

YY Inc.  
Form 20-F  
April 21, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

FORM 20-F

**(Mark One)**

**..REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR 12(G) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT  
<sup>X</sup>OF 1934  
For the fiscal year ended December 31, 2014.**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT  
OF 1934  
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  
For the transition period from to  
Commission file number: 001-35729

YY INC.

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

**Cayman Islands**

(Jurisdiction of incorporation or organization)

**Building 3-08, Yangcheng Creative Industry Zone**

**No. 309 Huangpu Avenue Middle**

**Tianhe District**

**Guangzhou 510655**

**The People's Republic of China**

(Address of principal executive offices)

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**No. 309 Huangpu Avenue Middle**

**Tianhe District**

**Guangzhou 510655**

**The People's Republic of China**

(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:

<b>Title of Each Class</b>	<b>Name of Exchange on Which Registered</b>
Class A common shares, par value US\$0.00001 per share	The NASDAQ Stock Market*
*	

Not for trading, but only in connection with the listing on The NASDAQ Stock Market of the American depositary shares ("ADSs"). Currently, one ADS represents 20 Class A common shares.

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

None

(Title of Class)

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

None

(Title of Class)

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. **706,173,568 Class A common shares, par value US\$0.00001 per share, and 427,352,696 Class B common shares, par value US\$0.00001 per share, were outstanding as of December 31, 2014.**

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 transition 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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 by the International Accounting Standards Board  Other

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

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

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## INTRODUCTION

Unless otherwise indicated and except where the context otherwise requires, references in this annual report on Form 20-F to:

"we," "us," "our company" and "our" refer to YY Inc., a Cayman Islands company, its subsidiaries and consolidated affiliated entities (also referred to as variable interest entities) and the subsidiaries of its consolidated affiliated entities, as the context may require;

"active user" for any period means a registered user account that has logged onto our platform at least once during such relevant period;

"concurrent users" for any point in time means the total number of YY users that are simultaneously logged onto our platform at such point in time;

"paying user" for any period means a registered user account that has purchased virtual items or other products and services on our platform at least once during the relevant period. A paying user is not necessarily a unique user, however, as a unique user may set up multiple paying user accounts on our platform; thus, the number of paying users referred to in this annual report may be higher than the number of unique users who are purchasing virtual items or other products and services;

"registered user account" means a user account that has downloaded, registered and logged onto our platform at least once since registration. We calculate registered user accounts as the cumulative number of user accounts at the end of the relevant period that have logged onto our platform at least once after registration. Each individual user may have more than one registered user account, and consequently, the number of registered user accounts we present in this annual report may overstate the number of unique individuals who are our registered users; and

"unique visitor" to Duowan.com means a visitor to Duowan.com from a specific IP address. No subsequent visits from the same IP address during a relevant period are added to our total unique visitors count for that period. An individual who accesses Duowan.com from more than one IP address is counted as a unique visitor for each IP address he or she uses.

## FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements that involve risks and uncertainties. All statements other than statements of historical facts are forward-looking statements. These forward-looking statements are made under the

"safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements.

You can identify these forward-looking statements by words or phrases such as "may," "will," "expect," "is expected to," "anticipate," "aim," "estimate," "intend," "plan," "believe," "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, but are not limited to, statements about:

- our growth strategies;

- our ability to retain and increase our user base and expand our product and service offerings;

- our ability to monetize our platform;

- our future business development, results of operations and financial condition;

- competition from companies in a number of industries, including internet companies that provide online voice and video communications services, social networking services and online games;



- expected changes in our revenues and certain cost or expense items;
- general economic and business condition in China and elsewhere; and
- assumptions underlying or related to any of the foregoing.

You should thoroughly read this annual report and the documents that we refer to herein with the understanding that our actual future results may be materially different from and/or worse than what we expect. Other sections of this annual report, including the Risk Factors and Operating and Financial Review and Prospects sections, discuss factors which could adversely impact our business and financial performance. Moreover, we operate in an evolving environment. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We qualify all of our forward-looking statements by these cautionary statements.

You should not rely upon forward-looking statements we make as predictions of future events. The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following table presents the selected consolidated financial information for our company. The selected consolidated statements of operations data for the three years ended December 31, 2012, 2013 and 2014 and the consolidated balance sheet data as of December 31, 2013 and 2014 have been derived from our audited consolidated financial statements which are included in this annual report beginning on page F-1. Our selected consolidated statements of operation data for the years ended December 31, 2010 and 2011 and our consolidated balance sheet data as of December 31, 2010, 2011 and 2012 have been derived from our audited consolidated financial statements not included in this annual report. Our consolidated financial statements are prepared and presented in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. Our historical results for any period are not necessarily indicative of results to be expected for any future period. You should read the following selected financial information in conjunction with the consolidated financial statements and related notes and the information under "Item 5. Operating and Financial Review and Prospects" included elsewhere in this annual report.

For the Year Ended December 31,					
2010	2011	2012	2013	2014	
RMB	RMB	RMB	RMB	RMB	US\$
(All amounts in thousands, except share, ADS, per share and per ADS data)					

Selected Consolidated Statements of Operations Data:

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Internet value-added service						
—Online music and entertainment	—	52,854	286,446	852,885	2,109,503	339,990
—Online games	86,316	165,933	332,287	602,111	811,699	130,822
—Others	1,282	13,589	83,655	205,212	609,823	98,286
Online advertising	40,740	87,279	117,643	163,260	147,343	23,747
Total net revenues	128,338	319,655	820,031	1,823,468	3,678,368	592,845
Cost of revenues <sup>(1)</sup>	(110,062 )	(182,699 )	(416,133 )	(881,999 )	(1,849,149 )	(298,029 )
Gross profit	18,276	136,956	403,898	941,469	1,829,219	294,816
Operating expenses: <sup>(1)</sup>						
Research and development expenses	(49,219 )	(106,804 )	(176,725 )	(267,005 )	(431,188 )	(69,495 )
Sales and marketing expenses	(12,363 )	(13,381 )	(16,954 )	(24,955 )	(102,527 )	(16,524 )
General and administrative expenses	(192,222 )	(118,241 )	(109,788 )	(200,554 )	(223,019 )	(35,944 )
Total operating expenses	(253,804 )	(238,426 )	(303,467 )	(492,514 )	(756,734 )	(121,963 )
Operating (loss) income	(235,528 )	(99,488 )	102,896	476,033	1,078,804	173,871
(Loss) income before income tax expenses	(236,023 )	(80,455 )	118,061	565,809	1,214,480	195,738
Net (loss) income attributable to YY Inc.	(238,857 )	(83,156 )	89,177	477,727	1,064,472	171,561
(Accretion) decretion to convertible redeemable preferred shares redemption value	(1,808,853 )	(223,663 )	1,293,875	—	—	—
Allocation of net income to participating preferred shareholders	—	—	(478,754 )	—	—	—
Net (loss) income attributable to common shareholders	(2,047,710 )	(306,819 )	904,298	477,727	1,064,472	171,561

For the Year Ended December 31,

2010	2011	2012	2013	2014	
RMB	RMB	RMB	RMB	RMB	US\$

Weighted average number of ADS used in calculating net (loss) income per ADS:

Basic	20,315,234	24,294,192	30,235,191	56,123,784	57,657,035	57,657,035
Diluted	20,315,234	24,294,192	49,623,442	59,056,065	59,927,174	59,927,174
Net (loss) income per ADS <sup>(2)</sup> :						
Basic	(100.80 )	(12.63 )	29.91	8.51	18.46	2.98
Diluted	(100.80 )	(12.63 )	1.80	8.09	17.76	2.86

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	For the Year Ended December 31,					US\$
	2010 RMB	2011 RMB	2012 RMB	2013 RMB	2014 RMB	
Weighted average number of common shares used in calculating net (loss) income per common share:						
Basic	406,304,672	485,883,845	604,703,810	1,122,475,688	1,153,140,699	1,153,140,699
Diluted	406,304,672	485,883,845	992,468,836	1,181,121,297	1,198,543,473	1,198,543,473
Net (loss) income per common share <sup>(2)</sup>						
Basic	(5.04	) (0.63	) 1.50	0.43	0.92	0.15
Diluted	(5.04	) (0.63	) 0.09	0.40	0.89	0.14

(1) Share-based compensation was allocated in cost of revenues and operating expenses as follows:

	For the Year Ended December 31,					US\$
	2010 RMB	2011 RMB	2012 RMB	2013 RMB	2014 RMB	
	(in thousands)					
Cost of revenues	31,709	15,449	8,407	9,860	18,037	2,907
Research and development expenses	21,627	31,672	35,441	39,587	54,141	8,726
Sales and marketing expenses	1,499	1,336	884	1,318	2,807	452
General and administrative expenses	182,101	86,544	55,619	66,331	59,647	9,613
Total	236,936	135,001	100,351	117,096	134,632	21,698

(2) Each ADS represents 20 Class A common shares.

	As of December 31,					US\$
	2010 RMB	2011 RMB	2012 RMB	2013 RMB	2014 RMB	
	(in thousands)					
Selected Consolidated Statements of Operations Data:						
Cash and cash equivalents	83,683	128,891	504,702	729,598	475,028	76,561
Short-term deposits	—	472,655	897,698	1,432,863	4,214,576	679,266

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Goodwill	706	706	1,604	1,577	300,382	48,413
Total assets	158,767	745,426	1,696,189	2,597,947	6,862,794	1,106,081
Total current liabilities	253,001	125,737	366,417	701,313	1,090,558	175,766
Convertible bonds	—	—	—	—	2,447,980	394,543
Long-term payable	—	—	—	—	183,000	29,494
Total mezzanine equity	2,257,271	2,480,934	—	—	—	—
Class A common shares (US\$0.00001 par value; 10,000,000,000 shares authorized, 179,400,000, 622,658,738, and 706,173,568 shares issued and outstanding as of December 31, 2012, 2013 and 2014, respectively)	—	—	11	38	43	7
Class B common shares (US\$0.00001 par value; 1,000,000,000 shares authorized, 907,833,224, 485,831,386 and 427,352,696 shares issued and outstanding as of December 31, 2012, 2013 and 2014, respectively)	32	37	60	34	30	5
(Accumulated deficits) Retained earnings	(2,350,448)	(2,433,604)	(1,311,767)	(874,697 )	173,963	28,038
Total shareholders' (deficits) equity	(2,351,505)	(1,861,693)	1,323,285	1,887,209	3,090,164	498,043

## Exchange Rate Information

Our business is primarily conducted in China and most of our revenues are denominated in RMB. Unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual report were made at a rate of RMB6.2046 to US\$1.00, the exchange rate on December 31, 2014 as set forth in the H.10 statistical release published by the Federal Reserve Board. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign currency and through restrictions on foreign exchange activities. On April 10, 2015, the exchange rate, as set forth in the H.10 statistical release of the Federal Reserve Board, was RMB6.2082 to US\$1.00.

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

Period	Noon Buying Rate			
	Period End	Average(1)	Low	High
	(RMB per US\$1.00)			
2010	6.6000	6.7696	6.8330	6.6000
2011	6.2939	6.3849	6.6364	6.2939
2012	6.2301	6.2990	6.3879	6.2221
2013	6.0537	6.1412	6.2438	6.0537
2014	6.2046	6.1704	6.2591	6.0402
October	6.1124	6.1251	6.1385	6.1107
November	6.1429	6.1249	6.1429	6.1117
December	6.2046	6.1886	6.2256	6.1490
2015				
January	6.2495	6.2181	6.1870	6.2535
February	6.2695	6.2518	6.2399	6.2695
March	6.2145	6.2422	6.2741	6.1955
April (through April 10, 2015)	6.2082	6.1989	6.2082	6.1930

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

#### B. Capitalization and Indebtedness

Not applicable.

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

Not applicable.

D. Risk Factors

An investment in our capital stock involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in this annual report, before making an investment decision. If any of the following risks actually occurs, our business, financial condition or results of operations could suffer. In that case, the trading price of our capital stock could decline, and you may lose all or part of your investment.

Risks Related to Our Business

Our business is based on a relatively new business model in a relatively new market in which user demand may change or decrease substantially.

Many of the elements of our business are unique, evolving and relatively unproven. The markets for our technology, especially our voice- and video-based technology, and products and services are relatively new and rapidly developing and are subject to significant challenges. Our business plan relies heavily upon increased revenues from internet value-added services, or IVAS, as well as our ability to successfully monetize our user base and products and services, and we may not succeed in any of these respects.

Some of our current monetization methods are in a relatively preliminary stage. If we fail to properly manage the supply and timing of our in-game virtual items and the appropriate price points for these products and services, for example, our users may be less likely to purchase in-game virtual items from us. For non-game virtual items, we consider industry standards and expected user demand in determining how to most effectively optimize virtual item merchandizing. Furthermore, as the online music and entertainment industry in China is relatively young and untested, there are few proven methods of projecting user demand or available industry standards on which we can rely. We cannot assure you that our attempts to monetize our user base and products and services will continue to be successful, profitable or widely accepted, and therefore the future revenue and income potential of our business are difficult to evaluate.

If we fail to effectively manage our growth or implement our business strategies, our business and results of operations may be materially and adversely affected.

We have experienced a period of significant rapid growth and expansion that has placed, and continues to place, significant strain on our management and resources. We cannot assure you that this level of significant growth will be sustainable or achieved at all in the future. We believe that our continued growth will depend on our ability to develop new sources of revenue, increase monetization, attract new users, retain and expand paying users, encourage additional purchases by our paying users, continue developing innovative technologies in response to user demand, increase brand awareness through marketing and promotional activities, react to changes in user access to and use of the internet, expand into new market segments, integrate new devices, platforms and operating systems, attract new advertisers and retain existing advertisers and take advantage of any growth in the relevant markets. We cannot assure you that we will achieve any of the above.

To manage our growth and maintain profitability, we anticipate that we will need to continue to implement, from time to time, a variety of new and upgraded operational and financial systems, procedures and controls on an as-needed basis, including the continued improvement of our accounting and other internal management systems. We will also need to further expand, train, manage and motivate our workforce and manage our relationships with users, third party game developers, advertisers and other business partners. All of these endeavors involve risks and will require substantial management efforts and skills and significant additional expenditures. We cannot assure you that we will be able to effectively manage our growth or implement our future business strategies, and failure to do so may materially and adversely affect our business and results of operations.

We are a relatively young company, and you should consider our prospects in light of the risks and uncertainties which early-stage companies in evolving industries in China with limited operating histories may be exposed to or encounter, including possible volatility in the trading prices of our ADSs.

We expect that we will continue to incur significant costs and expenses in many aspects of our business, such as research and development costs to update existing services and launch new services and rising bandwidth costs to support our video function, grow our user base and generally expand our business operations. We have been profitable since 2012 and achieved accumulated profitability in 2014, but we may not generate sufficient revenues to offset such costs to achieve or sustain profitability in the future. In addition, we expect to continue to invest heavily in our operations to maintain our current market position, support our anticipated future growth and meet our expanded reporting and compliance obligations as a public company.

Our profitability is also affected by other factors beyond our control. The continued success of our platform depends on our ability to identify which IVAS will appeal to our user base and to offer such IVAS on commercially acceptable terms. Our ability to finance our planned expansion also depends in part on our ability to convert active users into paying users and increase the average revenue per paying user, or ARPU, and successfully compete in a very



competitive market.

We have a limited operating history. We introduced YY Client in July 2008 and have experienced a high growth rate since then. As a result of our relatively short history, our historical results of operations may not provide a meaningful basis for evaluating our business, financial performance and future prospects. We may not be able to achieve similar growth rates in future periods. Accordingly, you should not rely on our results of operations for any prior periods as an indication of our future performance. We may again incur net losses in the future and you should consider our prospects in light of the risks and uncertainties which early-stage companies in evolving industries in China with limited operating histories such as ours may be exposed to or encounter, including risks associated with being a public company with business operations located mainly in China. See "Risks Related to Our ADSs—The trading prices of our ADSs are likely to be volatile, which could result in substantial losses to investors."

Our business is heavily dependent on revenues from IVAS. If our IVAS revenues decline in the future, our results of operations may be materially and adversely affected.

Historically, a majority of our revenues are revenues from IVAS, which mainly consists of revenues from online music and entertainment, online games, online dating, live game broadcasting and membership subscription fees. In the year ended December 31, 2014, revenues from IVAS constituted approximately 96.0% of our total net revenue. We expect that our business will continue to be dependent on revenues from IVAS in the future. Any decline in IVAS revenues may materially and adversely affect our results of operations. See "—The revenue model for each of our online music and entertainment and our membership program may not remain effective, which may affect our ability to retain existing users and attract new users and materially and adversely affect our business, financial condition and results of operations", "—The revenue model we adopt for online games may not remain effective, causing us to lose game players, which may materially and adversely affect our business, financial condition and results of operations", "—The revenue model for our online dating is relatively new and may not remain effective, which may adversely affect our financial condition and results of operations" and "—The revenue model for our live game broadcasting business is relatively new and may not remain effective, which may adversely affect our financial condition and results of operations."

