, 2012 and 2013 were as follows:

	<b>December 31,</b>		
	<b>2012</b>	<b>2013</b>	
	RMB	RMB	US\$
Computer equipment	327,736,364	311,542,614	51,463,174
Furniture and fixtures	23,188,141	23,525,921	3,886,205
Motor vehicles	4,669,096	5,718,594	944,644
Leasehold improvements	1,603,574	1,790,059	295,697
Property	213,510,969	213,658,976	35,293,949
Construction in progress		16,635,955	2,748,064
	570,708,144	572,872,119	94,631,733
Less: Accumulated depreciation	(230,465,770)	(217,070,676)	(35,857,522)
Property and equipment, net	340,242,374	355,801,443	58,774,211

Depreciation expense for the years ended December 31, 2011, 2012 and 2013, were RMB60,877,662, RMB60,669,884 and RMB49,458,028 (US\$8,169,884), respectively.

**7. INTANGIBLE ASSETS**

Intangible assets and their related accumulated amortization as of the respective balance sheet dates were as follows:

	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>As of December 31, 2013</b>		<b>Net Carrying Value</b>	<b>Net Carrying Value</b>
			<b>Impairment</b>	<b>Deconsolidation of a subsidiary</b>		
	RMB	RMB	RMB	RMB	RMB	US\$
Online game product development costs	29,482,070	(28,016,198)			1,465,872	242,145
Software	111,058,276	(79,327,481)		(8,873,233)	22,857,562	3,775,800
License fee	39,292,697	(8,053,478)	(20,100,000)		11,139,219	1,840,068

Intangible assets, net	179,833,043	(115,397,157)	(20,100,000)	(8,873,233)	35,462,653	5,858,013
------------------------	-------------	---------------	--------------	-------------	------------	-----------

## As of December 31, 2012

	<b>Gross Carrying Value RMB</b>	<b>Accumulated Amortization RMB</b>	<b>Impairment RMB</b>	<b>Deconsolidation of a subsidiary RMB</b>	<b>Net Carrying Value RMB</b>
Online game product development costs	41,449,773	(24,112,434)	(11,967,703)		5,369,636
Software	92,297,129	(63,768,558)	(1,098,354)		27,430,217
Intangible assets, net	133,746,902	(87,880,992)	(13,066,057)		32,799,853

Amortization expenses for the years ended December 31, 2011, 2012 and 2013 were RMB17,868,863, RMB13,901,987 and RMB25,244,143 (US\$4,170,036), respectively.

During the year ended December 31, 2013, the Group recorded an impairment charge of approximately RMB20,100,000 (US\$3,320,283) for the underperformance of a licensed online game. The impairment charge was recorded a cost of service. There were no indicators of impairment noted on the other intangible assets during the year ended December 31, 2013. The fair value measurement of the licensed online game was based on significant inputs that were not observable in the market and thus represented a Level 3 measurement as defined in ASC 820. Income Approach was adopted by management to evaluate the fair value. The fair value estimate was based on (i) a discount rate of 21.0%, (ii) projection period based on the remaining license period, and (iii) estimated Contributory Asset Charges ( CAC ) of the licensed game.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****7. INTANGIBLE ASSETS (CONT D)**

During the year ended December 31, 2012, the Group recorded an impairment charge of approximately RMB13,066,057, relating to the abandonment of certain prelaunch projects and one previously launched game that was underperforming. This amount was recorded within research and product development expense. There were no indicators of impairment noted related to the other intangible assets during the year ended December 31, 2012. There were no indicators of impairment noted related to the intangible assets during the year ended December 31, 2011.

The estimated annual amortization expense for each of the five succeeding fiscal years is as follows:

	<b>Amortization</b>	
	RMB	US\$
For the years ending December 31,		
2014	14,931,516	2,466,511
2015	11,926,432	1,970,106
2016	3,933,098	649,701
2017	1,975,629	326,351
2018	1,867,213	308,442

**8. GOODWILL**

Goodwill of RMB99,316,001 as of December 31, 2012 and 2013 represented the excess of the purchase price over the estimated fair value of the net tangible and identifiable intangible assets acquired relating to the acquisition of Snow Wolf Software during 2009, the acquisition of Julun Network during 2010 and the acquisition of Beijing Giant Zhengtu during 2012.

During the years ended December 31, 2012 and 2013, the Group performed a qualitative assessment to determine whether it was more likely than not that the fair value of a reporting unit was less than its carrying amount. Based on the qualitative assessment, the Group determined that it was not more likely than not that the fair value of the reporting unit was less than the carrying value. Accordingly, the first and second steps of the goodwill impairment test were not necessary in accordance with ASC 350-10. No impairment on goodwill was recognized for the years ended December 31, 2012 and 2013.



**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****9. LONG-TERM INVESTMENTS**

	<b>December 31,</b>		
	<b>2012</b>	<b>2013</b>	
	RMB	RMB	US\$
Yunfeng E-commerce A Fund, L.P. and Yunfeng E-Commerce B Fund, L.P. (Collectively known as Yunfeng E-Commerce Funds <sup>(1)</sup> )	377,095,598	365,780,630	60,422,656
Yangxun Computer Technology (Shanghai) Co., Ltd. ( Yangxun )	27,331,600	27,331,600	4,514,859
Beijing Innovation Works Development Fund ( Innovation Works )	18,000,000	22,500,000	3,716,735
Beijing Dijiang Network Technology Co., Ltd. ( Dijiang Network )	3,000,000	4,000,000	660,753
Shanghai Tianju Network Technology Co., Ltd. ( Tianju Network )	660,387		
Beijing Wula Century Technology Co., Ltd. ( Wula Century )		2,700,000	446,008
Yunfeng Fund II, L.P. ( Yunfeng Fund II )		9,390,144	1,551,141
Glorious Mission Network		5,934,190	980,258
<b>Total</b>	<b>426,087,585</b>	<b>437,636,564</b>	<b>72,292,410</b>

(1) Due to the Group's inability to obtain (i) quarterly financial statements of Yunfeng E-Commerce Funds, prepared in accordance with U.S. generally accepted accounting principles and (ii) readily determinable fair value, including financial information otherwise required to derive such fair value, of the Alibaba Group, the Group is precluded from applying the equity method of accounting for its investment in Yunfeng E-Commerce Funds. Accordingly, the Group applied the cost method of accounting.

In February 2014, the Group sold all of its investment in Yunfeng E-Commerce Funds to a third party at a consideration of RMB1,205,291,670 (US\$199,100,000), resulting in a gain of RMB890,581,243 (US\$147,113,541) after deducting the transaction cost, that is recognized in the first quarter of 2014 (Note 26).

In 2013, the Group identified an error in its accounting for the investment in Yunfeng E-Commerce Funds as of and for the year ended December 31, 2012, resulting in an overstatement of the investment, as well as unrealized gain through other comprehensive income, of RMB69,135,783. The Group has evaluated and determined that the error is not material to the consolidated financial statements as of and for the year ended December 31, 2012 and 2013. The error also has no impact on the measurement of the gain subsequently recognized through the sale of the investment in 2014.