The revenue model for each of our online music and entertainment and our membership program may not remain effective, which may affect our ability to retain existing users and attract new users and materially and adversely affect our business, financial condition and results of operations.

We operate an online music and entertainment platform using a virtual items-based revenue model whereby users can listen to music and access other forms of entertainment for free, and have the option of purchasing in-channel virtual items. We have generated, and expect to continue to generate, a substantial majority of our online and entertainment revenues using this revenue model. In 2014, online music and entertainment contributed 57.3% of our total net revenues.

We may not be able to continue to successfully implement the virtual items-based revenue model for online music and entertainment, as popular performers may leave our platform and we may be unable to attract new talent that can attract users or cause such users to increase the amount of time spent engaging and money spent on purchasing in-channel virtual items on our platform.

Furthermore, under our current arrangements with certain popular performers and channel owners, we share with them a portion of the revenues we derive from the sales of in-channel virtual items on our online music and entertainment platform. In the future, the amount we pay to these performers and channel owners may increase or we may fail to reach mutually acceptable terms with these performers or channel owners, which may adversely affect our revenues or cause popular performers and channel owners to leave our platform. In addition, we have been a pioneer in offering an online concert platform to music performers and YY users, but if our users decide to access online music and

entertainment content provided by our current or future competitors, our business, financial condition and results of operations could be materially and adversely affected.

In our membership program, users pay a flat monthly subscription fee in order to become members, and in exchange, we give them access to various privileges and enhanced features on our channels, including additional video usage, priority entrance to certain live performances, and exclusive rights to access VIP avatars, VIP ring-tones, VIP fonts and VIP emoticons. However, we may not be able to further build or maintain our membership base in the future for various reasons—for example, if we fail to continue to provide innovative products and services that are attractive to members, we may not be able to retain them and our business, financial condition and results of operations could be adversely affected.

***The revenue model we adopt for online games may not remain effective, causing us to lose game players, which may materially and adversely affect our business, financial condition and results of operations.***

We currently operate substantially all of our online games on YY using the virtual items-based revenue model, whereby players can play games for free, but have the option of purchasing in-game virtual items and in-game accessories. We have generated, and expect to continue to generate, a substantial majority of our online game revenues using this revenue model. However, we may not be able to continue successfully implementing the virtual items-based revenue model as we may not be able to develop, obtain or maintain the rights to host online games that attract game players or cause such game players to increase the amount of time spent playing and the amount of money spent on purchasing in-game virtual items. The sale of virtual items requires us to closely track game players' tastes and preferences and in-game consumption patterns. If we fail to offer popular virtual items, we may not be able to effectively convert our game player base into paying users or encourage existing paying users to spend more on YY.

In addition, PRC regulators have been implementing regulations designed to reduce the amount of time that youths in China spend playing online games. See "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Anti-fatigue Compliance System and Real-name Registration System." A revenue model that does not charge for playing time may be viewed by the PRC regulators as inconsistent with this goal. If we were to start charging for playing time, we may lose game players who may choose to play online games from other providers and on other platforms or choose to engage in other alternative forms of entertainment, including traditional offline personal computers, or PCs, or video games.

We cannot assure you that the revenue model that we have adopted for any of our online games will continue to be suitable, or that we will not in the future need to change our revenue model or introduce a new revenue model. We may change the revenue model for some of our online games if we believe the existing models are not generating adequate revenues. A change in revenue model could result in various adverse consequences, including disruptions of our online game operations, criticism from game players who have invested time and money in a game, a decrease in the number of our game players and a decrease in the revenues we generate from our online games. Therefore, such a change in revenue model may materially and adversely affect our business, financial condition and results of operations.

We generate a significant portion of our revenues from a limited number of popular online games. If we cannot continue to offer these popular games for any reason, if we are unable to successfully source new online games, if the terms of the revenue-sharing or exclusive license arrangements become less favorable, or if the number of our paying users for online games declines or ceases to grow for any reason, our revenues from online games may decrease, and our financial condition and results of operations may be materially and adversely affected.

We generate a significant portion of our revenues from a limited number of popular online games on YY, primarily through selling of game tokens to users for their purchase of in-game virtual items. In 2014, the five most popular online games contributed approximately 36.1% of our total online game revenues, as compared to 45.2% in 2013, representing a decrease in reliance on our top games. A majority of our popular online games are created by third party game developers under revenue-sharing arrangements that typically last one to two years, and which typically provide for automatic extension or renewal. A few of our online games are licensed to us by third party game developers under exclusive license arrangements. If we fail to maintain or renew these contracts on acceptable terms or at all, we may be unable to continue offering these popular online games, and our operating results will be adversely affected. For online games licensed to us under exclusive license arrangements, we also have to devote additional resources to promoting these games on our platform or licensing such games to the appropriate third party operators. If our users decide to access any of our online games through our competitors, or if they prefer other online games hosted by our competitors, our operating results could be materially and adversely affected.

Our revenues from online games accounted for 40.5%, 33.0% and 22.1% of our total net revenues in 2012, 2013 and 2014, respectively. We believe that most online games have a limited commercial lifespan. We must continually source new online games that appeal to our game players. Hence, we must maintain good relationships with our third party game developers to have access to new popular games with reasonable revenue-sharing or exclusive licensing terms. Under our current revenue-sharing and exclusive license arrangements, we retain a majority of the gross revenues generated from each particular game. In the future, we may not be able to achieve similarly attractive revenue-sharing or other commercial terms, which may adversely affect our net revenues. Additionally, we depend upon these third party game developers to provide the technical support necessary to operate their online games on our platform and to develop updates and expansion packs to sustain player interest in a game. Most of our third party game developers have limited operating histories and financial resources, and the contracts we enter into with them do not clearly provide for remedies to us in the event they fail to deliver the games or the promised updates and expansion packs as scheduled .

If we are not successful in sourcing and providing popular new online games, our revenues from online games under revenue-sharing and exclusive licensing arrangements and in-game virtual items may decrease. If this were to happen, our financial condition and results of operations may be materially and adversely affected.

The revenue model for our online dating business is relatively new and may not remain affective, which may adversely affect our financial condition and results of operations.

Our online dating business adopts a virtual items-based revenue model, which allows our users to participate or watch online dating shows for free and enjoy the option of purchasing in-channel virtual items. Our online dating business was based on the format of a popular reality dating TV show in China, and has experienced significant growth since it was launched at the end of 2013. We cannot assure you that we will continue to achieve a similar growth rate in the future, as the user demand for this service may change, decrease substantially or dissipate, or we may fail to anticipate and serve user demands effectively.

A majority of our online dating service active users also use other businesses on the YY platform. If we fail to attract new users or build and maintain a core user base for our online dating business, we may not be able to achieve growth in this part of our business, if at all. Online dating is the most engaging and interactive of all our businesses, and the successful monetization of this business relies upon the highly interactive relationship among the hosts, the participants and the audience. Failure to keep our users engaged in the dating service may result in reducing ARPU and the number of paying users, which may adversely affect our financial condition and results of operations.

The revenue model for our live game broadcasting business is relatively new and may not remain effective, which may adversely affect our financial condition and results of operations.

Our live game broadcasting business adopts a virtual items-based revenue model. We provide users with free access to the live streaming of different game plays, and offer the option of purchasing in-channel virtual items. The live game broadcasting market is relatively new in China, however, and we cannot assure you that we will continue to achieve growth in this business in the future as the user demand for this service may change, decrease substantially or dissipate, or we may fail to anticipate and serve user demands effectively.

Our live game broadcasting business relies on the availability of online games that users can play and stream on YY platform during the course of the game play. These online games are typically owned by or licensed to certain gaming companies or publishers, some of which compete with us in other lines of our business. These online games may not continue to be available to our users for live streaming purposes and we cannot assure you that the revenue model we have adopted for our live game broadcasting business will continue to be successful.

Live game broadcasting users tend to follow famous professional game teams and commentators. In order to retain existing users and attract new users, we cooperate with popular professional game teams and commentators to make their game play available on our platform by paying them fixed sponsorship fees. Most of the sponsorship contracts are renewed annually. In addition, we share with popular professional game teams and commentators a portion of the revenues we derive from the sales of in-channel virtual items in our live game broadcasting business. In the future, the sponsorship fees we pay to these professional game teams and commentators may increase or we may fail to reach mutually acceptable terms with these professional game teams or commentators at all, which may cause professional game teams or commentators to leave our platform. In turn, this may affect the user and revenue growth in this business, which may materially and adversely affect our financial condition and results of operations.

We generate a portion of our revenues from online advertising. If we fail to attract more advertisers to our platform or if advertisers are less willing to advertise with us, our revenues may be adversely affected.

In 2012, 2013 and 2014, online advertising accounted for 14.3%, 9.0% and 4.0%, respectively, of our total net revenues. Although we have become less dependent upon online advertising revenues due to a shift in the majority of our revenues from online advertising to IVAS, our revenues still partly depend on the continual development of the online advertising industry in China and advertisers' allocation of budgets to internet advertising. In addition, companies that decide to advertise online may utilize more established methods or channels for online advertising, such as more established Chinese internet portals or search engines, over advertising on our platform. If the online advertising market size does not increase from current levels, or if we are unable to capture and retain a sufficient share of that market, our ability to maintain or increase our current level of online advertising revenues and our profitability and prospects could be adversely affected. These risks may affect our revenues because we intend to offer new and different forms of online advertising in addition to online game-related advertising on Duowan.com, from which we have historically derived significant portions of our revenues.

We offer advertising services substantially through contracts entered into with third party advertising agencies. We cannot assure you that we will be able to retain existing direct advertisers or advertising agencies or attract new direct advertisers and advertising agencies. Since our arrangements with third party advertising agencies typically involve one-year framework agreements, these advertising arrangements may be easily amended or terminated without incurring liabilities. Failure to retain existing advertisers and advertising agencies or attract new direct advertisers and direct advertising agencies may adversely affect our business, financial condition and results of operations.

We have granted employee stock options and other share-based awards in the past and will continue to do so in the future. We recognize share-based compensation expenses in our consolidated statements of operations in accordance with the relevant rules under U.S. GAAP, which have had and may continue to have a material and adverse effect on our results of operations.

We have granted share-based compensation awards, including share options, restricted shares and restricted share units, to various employees, key personnel and other non-employees to incentivize performance and align their interests with ours. Under our 2009 employee equity incentive scheme, or the 2009 Scheme, we are authorized to grant options or restricted shares to purchase a maximum of 120,020,001 common shares. Under our 2011 share incentive plan, or the 2011 Plan, we are authorized to grant options, restricted shares or restricted share units to purchase a maximum of 43,000,000 common shares, plus an annual increase of 20,000,000 common shares on the first day of each fiscal year, beginning from 2013, or such smaller number of Class A common shares as determined by our board of directors. As of March 31, 2015, options to purchase 3,510,745 common shares, 20,184,033 restricted shares and 47,023,736 restricted share units were outstanding under the 2009 Scheme and the 2011 Plan. As a result of these grants and potential future grants, we had incurred in the past and expect to continue to incur significant share-based compensation expenses in the future. The amount of these expenses is based on the fair value of the share-based awards. We account for compensation costs for certain share-based compensation awards granted in the past using a graded-vesting method and recognize expenses in our consolidated statements of operations in accordance with the relevant rules under U.S. GAAP. The expenses associated with share-based compensation materially increased our net losses or reduced our net income in the past, and may reduce our net income in the future. In addition, any additional securities issued under share-based compensation schemes will dilute the ownership interests of our shareholders, including holders of our ADSs. However, if we limit the scope of the share-based compensation schemes, we may not be able to attract or retain key personnel who expect to be compensated by options, restricted shares or restricted share units.

The number of active users we have may fluctuate and we may fail to attract more paying users, which may materially and adversely affect our revenues growth, results of operations and financial condition.

The number of our average monthly active users increased by 22.6 million or 32.4% to 92.3 million for the three months ended December 31, 2013 and by 25.1 million or 27.6% to 117.4 million for the three months ended December 31, 2014. The decline in growth rate was due to the increase in the base number of the average monthly active users, and despite that, we continued to attract higher levels of new monthly active users during such periods.

However, the number of our monthly active users may substantially fluctuate from time to time. If we are unable to attract new users and retain them as active users and convert non-paying active users into paying users, our revenues may fail to grow and our results of operations and financial condition may suffer.



We may not be able to keep our users highly engaged, which may reduce our monetization opportunities and materially and adversely affect our revenues, profitability and prospects.

Our success depends on our ability to maintain and grow our user base and keep our users highly engaged. In order to attract and retain users and remain competitive, we must continue to innovate our products and services, implement new technologies and functionalities and improve the features of our platform in order to entice users to use our products and services more frequently and for longer durations.

The internet industry is characterized by constant changes, including rapid technological evolution, continual shifts in customer demands, frequent introductions of new products and services and constant emergence of new industry standards and practices. Thus our success will depend, in part, on our ability to respond to these changes on a cost-effective and timely basis; failure to do so may cause our user base to shrink and user engagement level to decline and our results of operations would be materially and adversely affected. For example, our plan to more fully extend online video-enabled services across our real-time interactive social platform and retain the ability to offer high quality delivery of voice and video data may cause us to incur significant additional costs and may not succeed.

Because of the viral nature of online social interactions, users may leave us for competitors' platforms more quickly than in other online sectors. A decrease in the number of active YY users may reduce the diversity and vibrancy of our platform's online social ecosystem and affect our user-generated channels, which may in turn reduce our monetization opportunities and have a material and adverse effect on our business, financial condition and results of operations.

We cannot assure you that our platform will continue to be sufficiently popular with our users to offset the costs incurred to operate and expand it. User satisfaction is particularly difficult to predict as internet users in China may not be familiar with the concept of a real-time interactive social platform such as ours which provides real-time voice, text and video online. We have historically relied on word of mouth referrals to increase user awareness of our products and services and to expand our user base. If we decide to engage in more conventional advertising or marketing campaigns, our sales and marketing expenses will increase, which could have an adverse effect on our results of operations. Failure to maintain or grow our user base in a cost-effective manner, or at all, and keep our users highly engaged would materially and negatively affect our results of operations.

We face competition in several major aspects of our business. If we fail to compete effectively, we may lose users and advertisers which could materially and adversely affect our business, financial condition and results of operations.

We face competition in several major aspects of our business, particularly from companies that provide social networking, online music and entertainment, online games and live game broadcasting services. Some of our competitors may have longer operating histories and significantly greater financial, technical and marketing resources than we do, and in turn may have an advantage in attracting and retaining users and advertisers. In addition, competitors in some areas of our business may have significantly larger user bases and more established brand names than we do and may be able to more effectively leverage their user bases and brand names to provide integrated social networking, internet communication, online games and other products and services, and thereby increase their respective market shares.

We may face potential competition from global online social networking service providers that seek to enter the China market, whether independently or through the formation of alliances with, or acquisition of, PRC domestic internet companies. In relation to voice-enabled technology, several internet voice communication service providers in China, including iSpeak, Tencent's QQtalk and Dudu, and leading international internet voice communication service providers, such as Skype, are expanding in the China market, and some other leading Chinese internet companies have announced the launch of internet voice communication services. In the online music and entertainment market, we compete with several domestic companies that are more focused on live music show or online KTVs, such as 9158.com, 6.cn and guagua.cn. A number of PRC internet companies have recently entered or announced their intention to enter into the music and entertainment market, such as NetEase, Baidu and Youku. In the live game broadcasting market, competition has intensified in the second half of 2014 following an inflow of venture capital investment. Our key competitors in live game broadcasting include douyutv.com, zhanqi.tv, and 17173.com. Furthermore, competition in domestic and overseas online game media markets is also intense. Other than its primary competitor, 17173.com, Duowan.com also competes with other major platforms that host online games, such as QQ and Qihoo 360. In addition, we compete with other internet companies that provide voice and video services to Chinese internet users.

If we are not able to effectively compete in any of our lines of business, our overall user base and level of user engagement may decrease, which could reduce our paying users or make us less attractive to advertisers. We may be required to spend additional resources to further increase our brand recognition and promote our products and

services, and such additional spending could adversely affect our profitability. Furthermore, if we are involved in disputes with any of our competitors that result in negative publicity to us, such disputes, regardless of their veracity or outcome, may harm our reputation or brand image and in turn lead to reduced number of users and advertisers. Any legal proceedings or measures we take in response to such disputes may be expensive, time-consuming and disruptive to our operations and divert our management's attention.

Our competitors may unilaterally decide to adopt a wide range of measures targeted at us, including possibly designing their products to negatively impact our operations, such as sending virus-like programs to attack elements of our platform. Some competitors may also make their applications incompatible with ours, effectively requiring users to either stop using our competitors' products or uninstall our products, leading to a reduction in our number of users. For example, in a widely publicized dispute between two of the largest companies providing user-end software in China, one of the companies announced that it would disable its own software on computers that had installed its rival's products. As a result, a significant number of users stopped using products from either or both of these companies. Due to the large number of internet users that were affected, the Ministry of Industry and Information Technology of China, or the MIIT, ordered the parties to ensure the compatibility of the relevant products. Similar events may occur in the future between our competitors and us, which may reduce our market share, negatively affect our brand and reputation, and materially and adversely affect our business, financial condition and results of operations.