F-41

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**10. AVAILABLE-FOR-SALE SECURITY**

On July 1, 2008, the Group entered into an agreement to purchase 18,508,208 preferred shares of 51.com, a private company in the PRC in exchange for the surrender of a promissory note of RMB34,312,761 (US\$5,000,000) and cash consideration of RMB314,370,245 (US\$45,809,524). The Group evaluated and determined that there was no embedded derivative requiring bifurcation from the Preferred Shares under the requirements of ASC 815, Derivatives and Hedging. The Group classified its investment in the Preferred Shares as an available-for-sale security.

During the year ended December 31, 2012, the fair value of the Preferred Shares significantly declined due to 51.com's significantly lower than expected core business revenues and operating cash flows resulted from events that occurred during the fourth quarter in 2012, such as the delay in its core research and development activities and the campaign of newly launched games. The significance of these fourth quarter events had a material adverse and prolonged effect on key fiscal 2013 sales and other operating assumptions within the long-range operating forecast used to estimate the fair value of 51.com, such that the immediate effects on the estimated fair value was material, and an other-than-temporary impairment loss of RMB240,725,709 comprising the difference between the investment cost and its estimated fair value was recorded as an investment loss in the Company's consolidated statements of comprehensive income. As a result, the new cost basis of the Preferred Shares was RMB78,740,916 as of December 31, 2012.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**11. HELD-TO-MATURITY SECURITIES**

During the second quarter of 2011, the Group invested RMB100,000,000 in CR Trust with an overall variable total yield ranging from 14% to 19.5% per year (including a fixed yield of 3% per year). The term of the CR Trust was five years with an option for the beneficiaries to redeem after the end of three years from the date of establishment. Such option was not exercisable by the beneficiaries when the trust previously distributed principal amounts of more than 60% of the total initial trust fund at establishment. The investment was guaranteed by China Yin Tai Holding Co., Ltd. Management accounted for this investment as a held-to-maturity security in accordance with ASC 320-10 at amortized cost. The estimated fair value of the investment as of December 31, 2012 approximated its carrying value as there were no impairment indicators present, events or changes in circumstances having occurred or expected to occur that would have an adverse effect on the underlying value of the investment.

In May 2012 and May 2013, the Group received RMB10,000,000 and RMB10,000,000 (US\$1,651,882) repayment of capital, respectively. In consideration of the slower than expected sales performance of the underlying real-estate projects, the CR Trust officially announced for an early termination on June 27, 2013. The distribution to the beneficiaries was the initial principal amount plus an average return of 14% per annum for 2011, 2012 and 2013. On July 2, 2013, the Group received RMB80,000,000 (US\$13,215,059) in return on fund capital and interest income of RMB22,525,753 (US\$3,720,989) was recognized.

In February 2012, the Group invested in a RMB100,000,000 two-year time deposit with the Bank of Communications, Zhuhai Branch, with a fixed annual interest rate of 4.4%. The investment was reclassified to short-term investments as of December 31, 2013.

In August 2013, the Group invested in a RMB10,000,000 (US\$1,651,882) two-year time deposit in Bank of Ningbo with a fixed annual interest rate of 3.75%.

The Group recorded interest income on the held-to-maturity securities in the amounts of RMB1,972,603, RMB6,593,015 and RMB23,581,661 (US\$3,895,413) for the years ended December 31, 2011, 2012 and 2013, respectively.

**12. SHORT TERM LOAN**

Short-term loan outstanding as of December 31, 2013 represented a bank borrowing of US\$100,600,000 obtained from China Merchant Bank, Hong Kong Branch, with a variable interest rate of the higher of 3-month LIBOR plus 1.2% per annum or the China Merchant Bank, Hong Kong Branch's cost of fund plus 1.2% per annum. The short term loan matures on June 25, 2014. The bank borrowing was made in connection with the dividend distribution declared on February 22, 2013 (Note 22).

**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****13. PAYABLES AND ACCRUED EXPENSES**

Payables and accrued expenses consisted of the following:

	December 31,		
	2012 RMB	2013 RMB	US\$
Payroll and welfare payables	67,327,973	72,238,085	11,932,881
Business and other taxes and related surcharges	64,905,302	66,060,009	10,912,336
Other payables			
- Property and equipment and intangible assets	4,960,542	12,706,745	2,099,005
- Share-based awards <sup>(1)</sup>	25,320,305	8,810,286	1,455,356
Accrued expenses	45,013,072	49,626,123	8,197,651
Payable for the reacquisition of Beijing Giant Zhengtu	28,625,000		
Others	2,441,891	1,880,246	310,595
<b>Total</b>	<b>238,594,085</b>	<b>211,321,494</b>	<b>34,907,824</b>

- (1) Starting from 2008, the Group uses a broker to facilitate the cashless exercise of share-based awards by employees which results in the Group receiving exercise proceeds from the broker with the related pass through proceeds due to employees recorded within other payables.

**14. GOVERNMENT FINANCIAL INCENTIVES**

The Group received government financial incentives of RMB47,746,000, RMB63,644,000 and RMB44,766,000 (US\$7,394,816) during the years ended December 31, 2011, 2012 and 2013, respectively, from the municipal government for prompt tax payments and qualification as a high technology company. Such financial incentives are recorded within operating expenses as they are calculated with reference to business tax, value-added tax, and corporate income tax, if any, paid or withheld by the Company's PRC subsidiaries or VIE at predetermined percentages. The central government or municipal government could decide at any time to immediately eliminate or reduce these financial incentives. There is no guarantee that the Group will continue to receive these government financial incentives in the future. There are no conditions or performance obligations attached to these government financial incentives and once received, are not refundable. As a result, government financial incentives are recognized as income when received.

**15. INCOME TAX EXPENSES**

*Cayman Islands and British Virgin Island*

Under the current laws of Cayman Islands and British Virgin Island, the Company and its subsidiaries incorporated in the British Virgin Islands ( BVI ) are not subject to tax on their income or capital gains. In addition, there is no income or other tax of the Cayman Islands or the British Virgin Islands imposed by withholding or otherwise on any dividend payment to be made to or by the Company or its BVI subsidiaries.

*Hong Kong*

Giant HK, the Company's wholly owned subsidiary incorporated in Hong Kong, is subject to Hong Kong corporate income tax at a rate of 16.5% on the estimated assessable profits arising in Hong Kong.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**15. INCOME TAX EXPENSES (CONT D)**

*China*

The Company's subsidiaries and the VIE and its consolidated entities that are each incorporated in the PRC are subject to corporate income tax ( CIT ) on the taxable income as reported in their respective statutory financial statements adjusted in accordance with the PRC Income Tax Laws, respectively. Pursuant to the PRC Income Tax Laws, the Company's PRC subsidiaries, the VIE and its consolidated entities are subject to a CIT statutory rate of 25%.

During 2008, Zhengtu Information received approval as a High and New Technology Enterprise ( HNTE ) which allows it to utilize a reduced income tax rate of 15% from 2008 to 2010. The HNTE status is subject to annual qualification and tri-annual renewal. Zhengtu Information applied for the renewal of HNTE in 2011 and was subsequently approved in April 2012 which allows it continue to enjoy the HNTE preferential tax rate of 15% from 2011 to 2013, subject to meeting all criteria in its annual compliance self-assessment. Zhengtu Information received approval as a key software enterprises in 2013 which allows it to enjoy a reduced CIT rate of 10% in 2011 and 2012 provided that no CIT exemption applies in the particular year.