Spammers and malicious applications may affect user experience, which could reduce our ability to attract users and advertisers and materially and adversely affect our business, financial condition and results of operations.

Spammers may use YY to send targeted and untargeted spam messages to users, which may affect user experience. As a result, our users may use our products and services less or stop using them altogether. In spamming activities, spammers typically create multiple user accounts for the purpose of sending spam messages. Although we attempt to identify and delete accounts created for spamming purposes, we may not be able to effectively eliminate all spam messages from our platform in a timely fashion. Any spamming activities could have a material and adverse effect on our business, financial condition and results of operations.

We use third party services and technologies in connection with our business, and any disruption to the provision of these services and technologies to us could result in adverse publicity and a slowdown in the growth of our users, which could materially and adversely affect our business, financial condition and results of operations.

Our business depends upon services provided by, and relationships with, third parties. If we are unable to retain or attract popular talents such as performers, channel managers, professional game players, commentators and hosts for online music and entertainment, live game broadcasting and online dating businesses or if these talents cannot draw fans or participants, our results of operations may be adversely affected. Also, if channel owners are unable to reach or maintain mutually satisfactory cooperation arrangements with the performers on their channels on the online music and entertainment platform, we may lose popular performers and our business and operations may be adversely affected. Furthermore, if we are unable to obtain or retain rights to host popular online games or popular in-game virtual items, or if we are required to share a bigger portion of our revenues with third party game developers, we could be required to devote greater resources and time to obtain hosting rights for new games and applications from other parties, and our results of operations may be impacted. In addition, some third party softwares we use in our operations are currently publicly available without charge. If the owner of any such software decides to charge users or no longer makes the software publicly available, we may need to incur significant cost to license the software, find replacement software or develop it on our own. If we are unable to find or develop replacement software at a reasonable cost, or at all, our business and operations may be adversely affected.

Some of the games offered on our platform run on a complex network of servers located in and maintained by third party data centers throughout China and our overall network relies on broadband connections provided by third party operators. We expect this dependence on third parties to continue. The networks maintained and services provided by such third parties are vulnerable to damage or interruption, which could impact our results of operations. See "—System failure, interruptions and downtime can result in adverse publicity for our products and result in net revenue losses, a slowdown in the growth of our registered user accounts and a decrease in the number of our active users. If any of these system disruptions occurs, our business, financial condition and results of operations may be materially and adversely affected."

Furthermore, we generate substantially all of our online advertising revenues through agreements entered into with various third party advertising agencies that represent advertisers. We do not have long-term cooperation agreements or exclusive arrangements with these agencies and they may elect to direct business opportunities to other advertising service providers. If we fail to retain and enhance our business relationships with these third party advertising agencies, we may suffer from a loss of advertisers and our business and results of operations may be materially and adversely affected.

In addition, we sell a significant portion of our products and services through third party online payment systems. If any of these third party online payment systems suffer from security breaches, users may lose confidence in such payment systems and refrain from purchasing our virtual items online, in which case our results of operations would be negatively impacted. See "—The security of operations of, and fees charged by, third party online payment platforms may have a material adverse effect on our business and results of operations."

We exercise no control over the third parties with whom we have business arrangements. If such third parties increase their prices, fail to provide their services effectively, terminate their service or agreements or discontinue their relationships with us, we could suffer service interruptions, reduced revenues or increased costs, any of which may have a material adverse effect on our business, financial condition and results of operations.

System failure, interruptions and downtime can result in adverse publicity for our products and result in net revenue losses, a slowdown in the growth of our registered user accounts and a decrease in the number of our active users. If any of these system disruptions occurs, our business, financial condition and results of operations may be materially and adversely affected.

Although we seek to reduce the possibility of disruptions or other outages, our services may be disrupted by problems with our own technology and system, such as malfunctions in our software or other facilities and network overload. Our systems may be vulnerable to damage or interruption from telecommunication failures, power loss, computer attacks or viruses, earthquakes, floods, fires, terrorist attacks and similar events. We have experienced system failures, including a partial system outage in 2009 caused by hackers hired by a competing business intending to maliciously overwhelm and clog our servers and our routing system. Those responsible were subsequently found guilty and penalized by the PRC courts and we have subsequently updated our system to make it more difficult for similar attacks to succeed in the future, but we cannot assure you that there will be no similar failures in the future. Parts of our system are not fully redundant, and our disaster recovery planning is not sufficient for all eventualities. Despite any precaution we may take, the occurrence of a natural disaster or other unanticipated problems at our hosting facilities could result in lengthy interruptions in the availability of our products and services. Any interruption in the ability of our users to use our products and services could reduce our future revenues, harm our future profits, subject us to regulatory scrutiny and lead users to seek alternative forms of online social interactions.

Our servers that process user payments experience some downtime on a regular basis, which may negatively affect our brand and user perception of the reliability of our systems. Any scheduled or unscheduled interruption in the ability of users to use our payment systems could result in an immediate, and possibly substantial, loss of revenues.

Almost all internet access in China is maintained through state-owned telecommunication operators under the control and supervision of the MIIT, and we use a limited number of telecommunication service providers to provide us with data communications capacity through local telecommunications lines and internet data centers to host our servers. Internet data centers in China are generally owned by telecommunication service providers with their own broadband networks and are leased to various customers through third party agents. These third party agents negotiate the terms of the leases, enter into lease agreements with end customers, handle customer interactions and manage the data centers on behalf of the data center owners. In the past, we signed data center lease agreements with multiple third party agents. With the expansion of our business, we may be required to purchase more bandwidth and upgrade our technology and infrastructure to keep up with the increasing traffic on our websites and increasing user levels on our platform overall. We cannot assure you that the telecommunications providers whose networks we lease or the third party agents that operate our data centers would be able to accommodate all of our requests for more bandwidth or upgraded infrastructure or network, or that the internet infrastructure and the fixed telecommunications networks in China will be able to support the demands associated with the continued growth in our internet usage.

Our users may use our products or services for critical transactions and communications, especially business communications. As a result, any system failures could result in damage to such users' businesses. These users could seek significant compensation from us for their losses. Even if unsuccessful, this type of claim would likely be time

consuming and costly for us to address.

We have limited control over the prices of the services provided by telecommunication service providers and may have limited access to alternative networks or services. If the prices we pay for telecommunications and internet services rise significantly, our results of operations may be materially and adversely affected. Furthermore, if internet access fees or other charges to internet users increase, our user traffic may decline and our business may be harmed.

The respective number of our registered user accounts, active users, paying users and unique visitors may overstate the number of unique individuals who register to use our products and services, log on to our platform, purchase virtual items or other products and services on our platform or access Duowan.com, respectively, and may therefore lead to an inaccurate interpretation of our average revenue per paying user metric and of our business operations by our management and by investors, and may affect advertisers' decisions on the amount spent on advertising with us.

We do not operate our platform on a real-name basis and therefore we cannot and do not track the number of unique paying users. Instead, we track the number of registered user accounts, active users, paying users and unique visitors. We calculate certain operating metrics in the following ways: (a) the number of registered user accounts is the cumulative number of user accounts at the end of the relevant period that have logged onto our platform at least once after registration, (b) the number of active users is the cumulative number of user accounts at the end of the relevant period that have signed onto our platform at least once during the relevant period, (c) the number of paying users is the cumulative number of registered user accounts that have purchased virtual items or other products and services on our platform at least once during the relevant period, and (d) the number of unique visitors is the number of visits to Duowan.com from specific IP addresses for the relevant period, with each IP address counting as a separate unique visitor. The actual number of unique individual users, however, is likely to be lower than that of registered user accounts, active users, paying users and unique visitors, potentially significantly, for three primary reasons. First, each individual user may register more than once and therefore have more than one account, and sign onto each of these accounts during a given period. For example, a user may (a) create separate accounts for community and personal use and log onto each account at different times for different activities or (b) if he or she lost his or her original username or password, he or she can simply register again and create an additional account. Second, we experience irregular registration activities such as the creation of a significant number of improper user accounts by a limited number of individuals, which may be in violation of our policies, including for the purpose of clogging our network or posting spam to our channels. We believe that some of these accounts may also be created for specific purposes such as to increase the number of votes for certain performers in various contests, but the number of registered user accounts, paying users and active users do not exclude user accounts created for such purposes. We have limited ability to validate or confirm the accuracy of information provided during the user registration process to ascertain whether a new user account created was actually created by an existing user who is registering duplicative accounts. Third, each individual user may access Duowan.com from more than one IP address; although subsequent visits from the same IP address do not add to our total unique visitors count, each new IP address used by an individual would be counted as a different unique visitor to Duowan.com. For example, a user would be counted as a unique visitor three times if he or she accessed Duowan.com from the user's home computer, office computer and mobile phone. Thus, the respective number of our registered user accounts, active users, paying users and unique visitors may overstate the number of unique individuals who register on our platform, sign onto our platform, purchase virtual items or other products and services on our platform and access Duowan.com, respectively which may lead to an inaccurate interpretation of our average revenue per paying user metric.

In addition, we may be unable to track whether we are successfully converting registered users or active users into paying users since we do not track the number of unique individuals or operate our platform on a real-name basis. If the growth in the number of our registered user accounts, active users, paying users or unique visitors is lower than the actual growth in the number of unique individual registered, active or paying users or unique visitors, our user engagement level, sales of IVAS and our business may not grow as quickly as we expect, and advertisers may reduce the amount spent on advertising with us, which may harm our business, financial condition and results of operations. In addition, such overstatement may cause inaccurate evaluation of our business operations by our management and



by investors, which may also materially and adversely affect our business and results of operations.

If we are unable to continue to successfully capture and retain the growing number of users that access internet services through mobile devices or successfully monetize mobile users, our business, financial condition and results of operations may be materially and adversely affected.

An increasing number of users are accessing our platform through mobile devices. For example, the number of downloads for Mobile YY, our music and entertainment application, had increased by 91.8% from 51.9 million in 2013 to 99.6 million in 2014. Mobile YY does not require users to log in to their user accounts to use its general features of listening to or watching different types of performances, but requires users to log in to their user accounts to access features that involve active user participation, including chatting and sending virtual flowers to performers free of charge. The number of monthly active users in Mobile YY increased by 80.1% from 16.7 million in the fourth quarter of 2013 to 30.1 million in the fourth quarter of 2014. An important element of our strategy is to continue to develop enhanced features for Mobile YY and to develop dedicated mobile applications for each part of our business to capture a greater share of the growing number of users that access internet services such as ours through mobile devices, which we expect to consume considerable resources. For example, in September 2014, we upgraded Mobile YY with a number of new features that we believe contributed to the increase in Mobile YY user numbers and revenue, but which also led to a significant increase in research and development expenses for the year.

As new laptops, mobile devices and operating systems are continually being released, it is difficult to predict the problems we may encounter in developing and updating versions of our products and services for use on these devices and operating systems, and we have devoted, and expect to continue to devote, significant resources to create, support and maintain these services. Devices providing access to our products and services are not manufactured and sold by us, and we cannot assure you that the companies manufacturing or selling these devices would always ensure that their devices perform reliably and are maximally compatible with our systems. Any faulty connection between these devices and our products and services may result in consumer dissatisfaction with us, which could damage our brand and have a material and adverse effect on our financial results. In addition, the lower resolution, functionality and memory associated with some mobile devices make the use of our products and services through such devices more difficult and the versions of our products and services we develop for these devices may fail to attract users. Manufacturers or distributors may establish unique technical standards for their devices and, as a result, our mobile applications may not work or be viewable on these devices. Furthermore, new social platforms or services may emerge which are specifically created to function on mobile operating systems, as compared to our platform that was originally designed to be accessed from PCs, and such new entrants may operate more effectively on mobile devices than our mobile applications do.

If we are unable to attract and retain the increasing number of mobile users, or if we are slower than our competitors in developing attractive services adaptable for mobile devices, we may fail to capture a significant share of an increasingly important portion of the market or may lose existing users. In addition, even if we are able to retain the increasing number of mobile users, we may not be able to successfully monetize them in the future. For example, because of the inherent limitations of mobile devices, such as a smaller display screen space as compared to PCs, we may not be able to provide as many kinds of virtual items on our mobile applications as we can on YY Client, which may limit the monetization potential of mobile users. Any of the above may have a material adverse effect on our business, financial condition and results of operations.

Growth in the use of mobile devices, where our ability to monetize is unproven, as a substitute for the use of YY platform on PCs may negatively affect our revenues and financial results.

Although we believe that users are unlikely to entirely migrate to mobile channel and cease to use YY through PCs and that most of our mobile users also access our YY platform through PCs, we cannot assure you that the increasing usage of mobile channel will not cause our users to cease accessing the YY platform from PCs. If a significant number of users migrate to mobile channel as a substitute for accessing the YY platform through PCs, our business, results of operations and financial condition would be negatively affected.

Concerns about collection and use of personal data could damage our reputation and deter current and potential users from using our products and services, which could lead to lower advertising revenues or lower IVAS revenues.

Concerns about our practices with regard to the collection, use or disclosure of personal information or other privacy-related matters, even if unfounded, could damage our reputation and operating results. We apply strict management and protection for any information provided by users and, under our privacy policy, without our users' prior consent, we will not provide any of our users' personal information to any unrelated third party. While we strive to comply with our privacy guidelines as well as all applicable data protection laws and regulations, any failure or perceived failure to comply may result in proceedings or actions against us by government entities or others, and could damage our reputation. User and regulatory attitudes towards privacy are evolving, and future regulatory or user concerns about the extent to which personal information is used or shared with advertisers or others may adversely affect our ability to share certain data with advertisers, which may limit certain methods of targeted advertising. Concerns about the security of personal data could also lead to a decline in general internet usage, which could lead to lower registered, active or paying user numbers on our platform. For example, if the PRC government authorities require real-name registration for YY Client users, the growth of our user numbers may slow and our business, financial condition and results of operations may be adversely affected. See "—Risks Related to Our Corporate Structure and Our Industry—We may be adversely affected by the complexity, uncertainties and changes in PRC regulation of internet business and companies." A significant reduction in registered, active or paying user numbers could lead to lower advertising revenues or lower IVAS revenues, which could have a material and adverse effect on our business, financial condition and results of operations.

The security of operations of, and fees charged by, third party online payment platforms may have a material adverse effect on our business and results of operations.

Currently, we sell all of our IVAS to our users through third party online payment systems. In the year ended December 31, 2014, 96.0% of our total net revenues were derived from IVAS. We expect that an increasing amount of our sales will be conducted over the internet as a result of the growing use of online payment systems. In all these online payment transactions, secured transmission of confidential information such as customers' credit card numbers and personal information over public networks is essential to maintain consumer confidence.

We do not have control over the security measures of our third party online payment vendors, and security breaches of the online payment systems that we use could expose us to litigation and possible liability for failing to secure confidential customer information and could, among other things, damage our reputation and the perceived security of all of the online payment systems that we use. If a well-publicized internet or mobile network security breach were to occur, users concerned about the security of their online financial transactions may become reluctant to purchase our virtual items even if the publicized breach did not involve payment systems or methods used by us. In addition, there may be billing software errors that would damage customer confidence in these online payment systems. If any of the above were to occur and damage our reputation or the perceived security of the online payment systems we use, we may lose paying users and users may be discouraged from purchasing our IVAS, which may have a material adverse effect on our business.

In addition, there are currently only a limited number of third party online payment systems in China. If any of these major payment systems decides to significantly increase the percentage they charge us for using their payment systems for our virtual items and other services, our results of operations may be materially and adversely affected.

Our core values of focusing on user experience and satisfaction first and acting for the long-term may conflict with the short-term operating results of our business, and also negatively impact our relationships with advertisers or other third parties.

One of our core values is to focus on user experience and satisfaction, which we believe is essential to our success and serves the best, long-term interests of our company and our shareholders. Therefore, we have made, and may make in the future, significant investments or changes in strategy that we think will benefit our users, even if our decision negatively impacts our operating results in the short-term. For example, in order to provide users of YY Client with uninterrupted entertainment options, we do not place significant advertising on YY Client. While this decision adversely affects our operating results in the short-term, we believe it enables us to provide higher quality user experience on YY Client, which will help us expand and maintain our current large user base and create better monetizing potential in the long-term. In addition, this philosophy of putting our users first may also negatively impact our relationships with advertisers or other third parties, and may not result in the long-term benefits that we expect, in which case the success of our business and operating results could be harmed.

Trademarks registered, internet search engine keywords purchased and domain names registered by third parties that are similar to our trademarks, brands or websites could cause confusion to our users, divert online customers away from our products and services or harm our reputation.