On December 3, 2010, Snow Wolf received a certificate for Software Enterprise. In 2011, Jujia Network, Juhuo Network, Zhengju Information and Beijing Giant Zhengtu, all being subsidiaries of the Company, received certificates for Software Enterprises. As software enterprises, they are entitled to a full exemption from corporate income tax ( CIT ) for the first and second profitable years, and a 50% reduction of statutory tax rate for the three succeeding years.

Giant Network, Zhengduo Information, Zhuhai Zhengtu, Juhe Network, Juquan Network, Juhuan Network, Jujia Network II, Juxin Network, Julun Network, Juzi Information, Jujia Network III, Juxiao Estate, Juyan Network and Beijing Haishen Network's applicable CIT rate is 25%.

In accordance with the PRC Income Tax Laws effective from January 1, 2008, enterprises established under the laws of foreign countries or regions but whose place of effective management is located within the PRC territory are considered as PRC resident enterprises, subject to the PRC income tax at the rate of 25% on worldwide income. The definition of place of effective management refers to an establishment that exercises, in substance, overall management and control over the production and business, personnel, accounting, properties, etc, of an enterprise. The Company, if considered a PRC tax residence enterprise for tax purpose, would be subject to CIT at the rate of 25% on its worldwide income.

Based on the assessment of facts and circumstances available at December 31, 2012 and 2013, management believes none of its non-PRC entities are more likely than not PRC tax resident enterprises. It is possible the assessment of tax residency status may change in the next twelve months, pending announcement of new PRC tax rules in the future. The Group will continue to monitor its tax status.





Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****15. INCOME TAX EXPENSES (CONT D)**

The Group had minimal operations in jurisdictions other than the PRC. Income before income tax expenses consisted of:

	For the year ended December 31,			
	2011	2012	2013	
	RMB	RMB	RMB	US\$
PRC	1,229,776,487	1,444,510,519	1,634,723,427	270,037,072
Non-PRC	37,215,603	(242,235,346)	4,067,080	671,833
<b>Total</b>	<b>1,266,992,090</b>	<b>1,202,275,173</b>	<b>1,638,790,507</b>	<b>270,708,905</b>

*(a) Current Tax*

Income tax expenses consisted of:

	For the year ended December 31			
	2011	2012	2013	
	RMB	RMB	RMB	US\$
Current income taxes	268,076,187	129,063,487	74,596,371	12,322,443
Deferred income tax expenses/(benefits)	84,302,034	(4,859,603)	222,025,987	36,676,080
<b>Taxation for the year</b>	<b>352,378,221</b>	<b>124,203,884</b>	<b>296,622,358</b>	<b>48,998,523</b>

The reconciliation of tax computed by applying the statutory income tax rate of 25% for the years ended December 31, 2011, 2012 and 2013 is as follows:

	For the year ended December 31			
	2011	2012	2013	
	RMB	RMB	RMB	US\$
Expected taxation at PRC CIT statutory rate of 25%	316,748,023	300,568,795	409,697,626	67,677,226

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Favorable tax rate	(131,302,690)	(53,513,461)	(116,133,683)	(19,183,918)
Foreign tax rate differences	(9,292,635)	61,497,661	4,972,700	821,432
Tax holiday	(12,694,680)	(213,843,843)	(193,466,873)	(31,958,451)
Non-deductible expenses (non-taxable income), net	4,388,219	4,219,822	(15,379,431)	(2,540,500)
Additional 50% tax deduction for qualified research and development expenses	(18,935,961)	(15,313,139)	(28,293,314)	(4,673,723)
Change in valuation allowance	2,885,413	19,141,064	(1,465,804)	(242,134)
Deferred tax benefits on future tax rate difference	(58,833,362)	(10,864,692)	(14,583,432)	(2,409,011)
Withholding taxes	259,415,894	32,311,677	251,274,569	41,507,602
Income tax expenses	352,378,221	124,203,884	296,622,358	48,998,523

Deferred tax benefits on future tax rate difference in 2011 relate to the increase of deferred tax assets recognized by Giant Network as a result of the impact of the change in the future enacted tax rate from 15% to 25% from the non-renewal of Giant Network's HNTE status in 2011.

The benefit of tax holiday per basic and diluted earnings per share was as follows:

	For the year ended			
	December 31			
	2011	2012	2013	
	RMB	RMB	RMB	US\$
Basic	0.05	0.90	0.81	0.13
Diluted	0.05	0.89	0.78	0.13

Table of Contents

## GIANT INTERACTIVE GROUP INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 15. INCOME TAX EXPENSES (CONT D)

*(b) Deferred Tax*

Deferred tax assets and liabilities reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities were as follows:

	2012	December 31,	
	RMB	2013	
		RMB	US\$
<b>Current deferred tax assets, net</b>			
Deferred revenue and advances from distributors	143,477,509	102,748,056	16,972,770
Accrued expenses	18,005,213	27,120,534	4,479,993
Allowance for doubtful accounts	619,697	4,754,691	785,419
Share-based compensation expense	5,704,336	16,583,266	2,739,360
Less: valuation allowance	(2,648,477)	(303,201)	(50,085)
<b>Current deferred tax assets, net</b>	<b>165,158,278</b>	<b>150,903,346</b>	<b>24,927,457</b>
<b>Non-current deferred tax assets, net</b>			
Intangible assets amortization	17,542,090	20,220,088	3,340,121
Share-based compensation expense	10,060,155	9,599,340	1,585,698
Deferred revenue		1,197,917	197,882
Tax loss	17,121,210	16,088,812	2,657,682
Less: valuation allowance	(19,378,000)	(13,991,436)	(2,311,221)
<b>Non-current deferred tax assets, net</b>	<b>25,345,455</b>	<b>33,114,721</b>	<b>5,470,162</b>
<b>Current deferred tax liabilities</b>			
Intangible assets amortization	12,723	12,472	2,060
Deferred revenue and income	2,500,000	2,193,845	362,397
Upfront fee amortization	5,833,333		
Welfare payable	1,439,123	1,401,737	231,551
Withholding taxes	109,769,916	336,704,060	55,619,548

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Current deferred tax liabilities	119,555,095	340,312,114	56,215,556
<b>Non-current deferred tax liabilities</b>			
Land use right amortization		3,416,956	564,441
Withholding taxes	32,311,676	17,364,573	2,868,423
Upfront fee amortization		1,197,917	197,882
Non-current deferred tax liabilities	32,311,676	21,979,446	3,630,746
Net current deferred tax assets (liabilities)	45,603,183	(189,408,768)	(31,288,099)
Net non-current deferred tax assets (liabilities)	(6,966,221)	11,135,275	1,839,416

Valuation allowances have been provided for deferred tax assets where, based on all available evidence, it was determined by management that more likely than not to be realized in future years. The Group recorded a full valuation allowance against deferred tax assets of those subsidiaries that are in a cumulative 3-year loss position as of December 31, 2012 and 2013.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****15. INCOME TAX EXPENSES (CONT D)***(b) Deferred Tax (Cont d)*

As of December 31, 2013, the Group had net operating tax losses carried forward in the total amount of RMB93,087,473 (US\$15,376,955) attributed to its PRC subsidiaries as per the filed tax returns for the year ended December 31, 2013. The net operating losses will expire between 2015 and 2019.