Competitors and other third parties may purchase (a) trademarks that are similar to our trademarks and (b) keywords that are confusingly similar to our brands or websites in internet search engine advertising programs and in the header and text of the resulting sponsored links or advertisements in order to divert potential customers from us to their websites. Preventing such unauthorized use is inherently difficult. If we are unable to prevent such unauthorized use,

competitors and other third parties may continue to drive potential online customers away from our platform to competing, irrelevant or potentially offensive platforms, which could harm our reputation and cause us to lose revenue.

We may be held liable for information or content displayed on, retrieved from or linked to our platform, or distributed to our users, and PRC authorities may impose legal sanctions on us, including, in serious cases, suspending or revoking the licenses necessary to operate our platform.

Our real-time interactive social platform enables users to exchange information, generate content, advertise products and services, conduct business and engage in various other online activities. However, our platform does not require real-name registration by our users and because a majority of the communications on our platform is conducted in real time, we are unable to verify the sources of all information posted thereon or examine the content generated by users before they are posted. Therefore, it is possible that users may engage in illegal, obscene or incendiary conversations or activities, including the publishing of inappropriate or illegal content that may be deemed unlawful under PRC laws and regulations on our platform. These issues exist on YY Client, YY.com, Duowan.com and 100.com. If any content on our platform is deemed illegal, obscene or incendiary, or if appropriate licenses and third party consents have not been obtained, claims may be brought against us for defamation, libel, negligence, copyright, patent or trademark infringement, other unlawful activities or other theories and claims based on the nature and content of the information delivered on or otherwise accessed through our platforms. For example, we have occasionally received fines for certain inappropriate materials placed by third parties on our platform, and may be subject to similar fines and penalties in the future. We also may face liability for copyright or trademark infringement, fraud, and other claims based on the nature and content of the materials that are delivered, shared or otherwise accessed through or published on our platform. Defending any such actions could be costly and involve significant time and attention of our management and other resources. In addition, if they find that we have not adequately managed the content on our platform, PRC authorities may impose legal sanctions on us, including, in serious cases, suspending or revoking the licenses necessary to operate our platform. See "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Information Security and Censorship" and "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Intellectual Property Rights."

We may be subject to intellectual property infringement claims or other allegations, which could result in our payment of substantial damages, penalties and fines, removal of relevant content from our website or seeking license arrangements which may not be available on commercially reasonable terms.

Third party owners or right holders of technology patents, copyrights, trademarks, trade secrets and website content may assert intellectual property infringement or other claims against us. In addition, content generated through our platform, including real-time content, may also potentially cause disputes regarding content ownership or intellectual property. For example, we could face copyright infringement claims with respect to songs performed live, recorded or made accessible on our music and entertainment platform, and online games being streamed live, recorded or made accessible on our live game broadcasting platform. We generated approximately 57.3% and 4.2% of our total net revenues in 2014 from online music and entertainment and live game broadcasting, respectively.

The validity, enforceability and scope of protection of intellectual property rights in internet-related industries, particularly in China, are uncertain and still evolving. As we face increasing competition and as litigation becomes a more common way to resolve disputes in China, we face a higher risk of being the subject of intellectual property

infringement claims. For example, Guangzhou NetEase Computer System Co., Ltd. has initiated a lawsuit against us in Guangzhou in December 2014, claiming the infringement of its rights of reproduction concerning the online game of *Fantasy Westward Journey* in the amount of RMB100 million. Although we believe that the claim is unjustified and commercially motivated, if the outcome of the proceeding is unfavourable to us, we may suffer considerable damage to our financial position and reputation. Under relevant PRC laws and regulations, online service providers which provide storage space for users to upload works or links to other services or content could be held liable for copyright infringement under various circumstances, including situations where an online service provider knows or should reasonably have known that the relevant content uploaded or linked to on its platform infringes the copyrights of others and the provider realizes economic benefits from such infringement activities. The "knows or should reasonably have known" element would be fulfilled under some statutorily specified circumstances. For example, online service providers are subject to liability if they fail to take necessary measures, such as deletion, blocking or disconnection, after receiving notification from the legal right holders. In particular, there have been cases in China in which the courts have found an online service provider to be liable for the copyrighted content posted by users which were accessible and stored on such provider's servers. On the other hand, to our knowledge, there is currently no precedent or settled court practice which provides clear guidance as to whether or to what extent a real-time online platform such as YY would be held liable for the unauthorized posting or live performances of copyrighted content by our users. See "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Intellectual Property Rights."

We have implemented procedures to reduce the likelihood that we may use, develop or make available any content or applications without the proper licenses or necessary third party consents; such procedures include requiring performers, channel owners and users to acknowledge and agree that they would not perform or upload copyrighted content without proper authorization and that they will indemnify us for any relevant copyright infringement claims. However, these procedures may not be effective in preventing unauthorized posting or use of copyrighted content on our platform or the infringement of other third party rights. Specifically, such acknowledgments and agreements by performers, channel owners and users are not enforceable against third parties who may nevertheless file claims of copyright infringement against us. Furthermore, individual performers or channel owners who generate content that may infringe on copyrights of third parties on our platform may not be easily traceable, if at all, by a plaintiff who may then choose to file a claim against us, and these individual performers and channel owners may not have resources to fully indemnify us, if at all, for any such claims. In addition, we have entered into revenue-sharing arrangements in the form of direct or indirect employment agreements with some of the popular singers, performers or channel owners on our platform, and we cannot assure you that PRC courts will not view these singers, performers or channel owners as our employees or agents, deem us to have control over their activities on our platform and the content they upload or otherwise make available on our platform, determine that we have knowingly uploaded such infringing content on our platform and hold us directly liable for their infringement activities on our platform. Separately, as our business expands, the cost of carrying out these procedures and obtaining authorization and licenses for the growing content on our platform may increase, which may potentially have material and adverse effects on our results of operations.

Although we have not been subject to claims or lawsuits outside China, we cannot assure you that we will not become subject to intellectual property laws in other jurisdictions, such as the United States, by virtue of our ADSs being listed on the Nasdaq Global Market, the ability of users to access our platform in the United States and other jurisdictions, the performance of songs and other content which are subject to copyright and other intellectual property laws of countries outside China, including the United States, the ownership of our ADSs by investors in the United States and other jurisdictions, or the extraterritorial application of foreign law by foreign courts or otherwise. In addition, as a publicly listed company, we may be exposed to increased risk of litigation.

If an infringement claim brought against us in China, the United States or any other jurisdiction is successful, we may be required to pay substantial statutory penalties or other damages and fines, remove relevant content from our platform or enter into license agreements which may not be available on commercially reasonable terms or at all. Litigation or other claims against us also subject us to adverse publicity which could harm our reputation and affect our ability to attract and retain users, including channel owners, singers and other performers, which could materially and adversely affect the popularity of our platform and therefore, our business, financial condition, results of operations and prospects may be materially and adversely affected.

We may not be able to successfully halt the operations of platforms that aggregate our data as well as data from other companies, including social networks, or "copycat" platforms that have misappropriated our data in the past or may misappropriate our data in the future. Those platforms may also lure away some of our users or advertisers or reduce our market share, causing material and adverse effects on our business operations.

From time to time, third parties have misappropriated our data through scraping our platform, robots or other means and aggregated this data on their platforms with data from other companies. In addition, "copycat" platforms or client applications have misappropriated data on our platform, implanted Trojan viruses in user PCs to steal user data from YY Client and attempted to imitate our brand or the functionality of our platform. When we became aware of such platforms, we employed technological and legal measures in an attempt to halt their operations. However, we may not be able to detect all such platforms in a timely manner and, even if we could, technological and legal measures may be insufficient to stop their operations. In those cases, our available remedies may not be adequate to protect us against such platforms. Regardless of whether we can successfully enforce our rights against these platforms, any measures that we may take could require significant financial or other resources from us. Those platforms may also lure away some of our users or advertisers or reduce our market share, causing material and adverse effects to our business operations.

We may not be able to prevent others from unauthorized use of our intellectual property, which could harm our business and competitive position.

We regard our trademarks, service marks, patents, domain names, trade secrets, proprietary technologies and similar intellectual property as critical to our success, and we rely on trademark and patent law, trade secret protection and



confidentiality and license agreements with our employees and others to protect our proprietary rights. As of December 31, 2014, we had registered 137 domain names, including YY.com, Duowan.com, 100.com, Chinaduo.com and Edu24oL.com, 123 software copyrights, 12 patents and 209 trademarks and service marks in China and overseas. In addition, as of December 31, 2014, we had filed 215 patent applications covering certain of our proprietary technologies and 277 trademark applications in China and overseas.

It is often difficult to create and enforce intellectual property rights in China. Patents, trademarks and service marks may also be invalidated, circumvented, or challenged. Trade secrets are difficult to protect, and our trade secrets may be leaked or otherwise become known or be independently discovered by others. Confidentiality agreements may be breached, and we may not have adequate remedies for any breach. Even where adequate, relevant laws exist in China, it may not be possible to obtain swift and equitable enforcement of such laws, or to obtain enforcement of a court judgment or an arbitration award delivered in another jurisdiction, and accordingly, we may not be able to effectively protect our intellectual property rights or enforce agreements in China. Policing any unauthorized use of our intellectual property is difficult and costly and the steps we have taken may be inadequate to prevent the misappropriation of our technologies. Given the potential cost, effort, risks and downsides of obtaining patent protection, in some cases we have not and do not plan to apply for patents or other forms of formal intellectual property protection for certain key technologies. If some of these technologies are later proven to be important to our business and are used by third parties without our authorization, especially for commercial purposes, our business and competitive position may be harmed.

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

In China, the valid period of utility model patent right or design patent right is ten years and is not extendable. Currently, we have patent applications pending in China, but we cannot assure you that we will be granted patents pursuant to our pending applications. Even if our patent applications succeed and we are issued patents in accordance with them, it is still uncertain whether these patents will be contested, circumvented or invalidated in the future. The rights granted under any issued patents may not provide us with proprietary protection or competitive advantages. Further, the claims under any patents that issue from our patent applications may not be broad enough to prevent others from developing technologies that are similar or that achieve results similar to ours. It is also possible that the intellectual property rights of others will bar us from licensing and from exploiting any patents that issue from our pending applications. Numerous U.S. and foreign issued patents and pending patent applications owned by others exist in the fields in which we have developed and are developing our technology. These patents and patent applications might have priority over our patent applications and could subject our patent applications to invalidation. Finally, in addition to those who may claim priority, any of our existing or pending patents may also be challenged by others on the basis that they are otherwise invalid or unenforceable.

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

We believe that maintaining and enhancing our brands is of significant importance to the success of our business. Well-recognized brands are important to increasing the number of users and the level of engagement of our users and enhancing our attractiveness to advertisers. Since we operate in a highly competitive market, brand maintenance and enhancement directly affect our ability to maintain our market position.

Although we have developed YY mostly through word of mouth referrals, as we expand, we may conduct various marketing and brand promotion activities using various methods to continue promoting our brands. We cannot assure you, however, that these activities will be successful or that we will be able to achieve the brand promotion effect we expect. In addition, any negative publicity in relation to our products or services, regardless of its veracity, could harm our brands and reputation.

We have sometimes received, and expect to continue to receive, complaints from users regarding the quality of the products and services we offer. Negative publicity or public complaints by users may harm our reputation and affect our ability to attract new users and retain existing users. If our users' complaints are not addressed to their satisfaction, our reputation and our market position could be significantly harmed, which may materially and adversely affect our business, results of operations and prospects.

Our business depends substantially on the continuing efforts of our executive officers and key employees, and our business operations may be severely disrupted if we lose their services.

Our future success depends substantially on the continued efforts of our executive officers and key employees. If one or more of our executive officers or key employees were unable or unwilling to continue their services with us, we might not be able to replace them easily, in a timely manner, or at all. In addition, our executive officers and key employees hold the equity interests in Beijing Tuda Science and Technology Co., Ltd., or Beijing Tuda, and Guangzhou Huaduo Network Technology Co., Ltd., or Guangzhou Huaduo, our PRC consolidated affiliated entities. In particular, Mr. David Xueling Li, our co-founder, chief executive officer and director, and Mr. Jin Cao, our executive vice president, own 97.7% and 0.8% of Beijing Tuda's equity interests, respectively. Messrs. Li and Cao and Beijing Tuda also own approximately 0.5%, 0.02% and 99.0% of Guangzhou Huaduo's equity interests, respectively, with 0.44% owned by Mr. Jun Lei, our co-founder and chairman. If any of these executive officers and key employees terminates their services with us, we have the contractual right to appoint designees to hold the PRC consolidated affiliated entities' equity interests. However, our business may be severely disrupted, our financial condition and results of operations may be materially and adversely affected and we may incur additional expenses to recruit, train and retain personnel. If any of our executive officers or key employees joins a competitor or forms a competing company, we may lose customers, know-how and key professionals and staff members. Each of our executive officers and key employees has entered into an employment agreement and a non-compete agreement with us. However, as advised by our PRC counsel, Fangda Partners, certain provisions under the non-compete agreement may not be deemed valid or enforceable under PRC laws. If any dispute arises between our executive officers and key employees and us, we cannot assure you that we would be able to enforce these non-compete agreements in China, where these executive officers reside, in light of uncertainties with China's legal system. See "[Risks Related to Doing Business in China—Uncertainties in the interpretation and enforcement of Chinese laws and regulations could limit the legal protections available to you and us.](#)"

If we are unable to attract, train and retain qualified personnel, our business may be materially and adversely affected.

Our future success depends, to a significant extent, on our ability to attract, train and retain qualified personnel, particularly management, technical and marketing personnel with expertise in the internet industry; inability to do so may materially and adversely affect our business. Since the internet industry is characterized by high demand and intense competition for talent, we cannot assure you that we will be able to attract or retain qualified staff or other highly skilled employees. As our company is relatively young, our ability to train and integrate new employees into our operations may not meet the growing demands of our business which may materially and adversely affect our ability to grow our business and hence our results of operations.

Our results of operations are subject to substantial quarterly and annual fluctuations due to seasonality.

We experience seasonality in our business, reflecting seasonal fluctuations in internet usage. As a result, comparing our operating results on a period-to-period basis may not be meaningful. For example, online user numbers tend to be lower during school holidays and certain parts of the school year, and advertising revenues tend to be lower during the Chinese New Year season, which negatively affects our cash flow for those periods. We may also experience a reduction in active users in the third quarter of each year because a significant portion of our users are students, and as the new school year begins, student access to computers and the internet are affected. Internet usage and the rate of internet growth may also be expected to decline during the summer school holidays as some students lose regular internet access. Furthermore, the number of paying users of our online music and entertainment platform correlates with the marketing campaigns and promotional activities we conduct which coincide with popular western or Chinese festivals celebrated by young Chinese people, many of which are in the fourth quarter and ending with the Chinese New Year holidays which typically fall in the first quarter.

As a result, our operating results in future quarters or years may fall below the expectations of securities analysts and investors. In such event, the trading price of our ADSs would likely be materially and adversely affected. See "Item 4. Information on the Company—B. Business Overview—Seasonality" for additional details regarding the effects of seasonality on our cash flow, operating performance and financial results.

Our business is sensitive to global economic conditions. A severe or prolonged downturn in the global or Chinese economy could materially and adversely affect our business, financial condition and results of operations.

The global financial markets have experienced significant disruptions since 2008 and the United States, Europe and other economies went into recession. The recovery from the lows of 2008 and 2009 was uneven and is facing new challenges, including the escalation of the European sovereign debt crisis since 2011, the slowdown of the Chinese economy since 2012, the end of quantitative easing by the U.S. Federal Reserve and the economic slowdown in Europe in 2014. It is unclear whether the European sovereign debt crisis/ economic slowdown will be contained and whether the Chinese economy will resume its high growth rate. There is considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies adopted by the central banks and financial authorities of some of the world's leading economies, including China's. There have also been concerns over political situations in different parts of the world, including unrest in the Middle East and Africa, which have resulted in volatility in oil and other markets. Economic conditions in China are sensitive to global economic conditions. Online music and entertainment, along with the online gaming and online advertising industries, which account for a significant portion of our revenues, may be affected by economic downturns. During a prolonged slowdown in the Chinese economy, our products and services may be viewed as discretionary by our users, who may choose to discontinue or reduce spending on such products and services during an economic downturn, there may be a reduced amount of online advertising, and our ability to retain existing users and increase new users will be adversely affected. Thus, our business, financial condition and results of operations may be affected by the macroeconomic environment in China.

Any prolonged slowdown in the global or Chinese economy may have a negative impact on our business, financial condition and results of operations, and continued turbulence in the international markets may adversely affect our ability to access the capital markets to meet liquidity needs.

Future strategic alliances or acquisitions may have a material and adverse effect on our business, reputation and results of operations.

We may enter into strategic alliances, including joint ventures or minority equity investments, with various third parties to further our business purpose from time to time. These alliances could subject us to a number of risks, including risks associated with sharing proprietary information, non-performance by the third party and increased expenses in establishing new strategic alliances, any of which may materially and adversely affect our business. We may have limited ability to monitor or control the actions of these third parties and, to the extent any of these strategic third parties suffers negative publicity or harm to their reputation from events relating to their business, we may also suffer negative publicity or harm to our reputation by virtue of our association with any such third party.

In addition, although we have no current acquisition plans, if appropriate opportunities arise, we may acquire additional assets, products, technologies or businesses that are complementary to our existing business. For example, in the fourth quarter of 2014, we acquired Beijing Huanqiu Xingxue Technology Development Co., Ltd. and Beijing Huanqiu Chuangzhi Software Co., Ltd., which operate Edu24oL.com, an online education website, and we believe such acquisition would effectively supplement our online education business. Past and future acquisitions and the subsequent integration of new assets and businesses into our own require significant attention from our management and could result in a diversion of resources from our existing business, which in turn could have an adverse effect on our business operations. Acquired assets or businesses may not generate the financial results we expect. Acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities, the occurrence of significant goodwill impairment charges, amortization expenses for other intangible assets and exposure to potential unknown liabilities of the acquired business. Moreover, the costs of identifying and consummating acquisitions may be significant. In addition to possible shareholders' approval, we may also have to obtain approvals and licenses from relevant government authorities for the acquisitions and to comply with any applicable PRC laws and regulations, which could result in increased delay and costs.

If we fail to maintain an effective system of internal control over financial reporting, we may be unable to accurately report our financial results or prevent fraud, and investor confidence in our company and the market price of our ADSs may be adversely affected.

The SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, adopted rules requiring most public companies to include a management report on such company's internal control over financial reporting in its annual report, which contains management's assessment of the effectiveness of the company's internal control over financial reporting. In addition, when a company meets the SEC's criteria, an independent registered

public accounting firm must report on the effectiveness of the company's internal control over financial reporting.

Our management and independent registered public accounting firm have concluded that our internal control over financial reporting was effective as of December 31, 2014. However, we cannot assure you that in the future our management or our independent registered public accounting firm will not identify material weaknesses during the Section 404 of the Sarbanes-Oxley Act audit process or for other reasons. In addition, because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. As a result, if we fail to maintain effective internal control over financial reporting or should we be unable to prevent or detect material misstatements due to error or fraud on a timely basis, investors could lose confidence in the reliability of our financial statements, which in turn could harm our business, results of operations and negatively impact the market price of our ADSs, and harm our reputation. Furthermore, we have incurred and expect to continue to incur considerable costs and to use significant management time and the other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

Some of our users may make sales or purchases through unauthorized third party platforms of virtual items we offer for free on our platform, which may affect our revenue-generating opportunities and exert downward pressure on the prices we charge for our virtual items.

We, from time to time, offer virtual items free of charge to attract users or encourage user participation in channels. Some of our users may sell or purchase such free virtual items through unauthorized third party sellers in exchange for real currency. For example, fans of a performer may pay other users to send flowers or gifts the latter have accumulated on our platform to the performer, in order to show support and raise the popularity ranking of the performer of their choice. These unauthorized transactions are usually arranged on third party platforms which we do not and are unable to track or monitor. Accordingly, these unauthorized purchases and sales from third party sellers may affect our revenue-generating opportunities and may impede our revenue and profit growth by, among other things, reducing the revenues we could have generated and exerting downward pressure on the prices we charge for our virtual items.

We have limited business insurance coverage, so that any uninsured occurrence of business disruption may result in substantial costs to us and the diversion of our resources, which could have an adverse effect on our results of operations and financial condition.

Insurance companies in China currently do not offer as extensive an array of insurance products as insurance companies do in more developed economies. We do not have any business liability or disruption insurance to cover our operations. We have determined that the costs of insuring for these risks and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. Any uninsured occurrence may disrupt our business operations, require us to incur substantial costs and divert our resources, which could have an adverse effect on our results of operations and financial condition.

#### Risks Related to Our Corporate Structure and Our Industry

If the PRC government finds that the structure we have adopted for our business operations does not comply with PRC laws and regulations, or if these laws or regulations or interpretations of existing laws or regulations change in the future, we could be subject to severe penalties, including the shutting down of our platform and our business operations.

Foreign ownership of internet-based businesses is subject to significant restrictions under current PRC laws and regulations. The PRC government regulates internet access, the distribution of online information and the conduct of online commerce through strict business licensing requirements and other government regulations. These laws and regulations also limit foreign ownership in PRC companies that provide internet information distribution services.



Specifically, foreign ownership in an internet information provider or other value-added telecommunication service providers may not exceed 50%. In addition, according to the Several Opinions on the Introduction of Foreign Investment in the Cultural Industry promulgated by the Ministry of Culture, or the MOC, the State Administration of Radio, Film and Television, or the SARFT, the General Administration of Press and Publication, or the GAPP, currently known as the State Administration of Press Publication, Radio, Film and Television after combination of SARFT and GAPP, the National Development and Reform Commission and the Ministry of Commerce, or the MOFCOM, in July 2005, foreign investors are prohibited from investing in or operating, among others, any internet cultural operating entities and from engaging in the business of transmitting audio-visual programs through information networks.

We are a Cayman Islands company and our PRC subsidiaries, Guangzhou Huanju Shidai Information Technology Co., Ltd., or Guangzhou Huanju Shidai, Huanju Shidai Technology (Beijing) Co., Ltd., or Beijing Huanju Shidai and Zhuhai Huanju Shidai Information Technology Co., Ltd., or Zhuhai Huanju Shidai, are each considered a wholly foreign owned enterprise. We conduct our operations in China primarily through a series of contractual arrangements entered into among our PRC subsidiary, Beijing Huanju Shidai, our PRC consolidated affiliated entities, Guangzhou Huaduo and Beijing Tuda, and Guangzhou Huaduo and Beijing Tuda's shareholders. As a result of these contractual arrangements, we exert control over our PRC consolidated affiliated entities and consolidate each of their operating results in our financial statements under U.S. GAAP. All of the equity (net assets) or deficit (net liabilities) and net income (loss) of the consolidated affiliated entities are attributed to us. For a detailed description of these contractual arrangements, see "Item 7. Major Shareholders and Related Party Transactions—B. Related Party—Contractual Arrangements with Beijing Tuda."

On September 28, 2009, the GAPP, the National Copyright Administration and the National Office of Combating Pornography and Illegal Publications, jointly issued a Notice on Further Strengthening the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games, or Circular 13. Circular 13 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 entering into contractual or technical arrangements such as the variable interest entity structural arrangements we adopted for our consolidated affiliated entities. We are not aware of any companies that have adopted a corporate structure that is the same as or similar to ours having been penalized or terminated under Circular 13 since the effective date of the circular. Furthermore, the enforcement of Circular 13 is still subject to substantial uncertainty, including possible subsequent joint actions by relevant authorities in charge, such as the MOC. The Regulation on Three Provisions stipulates that the MOC is authorized to regulate the online game industry, while the GAPP is authorized to approve the publication of online games before their launch on the internet. The Interpretation on Three Provisions further provides that once an online game is launched on the internet, it will be completely under the regulation of the MOC, and that if an online game is launched on the internet without obtaining prior approval from the GAPP, the MOC, instead of the GAPP, is directly responsible for investigating the game. In the event that we, our PRC subsidiaries or PRC consolidated affiliated entities are found to be in violation of the prohibition under Circular 13, the GAPP, in conjunction with the relevant regulatory authorities in charge, may impose applicable penalties, which in the most serious cases may include suspension or revocation of relevant licenses and registrations. In addition, various media sources have reported that the CSRC prepared a report proposing pre-approval by a competent central government authority of offshore listings by China-based companies with variable interest entity structures, such as ours, that operate in industry sectors subject to foreign investment restrictions. However, it is unclear whether the CSRC officially issued or submitted such a report to a higher level government authority or what any such report provides. Furthermore, on January 19, 2015, the MOFCOM issued a discussion draft of the proposed Foreign Investment Law, which may place restrictions on variable interest entity structures adopted by us, but the enactment timetable, interpretation, implementation and influence thereof remain unclear. See "—Risks Related to Doing Business in China—Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of draft PRC Foreign Investment Law and how it may impact the viability of our current corporate structure, corporate governance and business operations."

Based on understanding of current PRC laws, rules and regulations of our PRC legal counsel, Fangda Partners, our current ownership structure for our business operations, the ownership structure of our PRC subsidiaries and our PRC consolidated affiliated entities, the contractual arrangements among our PRC subsidiaries, our PRC consolidated affiliated entities and their shareholders, as described in this annual report on Form 20-F, are in compliance with existing PRC laws, rules and regulations. However, we were further advised by Fangda Partners that there is substantial uncertainty regarding the interpretation and application of current or future PRC laws and regulations and these laws or regulations or interpretations of these laws or regulations may change in the future. Furthermore, the relevant government authorities have broad discretion in interpreting these laws and regulations. Accordingly, we cannot assure you that PRC government authorities will not ultimately take a view contrary to the opinion of our PRC legal counsel.

If our ownership structure, contractual arrangements and businesses of our company, our PRC subsidiaries or our PRC consolidated affiliated entities are found to be in violation of any existing or future PRC laws or regulations, the relevant governmental authorities would have broad discretion in dealing with such violation, including levying fines,

confiscating our income or the income of our PRC subsidiaries or PRC consolidated affiliated entities, revoking or suspending the business licenses or operating licenses of our PRC subsidiaries or PRC consolidated affiliated entities, shutting down our servers or blocking our platform, discontinuing or placing restrictions or onerous conditions on our operations, requiring us to discontinue our operations, requiring us to undergo a costly and disruptive restructuring, restricting or prohibiting our use of proceeds from our initial public offering to finance our business and operations in China, and taking other regulatory or enforcement actions that could be harmful to our business. Any of these actions could cause significant disruption to our business operations and severely damage our reputation, which would in turn materially and adversely affect our business, financial condition and results of operations. In addition, if the imposition of any of these penalties causes us to lose the rights to direct the activities of our PRC consolidated affiliated entities or our right to receive their economic benefits, we would no longer be able to consolidate such entities. Our PRC consolidated affiliated entities contributed substantially all of our consolidated net revenues in the years ended December 31, 2012, 2013 and 2014.

We rely on contractual arrangements with our PRC consolidated affiliated entities and their shareholders for the operation of our business, which may not be as effective as direct ownership. If our PRC consolidated affiliated entities and their shareholders fail to perform their obligations under these contractual arrangements, we may have to resort to litigation to enforce our rights, which may be time-consuming, unpredictable, expensive and damaging to our operations and reputation.

Because of PRC restrictions on foreign ownership of internet-based businesses in China, we depend on contractual arrangements with our PRC consolidated affiliated entities in which we have no ownership interest to conduct our business. These contractual arrangements are intended to provide us with effective control over these entities and allow us to obtain economic benefits from them. Our PRC consolidated affiliated entities are owned directly by Messrs. David Xueling Li, Jun Lei, Tony Bin Zhao and Jin Cao, among whom certain shareholders are our directors, key executive officers and employees. For additional details on these ownership interests, see "—Risks Related to Our Business—Our business depends substantially on the continuing efforts of our executive officers and key employees, and our business operations may be severely disrupted if we lose their services" and "Item 4. Information on the Company—A. History and Development of the Company." However, these contractual arrangements may not be as effective in providing control as direct ownership. For example, each of our PRC consolidated affiliated entities and their shareholders could breach their contractual arrangements with us by, among other things, failing to operate our business in an acceptable manner or taking other actions that are detrimental to our interests. If we were the controlling shareholder of these PRC consolidated affiliated entities with direct ownership, we would be able to exercise our rights as shareholders to effect changes to their board of directors, which in turn could implement changes at the management and operational level. However, under the current contractual arrangements, as a legal matter, if our PRC consolidated affiliated entities or their shareholders fail to perform their obligations under these contractual arrangements, we may have to incur substantial costs to enforce such arrangements, and rely on legal remedies under PRC law, including contract remedies, which may not be sufficient or effective. In particular, the contractual arrangements provide that any dispute arising from these arrangements will be submitted to the China International Economic and Trade Arbitration Commission for arbitration in Beijing, the ruling of which will be final and binding. The legal framework and system in China, particularly those relating to arbitration proceedings, is not as developed as other jurisdictions such as the United States. As a result, significant uncertainties relating to the enforcement of legal rights through arbitration, litigation and other legal proceedings remain in China, which could limit our ability to enforce these contractual arrangements and exert effective control over our consolidated affiliated entities. If we are unable to enforce these contractual arrangements, or if we suffer significant delay or other obstacles in the process of enforcing these contractual arrangements, our business and operations could be severely disrupted, which could materially and adversely affect our results of operations and damage our reputation. See "—Risks Related to Doing Business in China—Uncertainties in the interpretation and enforcement of Chinese laws and regulations could limit the legal protections available to you and us."

Our existing shareholders have substantial influence over our company and their interests may not be aligned with the interests of our other shareholders, which may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their securities.

As of March 31, 2015, our management group—including Mr. David Xueling Li, our co-founder, chief executive officer and director, Mr. Jun Lei, our co-founder and chairman, Mr. Jin Cao, an executive vice president of our company, and

Mr. Rongjie Dong, another executive vice president,—and their respective affiliates, beneficially own an aggregate of 37.7% of our outstanding shares and 75.9% of the total voting power. Messrs. Li, Lei and Cao and Beijing Tuda together hold 99.96% of the equity interest in Guangzhou Huaduo and Messrs. Li and Cao together hold 98.5% of the equity interest in Beijing Tuda. Guangzhou Huaduo and Beijing Tuda are our variable interest entities. Our management group has substantial influence over our business, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of any contemplated sale of our company and may reduce the price of our ADSs. In addition, Messrs. Li, Dong and Cao could violate the terms of their non-compete or employment agreements with us or their legal duties by diverting business opportunities from us, resulting in our loss of corporate opportunities. These actions may take place even if they are opposed by our other shareholders. Additionally, Mr. Jun Lei, our co-founder, chairman and shareholder who owned 17.9% of our outstanding shares as of March 31, 2015, is in the business of making investments in internet companies in China. Mr. Lei currently holds direct and indirect interests in our direct competitor, iSpeak, and other entities which may have businesses that compete with ours. iSpeak is owned by Mr. Lei in part through Kingsoft Corporation Limited, or Kingsoft, which is engaged in the research, development operation and distribution of online games, mobile games, casual game services and internet software. He may, in the future, acquire additional interests in businesses that directly or indirectly compete with some of our lines of business or that are our suppliers or customers. Furthermore, Mr. Lei, whether through Kingsoft or otherwise, may pursue acquisitions or make further investments in our industries which may conflict with our interests. Although we adopted a code of business conduct and ethics to help restrict conflicts of interest involving directors and officers, any violation of this code by our existing officers or directors such as Mr. Lei may materially and adversely affect our business operations. For more information regarding the beneficial ownership of our company by our principal shareholders, see "Item 6. Directors, Senior management and Employees—E. Share Ownership."

We may lose the ability to use and enjoy assets held by our PRC consolidated affiliated entities that are important to the operation of our business if such entities go bankrupt or become subject to a dissolution or liquidation proceeding.

As part of our contractual arrangements with our PRC consolidated affiliated entities, Guangzhou Huaduo and Beijing Tuda, such entities hold certain assets, such as patents for the proprietary technology that are essential to the operations of our platform and important to the operation of our business. If either Guangzhou Huaduo or Beijing Tuda goes bankrupt and all or part of its assets become subject to liens or rights of third party creditors, we may be unable to continue some or all of our business activities, which could materially and adversely affect our business, financial condition and results of operations. If Guangzhou Huaduo or Beijing Tuda undergoes a voluntary or involuntary liquidation proceeding, the unrelated third party creditors may claim rights to some or all of these assets, thereby hindering our ability to operate our business, which could materially and adversely affect our business, financial condition and results of operations.

Our ability to enforce the equity pledge agreements between us and our PRC variable interest entities' shareholders may be subject to limitations based on PRC laws and regulations.

Pursuant to the equity interest pledge agreements between Beijing Huanju Shidai, our wholly owned subsidiary in China, and the shareholders of Guangzhou Huaduo and Beijing Tuda, our variable interest entities, or VIEs, each shareholders of each variable interest entities agrees to pledge its equity interests in the VIE to our subsidiary to secure the relevant VIE's performance of their obligations under the relevant contractual arrangements. The equity interest pledges of shareholders of VIEs under these equity pledge agreements have been registered with the relevant local branch of the SAIC. In addition, in the registration forms of the local branch of State Administration for Industry and Commerce for the pledges over the equity interests under the equity interest pledge agreements, the aggregate amount of registered equity interests pledged to Beijing Huanju Shidai represents 100% of the registered capital of Guangzhou Huaduo and Beijing Tuda. The equity interest pledge agreements with each of the VIEs' shareholders provide that the pledged equity interest shall constitute continuing security for any and all of the indebtedness, obligations and liabilities under all of the principal service agreements and the scope of pledge shall not be limited by the amount of the registered capital of that VIE. However, it is possible that a PRC court may take the position that the amount listed on the equity pledge registration forms represents the full amount of the collateral that has been registered and perfected. If this is the case, the obligations that are supposed to be secured in the equity interest pledge agreements in excess of the amount listed on the equity pledge registration forms could be determined by the PRC court as unsecured debt, which takes last priority among creditors.