The Company intended to permanently reinvest all undistributed earnings generated by its foreign subsidiaries except for Zhengju Information beginning in 2011 and onward to finance its future operations, as of December 31, 2012. Thus, the amount of unrecognized deferred tax liabilities for temporary differences related to investments in foreign subsidiaries was not determined because such a determination was not practicable, as of December 31, 2012. However, in November 2013, due to a non-binding proposal for privatization from the Company's Chairman and another shareholder (and certain of their affiliated entities), the Company anticipated the repatriation of earnings from the Group's PRC operations. As of December 31, 2013, the amount of undistributed earnings of the Company's PRC subsidiaries, which would be subject to withholding taxes to the extent dividends were declared and distributed by the Company's PRC subsidiaries to their respective immediate holding companies that reside outside of China, was RMB 4,246,995,434 (US\$ 701,547,059).

*(c) Unrecognized Tax Benefits*

As of December 31, 2012 and 2013, the Group recorded an unrecognized tax benefit of RMB47,579,967 and RMB47,579,967 (US\$7,859,651), respectively, related to excess share-based compensation expense deductions from prior years. The amount of unrecognized tax benefits will change in the next twelve months, pending clarification of current tax law or audit by the tax authorities, however, an estimate of the range of the possible change cannot be made at this time. The unrecognized tax benefit resulting from the difference between the share-based compensation expense deduction and the cumulative amount of compensation cost would be recorded to additional paid-in capital, when recognized. For the years ended December 31, 2011, 2012 and 2013, no interest or penalties related to uncertain tax positions were recognized. As of December 31, 2013, the Group's tax years ended December 31, 2008 through 2013 for the PRC entities remain open for statutory examination by the PRC tax authorities.

A roll-forward of unrecognized tax benefits is as follows:

	RMB
Balance as of January 1, 2012	44,451,522
Increases related to current year tax positions	3,128,445

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

Balance as of December 31, 2012 and January 1, 2013	47,579,967
Increases related to current year tax positions	
Balance as of December 31, 2013	47,579,967
Balance as of December 31, 2013 (US\$)	7,859,651

F-48

**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****16. EARNINGS PER SHARE**

Computation of basic and diluted earnings per share were as follows:

	<b>December 31</b>			
	2011 RMB	2012 RMB	2013 RMB	2013 US\$
<b>Numerator:</b>				
Net income attributable to ordinary shareholders	879,966,874	993,720,006	1,252,967,928	206,975,555
Numerator for basic earnings per share	879,966,874	993,720,006	1,252,967,928	206,975,555
Numerator for diluted earnings per share	879,966,874	993,720,006	1,252,967,928	206,975,555
<b>Denominator:</b>				
Number of shares outstanding, opening	228,019,412	235,234,959	239,252,672	239,252,672
Weighted average number of shares issued	4,104,619	1,911,200	399,925	399,925
Weighted average number of shares repurchased	(119,152)	(349,341)		
Weighted average number of shares outstanding basic	232,004,879	236,796,818	239,652,597	239,652,597
Dilutive effect of share options		4,024,309	7,182,662	7,182,662
Weighted average number of shares outstanding diluted	232,004,879	240,821,127	246,835,259	246,835,259
Earnings per share:				
Basic	3.79	4.20	5.23	0.86
Diluted	3.79	4.13	5.08	0.84

As of December 31, 2013, the Company issued 1,557,469 ordinary shares to its share depositary bank which will be used to settle share option awards upon their exercise. No consideration was received by the Company for this issuance of ordinary shares. These ordinary shares were issued but not outstanding. They are treated as escrowed shares for accounting purposes and therefore, have been excluded from the computation of earnings per share. Any ordinary shares not used in the settlement of share option awards will be returned to the Company.





**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**17. SHARE OPTION AND RESTRICTED SHARE SCHEMES**

On October 12, 2007, the Company authorized the 2007 Stock Incentive Scheme that provides for the issuance of awards to officers (including directors), employees of the Group and consultants (collectively, the grantees ). The maximum number of shares authorized for issuance under the 2007 Stock Incentive Scheme is 23,700,000. The share options and restricted shares, if and when issued, have a maximum term of ten years. The 2007 Stock Incentive Plan provides for two terms to grantees. These awards vest either over a five or a four year period, with 20% or 25%, respectively, of the share options and restricted shares to vest on each of the first, second, third, fourth and fifth anniversaries of the award dates as stipulated in the award agreements.

On October 17, 2007, the Board of Directors approved the grant of 1,743,500 share options (nonperformance-based and to be settled in shares) to certain officers and employees of the Group pursuant to the 2007 Stock Incentive Scheme. The exercise price of these options was US\$15.50.

On February 1, 2008, February 14, 2008 and September 9, 2008, the Board of Directors approved the grant of 60,000, 50,000 and 560,500 share options (nonperformance-based and to be settled in shares) at the exercise prices of US\$10.29, US\$10.50 and US\$8.01, respectively, pursuant to the 2007 Stock Incentive Scheme to certain officers and employees of the Group.

On February 27, 2009, the Board of Directors approved the grant of 335,000 share options (nonperformance-based and to be settled in shares) to certain employees of the Group at the exercise prices of US\$6.00, pursuant to the 2007 Stock Incentive Scheme.

By a resolution of the Board of Directors on April 23, 2010, 797,000 restricted shares under the 2007 Stock Incentive Scheme were granted to certain officers and employees of the Group. One fifth of the total restricted shares will become vested upon each annual anniversary of the grant date during the next five years.

On January 14, 2011, the Board of Directors approved the grant of 60,000 share options (nonperformance-based and to be settled in shares) at the exercise prices of US\$7.24 to the independent directors with a vesting period of 4 years, pursuant to the 2007 Stock Incentive Scheme.

On October 31, 2011, the Board of Directors approved the grant of 14,000,000 restricted shares under the 2007 Stock Incentive Scheme to selected employees and management members of the Group. One fifth of the total restricted shares will become vested upon each annual anniversary of the grant date during the next five years.

On August 8, 2011, the Company's Board of Directors authorized the accelerated vesting of 400,000 share options that were issued under the 2007 Stock Incentive Scheme to an employee upon his resignation from the Group. Share-based compensation expense of approximately RMB7,000,000 relating to the unvested share options was reversed upon his resignation, whereas an incremental compensation expense of approximately RMB10,000,000 relating to the accelerated vesting of such share options was immediately recognized as share-based compensation expense on the date of the modification.



Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****17. SHARE OPTION AND RESTRICTED SHARE SCHEMES (CONT'D)**

On October 31, 2011, the Company's Board of Directors authorized the repricing of certain share options granted to employees, directors and officers under the 2007 Performance Incentive Scheme from the original exercise price ranging from US\$6.00 to US\$7.24 per share to US\$4.07 per share. A total of 1,098,600 options belonging to 84 employees of the Group were repriced under the 2007 Stock Incentive Scheme based on the then fair market value in reference to the closing price of the Company's ADSs traded on the NYSE on October 28, 2011 (the modification date), which was the last trading day prior to the Board of Directors' approval. All eligible share option grantees affected by such changes entered into amended share option agreements with the Company.

The total incremental compensation cost for the modification was RMB2,114,102, of which, RMB1,449,156 was related to vested share options and therefore, was recognized as share-based compensation expense on the date of modification. The remaining unrecognized incremental compensation cost related to unvested share options have been amortized from the modification date to the end of the remaining vesting periods.

Share Options

The fair value of share options was estimated by management with the assistance of an independent third party valuation firm using the binomial option pricing model. The model requires the inputs of highly subjective assumptions including the expected stock price volatility and the expected price multiple at which employees are likely to exercise the share options. The Group used historical data to estimate forfeiture rate. For expected volatilities, the Group made reference to historical volatilities of several comparable companies. The risk-free rates for periods within the contractual lives of the options were based on the U.S. Treasury yield curve in effect at the time of the grants.

The fair values of share options granted to employees were estimated using the following assumptions:

	<b>Granted in 2011</b>
Suboptimal exercise factor	1.5
Risk-free interest rates	3.42%
Expected volatility	50.98
Expected dividend yield	2.5%
Fair value of share options	RMB15.75 to RMB19.85
Estimated forfeiture rate	2% per annum

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****17. SHARE OPTION AND RESTRICTED SHARE SCHEMES (CONT D)**

The following table summarizes the Company's share option activities as of and for the year ended December 31, 2013.

	Number of options	Weighted average exercise price (US\$)	Weighted average remaining contractual life (Years)	Aggregate intrinsic value (US\$)
Outstanding, January 1, 2013	907,900	3.99	4.67	1,284,896
Granted				
Exercised	(216,800)	3.75		
Forfeited/Cancelled	(800)	4.07		
Outstanding, December 31, 2013	690,300	4.07	3.83	4,949,451
Vested and expected to vest at December 31, 2013	676,494	4.07	3.83	4,850,462
Exercisable at December 31, 2013	645,300	4.07	3.81	4,626,801

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the fair value of the Company's shares as of December 31, 2013, for those awards that have an exercise price currently below the fair value of the Company's shares. The total intrinsic value of options exercised during the year ended December 31, 2013 was approximately RMB5,477,000 (US\$905,000) (2012: RMB39,399,000, 2011: RMB278,174,000).

The weighted average estimated fair value of options granted to employees of the Group during the fiscal year ended December 31, 2011 was RMB18.45. There were no share options granted during the years ended December 31, 2012 and 2013. The total fair value of options vested during the years ended December 31, 2011, 2012 and 2013 was RMB37,166,249, RMB6,249,777 and RMB599,325 (US\$99,001), respectively.

As of December 31, 2013, there was RMB52,392 (US\$8,655) of unrecognized estimated share-based compensation cost related to share options issued to employees. That deferred cost is expected to be recognized over a weighted-average vesting period of 0.45 years. To the extent the actual forfeiture rate is different from the original estimate, actual share-based compensation related to these awards may be different.

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

The following table sets forth the components of share-based compensation expense for share options issued to employees from the Company's share option scheme both in absolute amount and as a percentage of net revenue for the year indicated.

	For the year ended December 31,				
	2011 RMB	2012 RMB	RMB	2013 US\$	%
Net revenue	1,792,217,309	2,151,894,567	2,355,470,585	389,096,022	100%
Cost of services	562,225	270,407	32,962	5,445	0.00%
Research and product development expenses	2,269,898	1,202,645	373,181	61,645	0.02%
Sales and marketing expenses	199,684	197,871			0.00%
General and administrative expenses	7,901,262	694,690	275,944	45,583	0.01%
Total share-based compensation	10,933,069	2,365,613	682,087	112,673	0.03%

F-52

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****17. SHARE OPTION AND RESTRICTED SHARE SCHEMES (CONT D)**Restricted Shares

The fair value of a restricted share is simply the closing price of the unrestricted share as of the valuation date minus the present value of the expected dividends during the vesting period. The risk-free rate for periods within the contractual life of the share is based on the U.S. Treasury yield curve in effect at the time of grant.

The fair values of restricted shares granted to employees were estimated using the following assumptions:

	<b>Granted in 2011</b>	<b>Granted in 2012</b>	<b>Granted in 2013</b>
Risk-free interest rates	0.14%-0.93%	0.13%-0.78%	0.12%-1.49%
Expected dividend yield	5%	5%	5%
Fair value of restricted shares	RMB17.39 to RMB22.62	RMB18.73 to RMB25.52	RMB26.16 to RMB53.47

The following table summarized the Company's restricted shares activities under the 2007 Stock Incentive Scheme:

	<b>Number of restricted shares</b>	<b>Weighted average grant date fair value (US\$)</b>
Outstanding, January 1, 2013	10,605,200	34,039,563
Granted	750,000	5,107,500
Exercised	(1,030,400)	(3,936,128)
Forfeited/Cancelled	(124,000)	(375,720)
Outstanding, December 31, 2013	10,200,800	34,835,215
Vested and expected to vest at December 31, 2013	9,549,838	32,564,948

As of December 31, 2013, there was RMB92,879,015 (US\$15,342,520) of unrecognized estimated share-based compensation cost related to restricted shares issued to employees. That deferred cost is expected to be recognized over a weighted-average vesting period of 2.19 years. To the extent the actual forfeiture rate is different from the original estimate, actual share-based compensation related to these awards may be different.

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

The following table sets forth the components of share-based compensation expense for restricted shares issued to employees both in absolute amount and as a percentage of net revenue for the year indicated.

	For the year ended December 31				
	2011 RMB	2012 RMB	RMB	2013 US\$	%
Net revenue	1,792,217,309	2,151,894,567	2,355,470,585	389,096,022	100%
Cost of services	1,797,223	7,734,430	3,292,513	543,884	0.14%
Research and product development expenses	11,771,687	70,702,798	39,975,667	6,603,510	1.70%
Sales and marketing expenses	518,445	2,876,901	1,516,537	250,514	0.06%
General and administrative expenses	4,314,757	36,213,148	22,331,287	3,688,866	0.95%
Total share-based compensation	18,402,112	117,527,277	67,116,004	11,086,774	2.85%

The total share-based compensation cost capitalized as part of intangible assets – online game product costs for the years ended December 31, 2011, 2012 and 2013 were RMB87,497, RMB229,584 and nil, respectively.