Our contractual arrangements with our PRC consolidated affiliated entities may result in adverse tax consequences to us.

As a result of our corporate structure and the contractual arrangements among our PRC subsidiaries, our PRC consolidated affiliated entities and their shareholders, we are effectively subject to PRC turnover tax on revenues

generated by our subsidiaries from our contractual arrangements with our PRC consolidated affiliated entities. Such tax generally includes the PRC value added tax ("VAT") at a rate of 6% or 17% along with related surcharges. The applicable turnover tax is determined by the nature of the transaction generating the revenues subject to taxation. The PRC enterprise income tax law requires every enterprise in China to submit its annual enterprise income tax return together with a report on transactions with its affiliates or related parties to the relevant tax authorities. These transactions may be subject to audit or challenge by the PRC tax authorities within ten years after the taxable year during which the transactions are conducted. We may be subject to adverse tax consequences if the PRC tax authorities were to determine that the contracts between us and our PRC consolidated affiliated entities were not on an arm's length basis and therefore constitute a favorable transfer pricing arrangements. If this occurs, the PRC tax authorities could request that either of our PRC consolidated affiliated entities adjust its taxable income upward for PRC tax purposes. Such a pricing adjustment could adversely affect us by reducing expense deductions recorded by either PRC consolidated affiliated entities and thereby increasing these entities' tax liabilities, which could subject these entities to late payment fees and other penalties for the underpayment of taxes. Our consolidated net income may be materially and adversely affected if our PRC consolidated affiliated entities' tax liabilities increase or if it becomes subject to late payment fees or other penalties.

If our PRC consolidated affiliated entities fail to obtain and maintain the requisite licenses and approvals required under the complex regulatory environment for internet-based businesses in China, our business, financial condition and results of operations may be materially and adversely affected.

The internet industry in China is highly regulated. See "Item 4. Information on the Company—B. Business Overview—PRC Regulation." Guangzhou Huaduo, as our PRC consolidated affiliated entity, is required to obtain and maintain applicable licenses or approvals from different regulatory authorities in order to provide its current services. For example, an internet information service provider shall obtain an operating license, or the ICP License, from MIIT or its local counterparts before engaging in any commercial internet information services. An online game operator must also obtain an Internet Culture Operation License from the MOC and an Internet Publishing License from the GAPP to distribute online games, in addition to filing its online games with the GAPP and the MOC. An educational website operator shall obtain approvals from the local education authorities. Prior to July 2010, specific approvals on online bulletin board services were also required for the provision of BBS services. Guangzhou Huaduo has obtained a valid ICP License for provision of internet and mobile network information services, an Internet Culture Operation License for online games and music products, and an Internet Publishing License for publication of online games and mobile phone games. In addition, Guangzhou Huaduo holds a valid License for Online Transmission of Audio-Visual Programs under the business classification of converging and play-on-demand service for certain kinds of internet audio-visual programs—literary, artistic and entertaining—as prescribed in the newly issued provisional categories. On October 8, 2011, Guangzhou Huaduo was granted a License for Production and Operation of Radio and TV Programs, covering the production, reproduction and publication of broadcasting plays, TV dramas, cartoons (excluding production), special subjects, special columns (excluding current political news category) and entertainment programs. On January 17, 2013 and January 16, 2014, we were granted permission by relevant authorities to provide online education content on edu.YY.com and 100.com, respectively. In the fourth quarter of 2014, we acquired Beijing Huanqiu Xingxue Technology Development Co., Ltd., or Beijing Xingxue, and Beijing Huanqiu Chuangzhi Software Co., Ltd., or Beijing Chuangzhi, which operate Edu24oL.com, an online education website that is an online vocational training and language training platform, and Beijing Xingxue holds an ICP License and a Publication Operating License for the operation of Edu24oL.com. These licenses or permits are essential to the operation of our business and are generally subject to annual government review. However, we cannot assure you that we can successfully renew these licenses annually or that these licenses are sufficient to conduct all of our present or future business.

As we further develop and expand our video capabilities and functions, we will need to obtain additional qualifications, permits, approvals or licenses. In addition, with respect to specific services offered online, we or the service or content providers may be subject to additional separate qualifications, permits, approvals or licenses. For financial-related content offered on our channels, we are tightening our internal review of the relevant qualifications of the content providers as instructed by the competent authorities, while complying with other statutory requirements. We cannot assure you that we or the service or content providers will be granted such qualifications, permits, approvals or licenses in a timely manner or at all. Prior to the receipt of such qualifications, permits, approvals or licenses, we may be deemed as being in violation of relevant laws or regulations and be subject to penalties.

As the internet industry in China is still at a relatively early stage of development, new laws and regulations may be adopted from time to time to address new issues that come to the authorities' attention. In the interpretation and implementation of existing and future laws and regulations governing our business activities, considerable



uncertainties still exist. We cannot assure you that we will not be found in violation of any future laws and regulations or any of the laws and regulations currently in effect due to changes in the relevant authorities' interpretation of these laws and regulations. In addition, we may be required to obtain additional license or approvals, and we cannot assure you that we will be able to timely obtain or maintain all the required licenses or approvals or make all the necessary filings in the future. If we fail to obtain or maintain any of the required licenses or approvals or make the necessary filings, we may be subject to various penalties, such as confiscation of the net revenues that were generated through the unlicensed internet activities, the imposition of fines and the discontinuation or restriction of our operations. Any such penalties may disrupt our business operations and materially and adversely affect our business, financial condition and results of operations.

The shareholders of our PRC variable interest entities may have potential conflicts of interest with us, and if any such conflicts of interest are not resolved in our favor, our business may be materially and adversely affected.

Guangzhou Huaduo and Beijing Tuda are our variable interest entities. Messrs. David Xueling Li, Jun Lei, Tony Bin Zhao, Jin Cao and Beijing Tuda, together hold 100% of the equity interest in Guangzhou Huaduo and Messrs. Li, Zhao and Cao together hold 100% of the equity interest in Beijing Tuda. Messrs. Li, Lei and Cao are all senior executives and shareholders of our company, but Mr. Zhao had resigned his position as our director effective as of March 5, 2015, although he remains a shareholder of our company. The interests of Messrs. Li, Lei, Zhao and Cao as the controlling shareholders of the VIEs may differ from the interests of our company as a whole, as what is in the best interests of our VIEs may not be in the best interests of our company. We cannot assure you that when conflicts of interest arise, Messrs. Li, Lei, Zhao or Cao will act in the best interests of our company or that conflicts of interests will be resolved in our favor. In addition, Messrs. Li, Lei, Zhao or Cao may breach or cause Guangzhou Huaduo and Beijing Tuda and their respective subsidiaries to breach or refuse to renew the existing contractual arrangements with us. Currently, we do not have existing arrangements to address potential conflicts of interest Messrs. Li, Lei, Zhao or Cao may encounter in his capacity as a shareholder or director of our VIEs, on the one hand, and as a beneficial owner or director of our company, on the other hand; *provided* that we could, at all times, exercise our option under the exclusive option agreement with Messrs. Li, Lei, Zhao and Cao to cause them to transfer all of their equity ownership in Guangzhou Huaduo or Beijing Tuda to a PRC entity or individual designated by us, and this new shareholder of Guangzhou Huaduo or Beijing Tuda could then appoint a new director of Guangzhou Huaduo or Beijing Tuda to replace the existing directors. In addition, if such conflicts of interest arise, Beijing Huanju Shidai, our wholly owned PRC subsidiary, could also, in the capacity of attorney-in-fact for Messrs. Li, Lei, Zhao and Cao as provided under the relevant powers of attorney, directly appoint a new director of Guangzhou Huaduo or Beijing Tuda to replace the existing directors. We rely on Messrs. Li, Lei, Zhao and Cao to comply with the laws of China, which protect contracts and provide that directors and executive officers owe a duty of loyalty to our company and require them to avoid conflicts of interest and not to take advantage of their positions for personal gains. We also rely on Messrs. Li and Lei to abide by the laws of the Cayman Islands, which provide that directors have a duty of care and a duty of loyalty to act honestly in good faith with a view toward our best interests. However, the legal frameworks of China and the Cayman Islands do not provide guidance on resolving conflicts in the event of a conflict with another corporate governance regime. If we cannot resolve any conflicts of interest or disputes between us and Messrs. Li, Lei, Zhao and Cao, we would have to rely on legal proceedings, which could result in disruption of our business and subject us to substantial uncertainty as to the outcome of any such legal proceedings.

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

Pursuant to the labor contract law that took effect in January 2008, its implementation rules that took effect in September 2008 and its amendment that took effect in July 2013, employers are subject to stricter requirements in terms of signing labor contracts, minimum wages, paying remuneration, determining the term of employees' probation and unilaterally terminating labor contracts. Due to the limited period of time since its effectiveness, and lack of detailed interpretative rules and uniform implementation practices and possible penalties, it is uncertain as to how they it will affect our current employment policies and practices. Our employment policies and practices may violate the labor contract law or its implementation rules, and we may thus be subject to related penalties, fines or legal fees.

Compliance with the labor contract law and its implementation rules may increase our operating expenses, in particular our personnel expenses. In the event that we decide to terminate some of our employees or otherwise change our employment or labor practices, the labor contract law and its implementation rules may also limit our ability to effect those changes in a desirable or cost-effective manner, which could adversely affect our business and results of operations. On October 28, 2010, the Standing Committee of the National People's Congress promulgated the PRC Social Insurance Law, or the Social Insurance Law, which became effective on July 1, 2011. According to the Social Insurance Law, employees must participate in pension insurance, work-related injury insurance, medical insurance, unemployment insurance and maternity insurance and the employers must, together with their employees or separately, pay the social insurance premiums for such employees.

We expect our labor costs to increase due to the implementation of these new laws and regulations. As the interpretation and implementation of these new laws and regulations are still evolving, we cannot assure you that our employment practice will at all times be deemed in full compliance with labor-related laws and regulations in China, which may subject us to labor disputes or government investigations. If we are deemed to have violated relevant labor laws and regulations, we could be required to provide additional compensation to our employees and our business, financial condition and results of operations could be materially and adversely affected.

Further, labor disputes, work stoppages or slowdowns at our laboratories, patient service centers or any of our clients or suppliers could significantly disrupt our daily operation or our expansion plans and have a material adverse effect on our business.

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

While playing online games or participating on YY Client activities, players acquire and accumulate some virtual assets, such as special equipment and other accessories. Such virtual assets can be important to online game players and have monetary value and, in some cases, are sold for actual money. In practice, virtual assets can be lost for various reasons, often through unauthorized use of the game account of one user by other users and occasionally through data loss caused by a delay of network service, a network crash or hacking activities. Currently, there is no PRC law or regulation specifically governing virtual asset property rights. As a result, there is uncertainty as to who the legal owner of virtual assets is, whether and how the ownership of virtual assets is protected by law, and whether an operator of online games such as us would have any liability to game players or other interested parties (whether in contract, tort or otherwise) for loss of such virtual assets. Based on recent PRC court judgments, the courts have typically held online game operators liable for losses of virtual assets by game players, and ordered online game operators to return the lost virtual items to game players or pay damages and losses. In case of a loss of virtual assets, we may be sued by our game players or users and held liable for damages, which may negatively affect our reputation and business, financial condition and results of operations.

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

The issuance and use of "virtual currency" in the PRC has been regulated since 2007 in response to the growth of the online game industry in China. On January 25, 2007, the Ministry of Public Security, the MOC, the MIIT and the GAPP jointly issued a circular regarding online gambling which has implications for the use of virtual currency. To curtail online games that involve online gambling, as well as address concerns that virtual currency could be used for money laundering or illicit trade, the circular (a) prohibits online game operators from charging commissions in the

form of virtual currency in relation to winning or losing of games; (b) requires online game operators to impose limits on use of virtual currency in guessing and betting games; (c) bans the conversion of virtual currency into real currency or property; and (d) prohibits services that enable game players to transfer virtual currency to other players. On June 4, 2009, the MOC and the MOFCOM jointly issued a notice regarding strengthening the administration of online game virtual currency, or the Virtual Currency Notice. The MOC issued the Provisional Administrative Measures of Online Games, or the Online Games Measures, on June 3, 2010, which provides, among other things, that virtual currency issued by online game operators may be only used to exchange its own online game products and services and may not be used to pay for the products and services of other entities.

We issue virtual currency and prepaid game tokens to game players on our platform for them to purchase various items to be used in online games and channels, including music channels. We are in the process of adjusting the content of our platform but we cannot assure you that our adjustments will be sufficient to comply with the Virtual Currency Notice. Moreover, although we believe we do not offer online game virtual currency transaction services, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours. For example, certain virtual items we issue to users based on in-game milestones they achieve or time spent playing games are transferable and exchangeable for our virtual currency or the other virtual items we issue to users. If the PRC regulatory authorities deem such transfer or exchange to be a virtual currency transaction, then in addition to being deemed to be engaging in the issuance of virtual currency, we may also be deemed to be providing transaction platform services that enable the trading of such virtual currency. Simultaneously engaging in both of these activities is prohibited under the Virtual Currency Notice. In that event, we may be required to cease either our virtual currency issuance activities or such deemed "transaction service" activities and may be subject to certain penalties, including mandatory corrective measures and fines. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

In addition, the Virtual Currency Notice prohibits online game operators from setting game features that involve the direct payment of cash or virtual currency by players for the chance to win virtual items or virtual currency based on random selection through a lucky draw, wager or lottery. The notice also prohibits game operators from issuing currency to game players through means other than purchases with legal currency. It is unclear whether these restrictions would apply to certain aspects of our online games. Although we believe that we have rectified and ceased such prohibited activities and have taken adequate measures to prevent any of the above-mentioned prohibited activities, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours and deem such feature as prohibited by the Virtual Currency Notice, thereby subjecting us to penalties, including mandatory corrective measures and fines. For example, we were previously fined by a local authority in Guangzhou found that our games contained lucky draws. The occurrence of any of the foregoing could materially and adversely affect our business and results of operations.

Non-compliance on the part of third parties with which we conduct business could restrict our ability to maintain or increase our number of users or the level of traffic to our YY platform.

Our third party game developers or other business partners may be subject to regulatory penalties or punishments because of their regulatory compliance failures, which may disrupt our business. Although we conduct a rigid review of legal formalities and certifications before entering into contractual relationship with other businesses such as third party game developers and landlords, we cannot be certain whether such third party has or will infringe any third parties' legal rights or violate any regulatory requirements. We regularly identify irregularities or noncompliance in the business practices of any parties with whom we pursue existing or future cooperation and we cannot assure you that any of these irregularities will be corrected in a prompt and proper manner. The legal liabilities and regulatory actions on our commercial partners may affect our business activities and reputation and in turn, our results of operations. For example, according to PRC regulations, all lease agreements are required to be registered with the local housing authorities. We presently lease properties at approximately 19 different locations for daily operations and certain other properties serving as dormitories and canteens in China, and the landlords of some of these properties are still completing the registration of their ownership rights or the registration of our leases with the relevant authorities. Failure to complete these required registrations may expose our landlords, lessors and us to potential monetary fines. Some of our lessors have not provided us with appropriate title certificates, which may adversely affect the validity of the leases if the lessors do not have proper title. We cannot assure you that such certificates or registration will be obtained in a timely manner or at all, and in case of failures, we may be subject to monetary fines, have to relocate our offices and suffer economic losses.

We allow providers of some online services, such as online education and financial services, to establish channels on our platform. The online service providers and the producers of content on our platform may be required to meet specific qualifying standards, evidenced by approvals, permits or certificates, and to comply with various requirements when conducting business. We cannot predict if any noncompliance on the part of such commercial partners may cause potential liabilities to us and in turn disrupt our operations.

Intensified government regulation of the internet industry in China could restrict our ability to maintain or increase our user level or the level of user traffic to our YY platform.

The PRC government has, in recent years, intensified regulation on various aspects of the internet industry in China. For example, the PRC government adopted more stringent policies to monitor the online game industry due to adverse public reaction to perceived addiction to online games, particularly in children and minors. On April 15, 2007, eight PRC government authorities, including the GAPP, the Ministry of Education, the Ministry of Public Security and the MIIT issued a notice requiring all Chinese online game operators to adopt an "anti-fatigue system" in an effort to curb addiction to online games by minors. To help game operators identify which game players are minors, online game players in China are now required to register their names and identity card numbers before playing an online game, which information was to be submitted to and verified by the National Citizen Identity Information Center, a subordinate public institution of the Ministry of Public Security, as of October 1, 2011. These restrictions could limit our ability to increase our online game business among minors. See "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Anti-fatigue Compliance System and Real-name Registration System." In order to comply with these anti-fatigue rules, we set up our system so that after three hours of playing our online games, minors only receive half of the virtual items or other in-game benefits they would otherwise earn, and after playing for more than five hours, receive no in-game benefits. Failure to implement these restrictions, if detected by the relevant government agencies, may result in fines and other penalties for us, including the shutting down of our online game operations and license revocation. Furthermore, if these restrictions were expanded to apply to adult game players in the future, our online game business could be materially and adversely affected.