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****18. ACCUMULATED OTHER COMPREHENSIVE LOSS**

	<b>Unrealized holding gains (losses) on investments RMB</b>	<b>Foreign currency translation adjustments RMB</b>	<b>Unrecognized tax benefit RMB</b>	<b>Total RMB</b>	<b>Total US\$</b>
Balance as of December 31, 2011	39,364,932	(469,008,829)	28,414,111	(401,229,786)	(66,278,439)
Foreign currency translation		2,735,104		2,735,104	451,808
Unrealized holding gain	69,135,783			69,135,783	11,420,418
Amounts reclassified from accumulated other comprehensive loss	(39,364,932)			(39,364,932)	(6,502,624)
Balance as of December 31, 2012	69,135,783	(466,273,725)	28,414,111	(368,723,831)	(60,908,837)
Foreign currency translation		(2,926,501)		(2,926,501)	(483,424)
Unrealized holding loss	(1,614,739)			(1,614,739)	(266,736)
Balance as of December 31, 2013	67,521,044	(469,200,226)	28,414,111	(373,265,071)	(61,658,997)

**19. EMPLOYEE BENEFITS**

The full-time employees of the Company's subsidiaries, the VIE and its consolidated entities that are incorporated in the PRC are entitled to staff welfare benefits, including medical care, housing subsidies, unemployment insurance and pension benefits. These companies are required to accrue for these benefits based on certain percentages of the employees' salaries in accordance with the relevant regulations, and to make contributions to the state-sponsored pension and medical plans out of the amounts accrued for medical and pension benefits. The Company's PRC subsidiaries, the VIE and its consolidated entities have no legal obligation for the benefits beyond the contributions made. The total amounts expensed in the consolidated statements of comprehensive income for such employee benefits amounted to RMB42,567,100, RMB53,019,124 and RMB63,482,783 (US\$10,486,609), for the years ended December 31, 2011, 2012 and 2013, respectively. The PRC government is responsible for the medical benefits and ultimate pension liability to these employees.



**20. RELATED PARTY TRANSACTIONS**

The principal related parties which the Group had transactions with during the years presented were as follows:

<b>Name of related party</b>	<b>Relationship with the Group</b>
Jiante Biotechnology	Company controlled by Mr. Yuzhu Shi
Giant Investment	Company controlled by Mr. Yuzhu Shi
China Minsheng Banking Corp., Ltd. ( Minsheng Bank )	Company significantly influenced by Mr. Yuzhu Shi
Minsheng Royal Asset Management	Company significantly influenced by Mr. Yuzhu Shi
Juxian Network	Equity investee
Juxi Network	Equity investee
Tonghua Network	Equity investee
Beijing Giant Zhengtu	Equity investee before October 17, 2012
Shanghai Focus Media Defeng Co., Ltd. ( Focus Media Defeng )	Company controlled by Mr. Jason Nanchun Jiang
Union Sky Holding Group Limited ( Union Sky )	Company shareholder

F-54

Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****20. RELATED PARTY TRANSACTIONS (CONT D)**

Significant related party transactions were as follows:

	For the year ended December 31,			
	2011 RMB	2012 RMB	2013 RMB	US\$
Rental fees paid to Jiantech Biotechnology	(12,000,000)	(12,000,000)	(12,000,000)	(1,982,259)
Acquisition of Juxiao Estate from Jiantech Biotechnology (Note 3)			(800,000)	(132,151)
Acquisition of Juxiao Estate from Giant investment (Note 3)			(15,200,000)	(2,510,861)
Investment in convertible bonds issued by Minsheng Bank			(35,168,000)	(5,809,340)
Investment in Minsheng Royal Asset Management (Note 4)			(952,000,000)	(157,259,197)
Technical service fee from (paid to) Juxian Network	3,039,202		(2,000,000)	(330,376)
Technical service fee from Juxi Network		6,000,000		
Loan to Tonghua Network (Note 2(8))		6,000,000	6,000,000	991,129
Royalty fee, and technical service fee paid to Beijing Giant Zhengtu	(21,631,256)	(5,293,601)		
Marketing expense paid to Focus Media Defeng			(1,437,600)	(237,475)
Prepayment to Jiantech Biotechnology <sup>(1)</sup>	(958,800,000)			
Repayment from Union Sky <sup>(1)</sup>	958,800,000			
Interest income from Union Sky <sup>(1)</sup>	21,471,866			

(1) In April 2011, the Group made a prepayment to Jiantech Biotechnology, for a commitment to invest RMB958,800,000 in Sunshine Insurance Group Corporation, Ltd., a privately held insurance company. Due to investor sentiment, regulatory and other considerations, the Group subsequently unwound the transaction in August 2011 by transferring the commitment to Union Sky for the full amount of the prepayment plus accrued interest of RMB21,471,866, which was accrued from April through August 2011. Both of these amounts were settled in cash in September, 2011.

Due from related parties as of December 31, 2012 and 2013 were as follows:

Edgar Filing: Giant Interactive Group Inc. - Form 20-F

	<b>2012</b>	<b>December 31,</b>	
	RMB	RMB	US\$
<b>Receivable from:</b>			
- Juxi Network	955,956		
- Juxian Network	410,598	659,190	108,890
- Tonghua Network	5,753,468	5,662,621	935,398
- Other	250,000		
<b>Total</b>	<b>7,370,022</b>	<b>6,321,811</b>	<b>1,044,288</b>

Due to related parties as of December 31, 2012 and 2013 were as follows:

	<b>2012</b>	<b>December 31,</b>	
	RMB	RMB	US\$
<b>Payable to:</b>			
- Juxian Network	598,953	2,677,066	442,220
- Other		40	6
<b>Total</b>	<b>598,953</b>	<b>2,677,106</b>	<b>442,226</b>

All balances with the related parties as of December 31, 2012 and 2013 were unsecured, interest-free and have no fixed term of repayment.

Table of Contents

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**21. TREASURY STOCK**

During the year 2013, the Group did not repurchase any ADS under the extended Share Repurchase Plan 4. As of December 31, 2013, the Group repurchased an accumulated 35,746,994 ADSs, amounting to approximately RMB2,222,600,000 (US\$367,100,000).

Out of the repurchased ADSs, 4,693,709 ADSs were subsequently used to settle the exercise of share options.

**22. DIVIDEND TO THE COMPANY'S SHAREHOLDERS**

Pursuant to a Board of Directors' resolution dated February 24, 2012, the Company declared a total dividends of RMB446,302,773 paid out of the Company's 2011 net distributable profits, which were determined using an equity method basis of accounting for the stand-alone listed company financial statements, to the shareholders of the Company who were registered members of the Company as of March 23, 2012. The payments of these dividends were financed out of available cash held by the Company, subsequent to the declaration of dividends to the Company by Zhengtu Information.

Pursuant to the Board of Directors' resolutions dated February 22, 2013 and August 5, 2013, the Company declared total dividends of RMB629,736,221 (US\$104,025,013) and RMB342,963,886 (US\$56,653,598) paid out of the Company's 2012 and the first half of 2013 net distributable profits, respectively, which were determined using an equity method basis of accounting for the stand-alone listed company financial statements, to the shareholders of the Company who were registered members of the Company as of May 20, 2013 and December 12, 2013, respectively.

The payments of the dividend pursuant to the resolution dated February 22, 2013 were financed by the one-year facility loan obtained from China Merchant Bank Hong Kong (Note 12), while the payments of the dividend pursuant to the resolution dated August 5, 2013 were financed out of available cash held by the Company subsequent to the declaration of dividends to the Company by Zhengduo Information.