In addition, on February 25, 2007, 14 PRC regulatory authorities jointly promulgated a circular to further strengthen the oversight of internet cafes, one of the primary venues from which our platform is accessed. In recent years, a large number of unlicensed internet cafes have been closed, and the PRC government has imposed higher capital and facility requirements for the establishment of internet cafes. Governmental authorities may from time to time impose stricter requirements on internet cafes, such as customer age limits and regulated hours of operation. Since a substantial portion of our users access our platform from internet cafes, any reduction in the number, or slowdown in the growth, of internet cafes in China, or any new regulatory restrictions on their operations, could limit our ability to maintain or increase our revenues.

More stringent governmental regulations such as the ones outlined above may discourage game players from playing our games and have a material effect on our business operations.

#### Risks Related to Doing Business in China

Uncertainties in the interpretation and enforcement of Chinese laws and regulations could limit the legal protections available to you and us.

The PRC legal system is based on written statutes and prior court decisions have limited value as precedents. Each of our PRC subsidiaries, Beijing Huanju Shidai, Guangzhou Huanju Shidai and Zhuhai Huanju Shidai, is a foreign-invested enterprise and is subject to laws and regulations applicable to foreign-invested enterprises as well as various Chinese laws and regulations generally applicable to companies incorporated in China. However, since these laws and regulations are relatively new and the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involves uncertainties.

From time to time, we may have to resort to administrative and court proceedings to enforce our legal rights. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy 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 in a timely manner or at all) that may have retroactive effect. As a result, we may not be aware of our violation of these policies and rules until some time after the violation. Such uncertainties, including uncertainty over the scope and effect of our contractual, property (including intellectual property) and procedural rights, could materially and adversely affect our business and impede our ability to continue our operations.



Changes in China's economic, political or social conditions or government policies could have a material adverse effect on our business, financial condition and results of operations.

Substantially all of our assets and almost all of our customers are located in China. Accordingly, our business, financial condition, results of operations and prospects may be influenced to a significant degree by political, economic and social conditions in China generally and by continued economic growth in China as a whole.

The Chinese economy differs from the economies of most developed countries in many respects, including the level of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. Although the Chinese government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets, and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the Chinese government. In addition, the Chinese government continues to play a significant role in regulating industry development by imposing industrial policies. The Chinese government also exercises significant control over the Chinese economic growth through allocating resources, controlling payment of foreign currency-denominated obligations, setting monetary policy, and providing preferential treatment to particular industries or companies.

While the Chinese economy has experienced significant growth over the past decades, growth has been uneven, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall Chinese economy, but may also have a negative effect on us. The Chinese government has implemented certain measures, including interest rate increases, to control the pace of economic growth. These measures may cause decreased economic activity in China, which could in turn reduce the demand for our products and services and adversely affect our business, financial condition and results of operations.

We may be adversely affected by the complexity, uncertainties and changes in PRC regulation of internet business and companies.

The PRC government extensively regulates the internet industry, including foreign ownership of, and the licensing and permit requirements pertaining to, companies in the internet industry. These internet-related laws and regulations are relatively new and evolving, and their interpretation and enforcement involve significant uncertainty. As a result, in certain circumstances it may be difficult to determine what actions or omissions may be deemed to be in violations of applicable laws and regulations. Issues, risks and uncertainties relating to PRC regulation of the internet business include, but are not limited to, the following:

We only have contractual control over our platform. Guangzhou Huaduo, our PRC consolidated affiliated entity, owns our platform due to the restriction of foreign investment in businesses providing value-added telecommunication services in China, including internet content provision services. If Guangzhou Huaduo breaches its contractual arrangements with us and no longer remains under our control, this may significantly disrupt our business, subject us to sanctions, compromise enforceability of related contractual arrangements, or have other harmful effects on us.

There are uncertainties relating to the regulation of the internet business in China, including evolving licensing practices and the requirement for real-name registrations. Permits, licenses or operations at some of our subsidiaries and PRC consolidated affiliated entities levels may be subject to challenge, or we may fail to obtain permits or licenses that may be deemed necessary for our operations or we may not be able to obtain or renew certain permits or licenses. See "[Risks Related to Our Corporate Structure and Our Industry](#)—If our PRC consolidated affiliated entities fail to obtain and maintain the requisite licenses and approvals required under the complex regulatory environment for internet-based businesses in China, our business, financial condition and results of operations may be materially and adversely affected" and "[Item 4. Information on the Company—B. Business Overview—PRC Regulation](#)." In addition, although we currently have a real-name registration system in place for our online games in strict compliance with the relevant PRC regulations, we are currently not required by PRC law to ask users for their real name and personal information when they register for a YY user account. We cannot assure you that PRC regulators would not require us to implement compulsory real-name registration on our platform in the future. In late 2011, for example, the Beijing municipal government required microbloggers in China to implement real-name registration for all of their registered users. If we were required to implement real-name registration on YY, we may lose large numbers of registered user accounts for various reasons, because users may no longer maintain multiple accounts and users who dislike giving out their private information may cease to use our products and services altogether.

The evolving PRC regulatory system for the internet industry may lead to the establishment of new regulatory agencies. For example, in May 2011, the State Council announced the establishment of a new department, the State Internet Information Office (with the involvement of the State Council Information Office, or the SCIO, the MIIT and the Ministry of Public Security). The primary role of this new agency is to facilitate the policy-making and legislative development in this field to direct and coordinate with the relevant departments in connection with online content administration and to deal with cross-ministry regulatory matters in relation to the internet industry. We are unable to determine what policies this new agency or any new agencies to be established in the future may have or how they may interpret existing laws, regulations and policies and how they may affect us. Further, new laws, regulations or policies may be promulgated or announced that will regulate internet activities, including online video and online advertising businesses. If these new laws, regulations or policies are promulgated, additional licenses may be required for our operations. If our operations do not comply with these new regulations after they become effective, or if we fail to obtain any licenses required under these new laws and regulations, we could be subject to penalties.

On July 13, 2006, the MIIT issued the Notice of the Ministry of Information Industry on Intensifying the Administration of Foreign Investment in Value-added Telecommunications Services. This notice prohibits domestic telecommunication service providers from leasing, transferring or selling telecommunication business operating licenses to any foreign investor in any form, or providing any resources, sites or facilities to any foreign investor for their illegal operation of a telecommunication business in China. According to this notice, either the holder of a value-added telecommunication business operating license or its shareholders must be the registered holders of the domain names and trademarks used by such license holders in their provision of value-added telecommunication services. The notice also requires each license holder to have the necessary facilities, including servers, for its approved business operations and to maintain such facilities in the regions covered by its license. Currently, all contracts with telecommunication carriers and other service providers to host the servers used in our business were entered into by Guangzhou Huaduo, our PRC consolidated affiliated entity, and such arrangements are in compliance with this notice. Guangzhou Huaduo also owns the related domain names and trademarks, and holds the ICP License necessary to conduct our operations in China.

On June 3, 2010, the MOC promulgated the Provisional Administration Measures of Online Games, or the Online Games Measures, which became effective on August 1, 2010. The Online Games Measures provide that any entity engaging in online game operation activities shall obtain the Internet Culture Operation License and must meet certain requirements such as minimum registered capital. Online game developers are generally involved in the purchase of servers and bandwidth, the control and management of game data, the maintenance of game systems and certain other maintenance tasks in our operation of online games. The Guangzhou branch of the MOC has confirmed that such outsourcing and cooperation activities are not considered conducting online game operation activities, and that online game developers do not have to obtain the Internet Culture Operation License in accordance with the Online Games Measures. However, because of the limited time in which these measures have been in effect, there are still uncertainties on the MOC's interpretation and implementation of these measures. If the MOC determines in the future that such qualifications or requirements apply to the online game developers for their involvement in the online game operations, we may have to terminate our revenue-sharing arrangements with certain unqualified online game developers and may even be subject to various penalties, which may negatively impact our results of operations and financial condition.

The interpretation and application of existing PRC laws, regulations and policies and possible new laws, regulations or policies relating to the internet industry have created substantial uncertainties regarding the legality of existing and future foreign investments in, and the businesses and activities of, internet businesses in China, including our business. There are also risks that we may be found to violate the existing or future laws and regulations given the uncertainty and complexity of China's regulation of internet business.

Content posted or displayed on our platform may be found objectionable by PRC regulatory authorities and may subject us to penalties and other severe consequences.

The PRC government has adopted regulations governing internet access and the distribution of information over the internet. Under these regulations, internet content providers and internet publishers are prohibited from posting or

displaying over the internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China or the public interest, or is obscene, superstitious, fraudulent or defamatory. Furthermore, internet content providers are also prohibited from displaying content that may be deemed by relevant government authorities as "socially destabilizing" or leaking "state secrets" of the PRC. Failure to comply with these requirements may result in the revocation of licenses to provide internet content and other licenses, the closure of the concerned platforms and reputational harm. The operator may also be held liable for such censored information displayed on or linked to their platform. For a detailed discussion, see "Item 4. Information on the Company—B. Business Overview—PRC Regulation."

We allow visitors to our portal websites to upload written materials, images, pictures, and other content on the forums on our websites, and also allow users to share, link to and otherwise access audio, video, games and other content from third parties through our platform. For a description of how content can be accessed on or through our real-time interactive social platform, and what measures we take to lessen the likelihood that we will be held liable for the nature of such content, see "Item 4. Information on the Company—B. Business Overview—Technology," "Item 4. Information on the Company—B. Business Overview—Intellectual Property," and "—Risks Related to Our Business—We may be subject to intellectual property infringement claims or other allegations, which could result in our payment of substantial damages, penalties and fines, removal of relevant content from our website or seeking license arrangements which may not be available on commercially reasonable terms."

Since our inception, we have worked closely with relevant government authorities to monitor the content on our platform and to make the utmost effort in complying with relevant laws and regulations. However, it may not be possible to determine in all cases the types of content that could result in our liability as an internet operator, and if any of our internet content is deemed by the PRC government to violate any content restrictions, we would not be able to continue to display such content and could become subject to penalties, including confiscation of income, fines, suspension of business and revocation of required licenses, which could materially and adversely affect our business, financial condition and results of operations. We may also be subject to potential liability for any unlawful actions of our users or third party service providers on our platform or for content we distribute that is deemed inappropriate. For example, we have previously been subject to a few warnings and fines each of RMB40,000 or less for having inappropriate content on our platform. Although we corrected these non-compliances and undertook measures to prevent the recurrence of such instances, it may be difficult to determine the type of content or actions that may result in liability to us, and if we are found to be liable, we may be prevented from operating our business in China. Moreover, the costs of compliance with these regulations may continue to increase as a result of more content being uploaded or made available by an increasing number of users and third party partners and developers, which may adversely affect our results of operations. Although we have adopted internal procedures to monitor content uploaded to our website and to remove offending content once we become aware of any potential or alleged violation, we may not be able to identify all the content that may violate relevant laws and regulations or third party intellectual property rights and even if we manage to identify and remove offending content, we may still be held liable for such third-party content. Users may upload content or images containing copyright violations and other illegal content and we may be subject to claims or become involved in litigation proceedings. As a result, our reputation, business and results of operations may be materially and adversely affected.

Advertisements shown on our platform may subject us to penalties and other administrative actions.

Under PRC advertising laws and regulations, we are obligated to monitor the advertising content shown on our platform to ensure that such content is true and accurate and in full compliance with applicable laws and regulations. In addition, where a special government review is required for specific types of advertisements prior to internet posting, such as advertisements relating to pharmaceuticals, medical instruments, agrochemicals and veterinary pharmaceuticals, we are obligated to confirm that such review has been performed and approval has been obtained. Violation of these laws and regulations may subject us to penalties, including fines, confiscation of our advertising income, orders to cease dissemination of the advertisements and orders to publish an announcement correcting the misleading information. In circumstances involving serious violations by us, PRC governmental authorities may force us to terminate our advertising operations or revoke our licenses.

While we have made significant efforts to ensure that the advertisements shown on our platform are in full compliance with applicable PRC laws and regulations, we cannot assure you that all the content contained in such advertisements or offers is true and accurate as required by the advertising laws and regulations, especially given the uncertainty in the interpretation of these PRC laws and regulations. If we are found to be in violation of applicable PRC advertising laws and regulations, we may be subject to penalties and our reputation may be harmed, which may have a material adverse effect on our business, financial condition, results of operations and prospects.

Under the PRC enterprise income tax law, we may be classified as a PRC "resident enterprise," which could result in unfavorable tax consequences to us and our shareholders and have a material adverse effect on our results of operations and the value of your investment.

Under the PRC enterprise income tax law that became effective on January 1, 2008, an enterprise established outside the PRC with "de facto management bodies" within the PRC is considered a "resident enterprise" for PRC enterprise income tax purposes and is generally subject to a uniform 25% enterprise income tax rate on its worldwide income. On April 22, 2009, the State Administration of Taxation, or the SAT, issued the Notice Regarding the Determination of Chinese-Controlled Overseas Incorporated Enterprises as PRC Tax Resident Enterprise on the Basis of De Facto Management Bodies, or SAT Circular 82, which provides certain specific criteria for determining whether the "de facto management body" of a PRC-controlled enterprise that is incorporated offshore is located in China. Further to SAT Circular 82, on August 3, 2011, the SAT issued the Administrative Measures of Enterprise Income Tax of Chinese-Controlled Offshore Incorporated Resident Enterprises (Trial), or SAT Bulletin 45, to provide more guidance on the implementation of SAT Circular 82; the bulletin became effective on September 1, 2011. SAT Bulletin 45 clarified certain issues in the areas of resident status determination, post-determination administration and competent tax authorities.

According to SAT Circular 82, an offshore incorporated enterprise controlled by a PRC enterprise or a PRC enterprise group will be considered as a PRC tax resident enterprise by virtue of having its "de facto management body" in China and will be subject to PRC enterprise income tax on its worldwide income only if all of the following conditions are met: (a) the senior management and core management departments in charge of its daily operations function have their presence mainly in the PRC; (b) its financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (c) its major assets, accounting books, company seals, and minutes and files of its board and shareholders' meetings are located or kept in the PRC; and (d) more than half of the enterprise's directors or senior management with voting rights habitually reside in the PRC. SAT Bulletin 45 further clarifies the resident status determination, post-determination administration, as well as competent tax authorities. It also specifies that when provided with a copy of Chinese tax resident determination certificate from a resident Chinese controlled offshore incorporated enterprise, the payer should not withhold 10% income tax when paying the Chinese-sourced dividends, interest, royalties, etc. to the Chinese controlled offshore incorporated enterprise.

Although SAT Circular 82 and SAT Bulletin 45 only apply to offshore incorporated enterprises controlled by PRC enterprises or PRC enterprise group instead of those controlled by PRC individuals or foreigners, the determination criteria set forth therein may reflect SAT's general position on how the term "de facto management body" could be applied in determining the tax resident status of offshore enterprises, regardless of whether they are controlled by PRC enterprises, individuals or foreigners.

We do not meet all of the conditions above; therefore, we believe that we should not be treated as a "resident enterprise" for PRC tax purposes even if the standards for "de facto management body" prescribed in the SAT Circular 82 are applicable to us. For example, our minutes and files of the resolutions of our board of directors and the resolutions of our shareholders are maintained outside the PRC. In addition, we are not aware of any offshore holding companies with a corporate structure similar to ours ever having been deemed to be a PRC "resident enterprise" by the PRC tax authorities.

However, it is possible that the PRC tax authorities may take a different view. If the PRC tax authorities determine that our Cayman Islands holding company is a PRC resident enterprise for PRC enterprise income tax purposes, then our world-wide income could be subject to PRC tax at a rate of 25%, which could materially reduce our net income. In addition, we will also be subject to PRC enterprise income tax reporting obligations.

Although dividends paid by one PRC tax resident to another PRC tax resident should qualify as "tax-exempt income" under the enterprise income tax law, we cannot assure you that dividends by our PRC subsidiaries to our Cayman Islands holding company will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax on dividends, and the PRC tax 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.



Foreign ADS holders may also be subject to PRC withholding tax on dividends payable by us and gains realized on the sale or other disposition of ADSs or common shares, if such income is sourced from within the PRC. Although our holding company is incorporated in the Cayman Islands, it remains unclear whether dividends received and gains realized by our foreign ADS holders will be regarded as income from sources within the PRC if we are classified as a PRC resident enterprise. Any such tax will reduce the returns on your investment in our ADSs.