For the years ended December 31, 2011, 2012 and 2013, the Company paid dividends of RMB4,810,164,772, RMB446,302,773 and RMB972,700,107 (US\$160,678,611), respectively.

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**23. STATUTORY RESERVES**

In accordance with the Regulations on Enterprises with Foreign Investment of China and the articles of association, Zhengtu Information, Zhengduo Information, Zhengju Information, Jujia Network, Zhuhai Zhengtu and Juhuo Network being foreign invested enterprises established in the PRC, are required to provide for certain non-distributable reserves, namely general reserve fund, enterprise expansion fund and staff welfare and bonus fund, all of which are appropriated from after-tax profit as reported in its PRC statutory financial statements. Zhengtu Information, Zhengduo Information, Zhengju Information Jujia Network, Zhuhai Zhengtu and Juhuo Network are required to allocate at least 10% of their after-tax profits to the general reserve fund until such fund has reached 50% of its registered capital. Appropriations to the enterprise expansion fund and staff welfare and bonus fund are at the discretion of the board of directors of Zhengtu Information, Zhengduo Information, Zhengju Information, Jujia Network, Zhuhai Zhengtu and Juhuo Network. Appropriation to the staff welfare and bonus fund, if any, is charged to general and administrative expenses. There have not been any appropriations to the enterprise expansion fund and staff welfare and bonus fund for any of the periods stated herein.

In accordance with the PRC Company Laws, Giant Network, being a domestic company, must make appropriation from its after-tax profit as reported in its PRC statutory financial statements to non-distributable reserve funds, namely, the statutory surplus fund, statutory public welfare fund and discretionary surplus fund. Giant Network is required to allocate at least 10% of its after-tax profit to the statutory surplus fund until such fund has reached 50% of its registered capital. Appropriations to the statutory public welfare fund and the discretionary surplus fund are made at the discretion of Giant Network. There have not been any appropriations to the statutory public welfare fund and the discretionary surplus fund for any of the periods stated herein.

General reserve fund and statutory surplus fund are restricted to offset against losses, expansion of production and operation and increasing registered capital of the respective company. Staff welfare and bonus fund and statutory public welfare fund are restricted to the capital expenditures for the collective welfare of employees. Enterprise expansion fund is restricted to expansion of production and operation and increasing registered capital of the respective company. The reserves are not allowed to be transferred to the Company in terms of cash dividends, loans or advances, neither are they allowed for distribution except under liquidation.

As of December 31, 2013, Giant Network, Zhengtu Information, Zhengduo Information, Jujia Network, Juhuo Network, Zhengju Information and Zhuhai Zhengtu appropriated RMB5,000,000 (US\$825,941), RMB11,588,745 (US\$1,914,324), RMB15,399,300 (US\$2,543,783), RMB2,500,000 (US\$412,971), RMB2,000,000 (US\$330,376), RMB14,500,000 (US\$2,395,229) and RMB147,923 (US\$24,436) to statutory surplus fund and general reserve fund, respectively.

The following amounts that are restricted from being distributed include paid-in capital and statutory reserve funds of the Company's subsidiaries, Giant Network and its consolidated entities, as determined pursuant to the PRC generally accepted accounting principles, totaling an aggregate of RMB404,703,908 and RMB386,409,924 (US\$63,830,372) as of December 31, 2012 and 2013, respectively.



Table of Contents**GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****24. COMMITMENTS AND CONTINGENCIES***Operating lease agreements*

The Group entered into operating lease arrangements mainly relating to its office premises and IDC space rental. Payments under operating leases are expensed on a straight-line basis over the periods of the respective leases. The terms of the leases do not contain rent escalation or contingent rents. Future minimum lease payments for non-cancelable operating leases as of December 31, 2013 were as follows:

	Office premises RMB	IDC space rental RMB	Total RMB	US\$
2014	5,049,070	25,159,900	30,208,970	4,990,166
2015	1,774,404	126,000	1,900,404	313,924
Thereafter				
Total	6,823,474	25,285,900	32,109,374	5,304,090

Total rental expenses were RMB77,345,611, RMB75,283,297 and RMB75,694,814 (US\$12,503,892) for the years ended December 31, 2011, 2012 and 2013 respectively.

*Commitments*Capital commitments

The Group has a commitment to invest a remaining amount of RMB7,500,000 (US\$1,238,912) in Innovation Works upon capital call from Innovation Works.

The Group has a commitment to invest a remaining amount of RMB4,000,000 (US\$660,753) in Dijiang Network and the commitment is due under certain contractual conditions.

The Group has a commitment to invest a remaining amount of RMB111,750,390 (US\$18,459,849) in Yunfeng Fund II upon capital call.

The Group has a commitment to invest a remaining amount of RMB1,300,000 (US\$214,745) in Wula Century and the commitment is due under certain contractual conditions.

Capital commitments for the construction of an additional office space and purchases of property and equipment as of December 31, 2013 were approximately RMB99,300,155 (US\$16,403,217).

Online game licensing fee commitments

As of December 31, 2013, the Group had a commitment to pay licensing fees to a third party of RMB21,187,950 (US\$3,500,000), according to previously agreed payment terms.

F-58



**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**24. COMMITMENTS AND CONTINGENCIES (CONT D)**

**Income taxes**

As of December 31, 2013, the Group recognized RMB47,579,967 (US\$7,859,651) (2012: RMB47,579,967) of unrecognized tax benefits. The final outcome of these tax uncertainties is dependent upon various matters including tax examinations, changes in regulatory tax laws, interpretation of those tax laws or expiration of status of limitation. However, due to the uncertainties associated with the status of examinations, including the protocols of finalizing audits by the relevant tax authorities, there is a high degree of uncertainty regarding the future cash outflows associated with these tax uncertainties.

**25. FAIR VALUE MEASUREMENT**

Effective January 1, 2008, the Group adopted ASC subtopic 820-10 ( ASC 820-10 ), Fair Value Measurement and Disclosure: Overall. ASC 820-10 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Although the adoption of ASC 820-10 did not impact the Group's financial condition, results of operations or cash flow, ASC 820-10 requires additional disclosures to be provided on fair value measurement.

ASC 820-10 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 Unobservable inputs which are supported by little or no market activity.

ASC 820-10 describes three main approaches to measuring the fair value of assets and liabilities: (1) market approach; (2) income approach and (3) cost approach. The market approach uses prices and other relevant information generated from market transactions involving identical or comparable assets or liabilities. The income approach uses valuation techniques to convert future amounts to a single present value amount. The measurement is based on the value indicated by current market expectations about those future amounts. The cost approach is based on the amount that would currently be required to replace an asset.

Table of Contents

## GIANT INTERACTIVE GROUP INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 25. FAIR VALUE MEASUREMENT (CONT'D)

In accordance with ASC 820-10, the Group measures available-for-sale security at fair value on a recurring basis. The fair values of the Group's available-for-sale security as measured and held-to-maturity securities as disclosed are classified within Level 3 and determined based on the discounted cash flow model using the discount curve of market interest rates. The fair value of the investments was determined by management with the assistance of independent third party valuation firms. The fair values of the Group's cash equivalents, restricted cash, short-term investments as disclosed are classified within Level 1 as they are valued using a quoted market price in active markets for identical assets.

The Group measures certain financial assets, including available-for-sale security at fair value on a nonrecurring basis only if it was determined to be impaired on an other-than-temporary basis. The Group's non-financial assets, such as intangible assets, long term investment at cost and goodwill, would be measured at fair value post-acquisition, if there is any impairment or disposal, by the Group.

Assets measured at fair value on a recurring basis and non-recurring basis are summarized below:

	Fair Value Measurement at December 31, 2013 Using				
	Quoted Prices			Fair Value at December 31,	
	in				
	Active Markets for Identical (Level 1) Assets RMB	Significant Observable (Level 2) Inputs RMB	Other Inputs (Level 3) Unobservable RMB	RMB	US\$
<b><u>Fair value disclosure</u></b>					
Short term investments					
- Fixed rate time deposits	250,486,050			250,486,050	41,377,347
- Investment contracts	2,549,200,000			2,549,200,000	421,097,842
Held-to-maturity					
- Fixed rate time deposit	10,000,000			10,000,000	1,651,882
<b><u>Fair value measurement</u></b>					
<b><u>Recurring</u></b>					
Available-for-sale security			74,772,662	74,772,662	12,351,564
<b><u>Non-recurring</u></b>					
Intangible asset impairment			20,100,000	20,100,000	3,320,283

(Note 7)

Long-term investment in Glorious Mission Network (Note 1)	5,934,190	5,934,190	980,258
---	-----------	-----------	---------

F-60

Table of Contents

## GIANT INTERACTIVE GROUP INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 25. FAIR VALUE MEASUREMENT (CONT D)

Fair Value Measurement at December 31, 2012 Using  
Quoted Prices in  
Active Markets for

	Identical Assets (Level 1) RMB	Significant Other Observable Inputs (Level 2) RMB	Unobservable inputs (Level 3) RMB	Fair Value at December 31, 2012 RMB
<b><u>Fair value disclosure</u></b>				
Cash equivalents				
- Fixed rate time deposits	700,000,000			700,000,000
Short term investments				
- Fixed rate time deposits	139,314,900			139,314,900
- Investment contracts	600,000,000			600,000,000
Held-to-maturity				
- Fixed rate time deposit	100,000,000			100,000,000
- CR Trust			118,000,000-	118,000,000-
			134,000,000	134,000,000

**Fair value measurement****Recurring**

Available-for-sale security	78,740,916	78,740,916
-----------------------------	------------	------------

**Non-recurring**

Impairment loss on the available-for-sale security	240,725,709	240,725,709
--	-------------	-------------

The following table summarizes the valuation of the available-for-sale securities:

	Amount RMB
Fair value of available-for-sale securities as of January 1, 2012	386,851,118
Reversal of unrealized holding gains	(39,364,932)
Transfer to long-term investment at cost	(34,149,500)
Impairment of the Preferred Shares (Note 10)	(240,725,709)
Effect of exchange rate change	6,129,939

Fair value of available-for-sale security as of December 31, 2012	78,740,916
Unrealized loss on the Preferred Shares (Note 10)	(1,614,739)
Effect of exchange rate change	(2,353,515)
Fair value of available-for-sale security as of December 31, 2013	74,772,662
Fair value of available-for-sale security as of December 31, 2013 (US\$)	12,351,564

The fair value of the available-for-sale security of the Preferred Shares as of December 31, 2012 and 2013 was estimated using an enterprise value allocation ( EVA ) model.

F-61

**Table of Contents****GIANT INTERACTIVE GROUP INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****25. FAIR VALUE MEASUREMENT (CONT D)**

The EVA model requires inputs of highly subjective assumptions including the expected stock price volatility and the probability of occurrence under three different scenarios (which is based on management reasonable estimation), namely 1) an initial public offering occurs ( IPO ), 2) 51.com liquidates ( Liquidation ) and 3) the Preferred Shares are redeemed at maturity ( Redemption ). For the expected volatilities, the Group made reference to historical volatilities of several comparable companies. The risk-free rate was based on the yield of U.S. Dollar China Sovereign Bond as of December 31, 2012 and 2013 with the term corresponding to the maturity of the Preferred Shares.

The fair value of the Preferred Shares under the EVA model for 2012 and 2013 was estimated using the following assumptions:

	<b>December 31, 2012 (EVA model)</b>	<b>December 31, 2013 (EVA model)</b>
Risk-free interest rates	0.14%	0.12%
Expected volatility	42.78%	42.24%
Probabilities of different scenarios:		
- IPO	0%	0%
- Liquidation	100%	100%
- Redemption	0%	0%

Due to 2012 events previously discussed in Note 10 that resulted in other-than-temporary impairment, the valuation model for the valuation dates of December 31, 2012 and 2013 ignored certain liquidation rights associated with the Preferred Shares as the realization of these rights are remote. Under this condition, the value of a preferred share is the same as that of an ordinary share and thus the value of the Preferred Share is equal to the total equity value of 51.com divided by the number of all preferred shares and ordinary shares. The fair value of the 100% equity interest of 51.com was determined by management with the assistance of an independent third party valuation firm using an income approach.

**26. SUBSEQUENT EVENTS**

In February 2014, the Group sold all of its investment in Yunfeng E-Commerce Funds to a third party for cash consideration of RMB1,205,291,670 (US\$199,100,000), resulting in a gain of RMB890,581,243 (US\$147,113,541) after deducting the transaction cost, that is recognized in the first quarter of 2014.

On March 17, 2014, the Company entered into a definitive agreement and plan of merger (the Merger Agreement ) with Giant Investment Limited (the Parent Company ) and Giant Merger Limited, a wholly-owned subsidiary of the Parent Company (the Merger Subsidiary ). Pursuant to the Merger Agreement, the Parent Company will acquire the Company at US\$12.00 per ordinary share of the Company and US\$12.00 per ADS of the Company, each representing

one ordinary share, for cash consideration of US\$3,000,000,000 in aggregate.

F-62

**Table of Contents**

**GIANT INTERACTIVE GROUP INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**26. SUBSEQUENT EVENTS (CONT D)**

In March and April 2014, respectively, three class action complaints were filed on behalf of all holders of ADSs against the Company, board members of the Company, the Parent Company and the Merger Subsidiary alleging that each of the directors of the Company breached fiduciary duties by not appropriately valuing the Company in connection with the proposed going private transaction and that the Company, the Parent Company and the Merger Subsidiary aided and abetted these violations. Management believes that these complaints are without merit and will not have material impact to the Company's consolidated financial statements as of and for the year ended December 31, 2013.

In January 28, March 3 and March 18, 2014, the Group early terminated its short-term investment contracts in Minsheng Baoteng Plan with Minsheng Royal Asset Management of RMB519,000,000 (US\$85,732,693), RMB220,000,000 (US\$36,341,411) and RMB213,000,000 (US\$35,185,093), with actual yield of return of 4.85%, 4.56% and 5.00%, respectively. The Group recognized a total interest income of RMB21,514,209 (US\$3,553,894) in 2014 (Note 4).