Finally, we face uncertainties on the reporting and consequences on private equity financing transactions, private share transfers and share exchange involving the transfer of shares in our company by non-resident investors. According to the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises issued by the PRC State Administration of Taxation on December 10, 2009, with retroactive effect from January 1, 2008, or SAT Circular 698, and the Notice on Several Issues Concerning Enterprise Income Tax for Indirect Share Transfer by Non-PRC Resident Enterprises, issued by the PRC State Administration of Taxation on February 3, 2015, or SAT Circular 7, an "indirect transfer" of assets of a PRC resident enterprise, including equity interests in a PRC resident enterprise, by non-PRC resident enterprises may be re-characterized and treated as a direct transfer of PRC taxable properties, if such transaction arrangement lacks reasonable commercial purpose and was established for the purpose of reducing, avoiding or deferring PRC enterprise income tax. As a result, gains derived from such indirect transfer may be subject to PRC enterprise income tax, and tax filing or withholding obligations may be triggered, depending on the nature of the PRC taxable properties being transferred. According to SAT Circular 7, "PRC taxable properties" include assets of a PRC establishment or place of business, real properties in the PRC, and equity investments in PRC resident enterprises, in respect of which gains from their transfer by a direct holder, being a non-PRC resident enterprise, would be subject to PRC enterprise income taxes. When determining if there is a "reasonable commercial purpose" of the transaction arrangement, features to be taken into consideration include: whether the main value of the equity interest of the relevant offshore enterprise derives from PRC taxable properties; whether the assets of the relevant offshore enterprise mainly consists of direct or indirect investment in China or if its income mainly derives from China; whether the offshore enterprise and its subsidiaries directly or indirectly holding PRC taxable properties have real commercial nature which is evidenced by their actual function and risk exposure; the duration of existence of the business model and organizational structure; the replicability of the transaction by direct transfer of PRC taxable properties; and the tax situation of such indirect transfer and applicable tax treaties or similar arrangements. In respect of an indirect offshore transfer of assets of a PRC establishment or place of business of a foreign enterprise, the resulting gain is to be included with the annual enterprise filing of the PRC establishment or place of business being transferred, and would consequently be subject to PRC enterprise income tax at a rate of 25%. Where the underlying transfer relates to PRC real properties or to equity investments in a PRC resident enterprise, which is not related to a PRC establishment or place of business of a non-resident enterprise, a PRC enterprise income tax at 10% would apply, subject to available preferential tax treatment under applicable tax treaties or similar arrangements, and the party who is obligated to make the transfer payments has the withholding obligation. Where the payor fails to withhold any or sufficient tax, the transferor shall declare and pay such tax to the competent tax authority by itself within the statutory time limit. Late payment of applicable tax will subject the transferor to default interest. Currently, neither SAT Circular 698 nor SAT Circular 7 applies to the sale of shares by investors through a public stock exchange where such shares were acquired from a transaction through a public stock exchange.

We cannot assure you that the PRC tax authorities will not, at their discretion, adjust any capital gains and impose tax return filing and withholding or tax payment obligations on the transferors and transferees, while our PRC subsidiaries may be requested to assist in the filing. Any PRC tax imposed on a transfer of our shares or any adjustment of such gains would cause us to incur additional costs and may have a negative impact on the value of your investment in our company.

If our preferential tax treatments are revoked or become unavailable or if the calculation of our tax liability is successfully challenged by the PRC tax authorities, we may be required to pay tax, interest and penalties in excess of our tax provisions, and our financial condition and results of operations could be materially and adversely affected.

The Chinese government has provided various tax incentives to our subsidiaries in China. These incentives include reduced enterprise income tax rates. For example, under the PRC Enterprise Income Tax Law, or the EIT Law, which became effective on January 1, 2008, the statutory enterprise income tax rate is 25%. However, Guangzhou Huaduo, our PRC consolidated affiliated entity in the PRC, was recognized as a high and new technology enterprise, or HNTE, as of September 26, 2010 and, subject to the approval of an annual review by competent tax authorities in Guangdong, would be entitled to enjoy a preferential enterprise income tax rate of 15% for two years, from 2011 through 2012. Guangzhou Huaduo recorded losses in 2010 and has not benefited from such preferential tax rate. Guangzhou Huaduo has applied for and obtained the preferential tax treatment with Guangzhou State Tax Bureau, but the high and new technology enterprise qualification was only effective until September 26, 2013.

In 2013, Guangzhou Huaduo applied to renew its qualification as a high and new technology enterprise. The review process has been completed and Guangdong Department of Science and Technology has announced that Guangzhou Huaduo continues to qualify as an HNTE. Therefore, Guangzhou Huaduo enjoyed the preferential tax rate of 15% in place of the statutory enterprise income tax rate of 25% in 2013 and 2014, and will be entitled to enjoy such preferential tax rate in 2015. In addition, Guangzhou Huanju Shidai has been recognized as a software enterprise since 2013, and is therefore entitled to a two-year exemption from enterprise income tax followed by three years at 50% of the standard enterprise income tax rate starting from 2014, the first profit-making year. However, if either Guangzhou Huaduo or Guangzhou Huanju Shidai fails to maintain its qualification for preferential tax treatments, its applicable enterprise income tax rate may increase to 25%, which could materially and adversely affect our financial condition and results of operations.

China's M&A Rules and certain other PRC regulations establish complex procedures for certain acquisitions of Chinese companies by foreign investors, which could make it more difficult for us to pursue growth through acquisitions in China.

Six PRC regulatory agencies promulgated regulations effective on September 8, 2006, subsequently amended, that are commonly referred to as the M&A Rules. See "Item 4. Information on the Company—B. Business Overview—PRC Regulation—New M&A Regulations and Overseas Listings." The M&A Rules establish procedures and requirements that could make some acquisitions of Chinese companies by foreign investors more time-consuming and complex, including requirements in some instances that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a Chinese domestic enterprise or a foreign company with substantial PRC operations, if certain thresholds under the Provisions on Thresholds for Prior Notification of Concentrations of Undertakings, issued by the State Council on August 3, 2008, are triggered. Moreover, the Anti-Monopoly Law promulgated by the Standing Committee of the National People's Congress on August 30, 2007 which became effective on August 1, 2008 requires that transactions which are deemed concentrations and involve parties with specified turnover thresholds (for example, during the previous fiscal year, (i) the total global turnover of all operators participating in the transaction exceeds RMB10 billion (US\$1.6 billion) and at least two of these operators each had a turnover of more than RMB400 million (US\$64.5 million) within China, or (ii) the total turnover within China of all the operators participating in the concentration exceeded RMB2 billion (US\$0.3 billion) and at least two of these operators each had a turnover of more than RMB400 million (US\$64.5 million) within China) must be cleared by the MOFCOM before they can be completed. In addition, on February 3, 2011, the General Office of the State Council promulgated a Notice on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the Circular No. 6, which officially established a security review system for mergers and acquisitions of domestic enterprises by foreign investors. Under Circular No. 6, a security review is required for mergers and acquisitions by foreign investors having "national defense and security" concerns and mergers and acquisitions by which foreign investors may acquire the "de facto control" of domestic enterprises with "national security" concerns.

In the future, we may grow our business by acquiring complementary businesses. Complying with the requirements of the above-mentioned regulations and other relevant rules to complete such transactions could be time consuming, and any required approval processes, including obtaining approval from the MOFCOM or its local counterparts, may delay or inhibit our ability to complete such transactions. It is unclear whether our business would be deemed to be in an industry that raises "national defense and security" or "national security" concerns. However, MOFCOM or other government agencies may publish explanations in the future determining that our business is in an industry subject to the security review, in which case our future acquisitions in the PRC, including those by way of entering into contractual control arrangements with target entities, may be closely scrutinized or prohibited. Our ability to expand our business or maintain or expand our market share through future acquisitions would as such be materially and adversely affected.

PRC regulations relating to offshore investment activities by PRC residents may limit our PRC subsidiaries' ability to increase their registered capital or distribute profits to us or otherwise expose us to liability and penalties under PRC law.

The PRC State Administration of Foreign Exchange, or SAFE, has promulgated regulations, including the Notice on Relevant Issues Relating to Domestic Residents' Investment and Financing and Round-Trip Investment through Special Purpose Vehicles, or SAFE Circular No. 37, effective on July 4, 2014, and its appendixes, that require PRC residents, including PRC institutions and individuals, to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular No. 37 as a "special purpose vehicle." SAFE Circular No. 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in their ability to contribute additional capital into its PRC subsidiary. Further, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for foreign exchange evasion, including (i) the requirement by SAFE to return the foreign exchange remitted overseas within a period specified by SAFE, with a fine of up to 30% of the total amount of foreign exchange remitted overseas and deemed to have been evasive and (ii) in circumstances involving serious violations, a fine of no less than 30% of and up to the total amount of remitted foreign exchange deemed evasive. Furthermore, the persons-in-charge and other persons at our PRC subsidiaries who are held directly liable for the violations may be subject to criminal sanctions.

Our PRC resident shareholders, Messrs. David Xueling Li, Tony Bin Zhao, Jin Cao and Jun Lei, had registered with the local SAFE branch in relation to our existing private placement financings by the end of 2011 as required by the SAFE regulations, and had subsequently filed amendments to update their registrations reflecting shareholding changes in our company resulting from our initial public offering in March 2015. Since SAFE Circular No. 37 was recently issued, there remains uncertainty with respect to its interpretation and implementation, and we cannot predict how such SAFE regulations will affect our business operations. For example, our present and prospective PRC subsidiaries' ability to conduct foreign exchange activities, such as the remittance of dividends and foreign currency-denominated borrowings, may be subject to compliance with the SAFE regulations by our PRC resident shareholders. In addition, in some cases, we may have little control over either our present or prospective direct or indirect PRC resident shareholders or the outcome of such registration procedures. A failure by our current or future PRC resident shareholders to comply with the SAFE regulations, including but not limited to any delay in subsequent filings, could subject us to fines or other legal sanctions, restrict our cross-border investment activities, limit our subsidiary's ability to make distributions or pay dividends or affect our ownership structure, which could adversely affect our business and prospects.

On February 15, 2012, SAFE promulgated the Notices on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plans of Overseas Publicly-Listed Companies, or the Stock Option Rules, which replaced the Application Procedures of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Ownership Plans or Stock Option Plans of Overseas Publicly-Listed Companies issued by SAFE on March 28, 2007. Under the Stock Option Rules and other relevant rules and regulations, PRC residents who participate in stock incentive plan in an overseas publicly-listed company are required to register with SAFE or its local branches and complete certain other procedures. Participants of a stock incentive plan who are PRC residents must retain a qualified PRC agent, which could be a PRC subsidiary of such overseas publicly listed company or another qualified institution selected by such PRC subsidiary, to conduct the SAFE registration and other procedures with respect to the stock incentive plan on behalf of its participants. Such participants must also retain an overseas entrusted institution to handle matters in connection with their exercise of stock options, the purchase and sale of corresponding stocks or interests and fund transfers. In addition, the PRC agent is required to amend the SAFE registration with respect to the stock incentive plan if there is any material change to the stock incentive plan, the PRC agent or the overseas entrusted institution or other material changes. We and our PRC employees who have been granted stock options, restricted shares and restricted share units are subject to these regulations, and are preparing to complete such SAFE registrations. Failure of our PRC stock option holders, restricted shareholders or restricted share units holders to complete their SAFE registrations may subject these PRC residents to fines and legal sanctions and may also limit our ability to contribute additional capital into our PRC subsidiaries, limited our PRC subsidiaries' ability to distribute dividends to us, or otherwise materially and adversely affect our business.

PRC regulation of direct investment and loans by offshore holding companies to PRC entities may delay or limit us from using the proceeds of our initial public offering to make additional capital contributions or loans to our PRC subsidiaries.

We are an offshore holding company conducting our operations in China through our PRC subsidiaries and variable interest entities. We may make loans to our PRC subsidiaries and variable interest entities, or we may make additional

capital contributions to our PRC subsidiaries.

Any capital contributions or loans that we, as an offshore entity, make to our PRC subsidiaries, including from the proceeds of our initial public offering, are subject to PRC regulations. For example, none of our loans to a PRC subsidiary can exceed the difference between its total amount of investment and its registered capital approved under relevant PRC laws, and the loans must be registered with the local branch of SAFE. Our capital contributions to our PRC subsidiaries must be approved by the MOFCOM or its local counterpart.

In August 2008, SAFE issued the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises, or SAFE Circular 142, regulating the conversion by a foreign-invested enterprise of foreign currency-registered capital into RMB by restricting how the converted RMB may be used. In addition, SAFE promulgated Circular 45 on November 9, 2011 in order to clarify the application of SAFE Circular 142. Under SAFE Circular 142 and Circular 45, the RMB capital converted from foreign currency registered capital of a foreign-invested enterprise may only be used for purposes within the business scope approved by the applicable government 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 RMB capital converted from foreign currency registered capital of foreign-invested enterprises. The use of such RMB capital may not be changed without SAFE's approval, and such RMB capital may not in any case be used to repay RMB loans if the proceeds of such loans have not been used.

Since SAFE Circular 142 has been in place for more than five years, in 2014, SAFE decided to further reform the foreign exchange administration system in order to satisfy and facilitate the business and capital operations of foreign invested enterprises, and issued the Circular on the Relevant Issues Concerning the Launch of Reforming Trial of the Administration Model of the Settlement of Foreign Currency Capital of Foreign-Invested Enterprises in Certain Areas on July 4, 2014, or SAFE Circular 36. SAFE Circular 36 suspends the application of SAFE Circular 142 in certain areas and allows a foreign-invested enterprise registered in such areas to use the RMB capital converted from foreign currency registered capital for equity investments within the PRC, which will be regarded as the reinvestment of foreign-invested enterprise. On March 30, 2015, SAFE issued the Circular on the Reforming of the Management Method of the Settlement of Foreign Currency Capital of Foreign-Invested Enterprises, or SAFE Circular 19, which is scheduled to take effect on June 1, 2015. Under SAFE Circular 19, a foreign-invested enterprise may also choose to convert its registered capital from foreign currency to RMB on a discretionary basis, and the RMB capital so converted can be used for equity investments within PRC, which will be regarded as the reinvestment of foreign-invested enterprise. After Circular 19 takes effect, Circular 142 and Circular 36 will be abolished.

In light of the various requirements imposed by PRC regulations on loans to and direct investment in PRC entities by offshore holding companies, we cannot assure you that we will be able to complete the necessary registration or obtain the necessary approval on a timely basis, or at all. If we fail to complete the necessary registration or obtain the necessary approval, our ability to make loans or equity contributions to our PRC subsidiaries may be negatively affected, which could adversely affect our PRC subsidiaries' liquidity and their ability to fund their working capital and expansion projects and meet their obligations and commitments.

Our PRC subsidiaries and PRC consolidated affiliated entities are subject to restrictions on paying dividends or making other payments to us, which may restrict our ability to satisfy our liquidity requirements.

We are a holding company incorporated in the Cayman Islands. We rely on dividends from our PRC subsidiaries as well as consulting and other fees paid to us by our PRC consolidated affiliated entities for our cash and financing requirements, such as the funds necessary to pay dividends and other cash distributions to our shareholders, including holders of our ADSs, and service any debt we may incur. Current PRC regulations permit our PRC subsidiaries to pay dividends to us only out of their accumulated after-tax profits upon satisfaction of relevant statutory condition and procedures, if any, determined in accordance with Chinese accounting standards and regulations. In addition, each of our PRC subsidiaries is required to set aside at least 10% of its accumulated profits each year, if any, to fund certain reserve funds until the total amount set aside reaches 50% of its registered capital. As of December 31, 2014, appropriations to statutory reserves amounting to RMB56.5 million were made by three of our PRC consolidated affiliated entities. These reserves are not distributable as cash dividends. Furthermore, if our PRC subsidiaries and PRC consolidated affiliated entities incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us, which may restrict our ability to satisfy our liquidity requirements.

In addition, the EIT Law, and its implementation rules provide that withholding tax rate of 10% will be applicable to dividends payable by Chinese companies to non-PRC-resident enterprises unless otherwise exempted or reduced



according to treaties or arrangements between the PRC central government and governments of other countries or regions where the non-PRC-resident enterprises are incorporated.

Fluctuations in exchange rates could have a material adverse effect on our results of operations and the value of 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, is based on rates set by the People's Bank of China. The PRC government allowed the Renminbi to appreciate more than 20% against the U.S. dollar between July 2005 and July 2008. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the Renminbi and the U.S. dollar remained within a narrow band. Since June 2010, the PRC government has allowed the Renminbi to appreciate slowly against the U.S. dollar again, though there have been periods when the U.S. dollar has appreciated against the Renminbi as well. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the Renminbi and the U.S. dollar in the future.

There remains significant international pressure on the Chinese government to adopt a flexible currency policy to allow the Renminbi to appreciate against the U.S. dollar. Significant revaluation of the Renminbi may have a material adverse effect on your investment. Substantially all of our revenues and costs are denominated in Renminbi. Any significant revaluation of Renminbi may materially and adversely affect our revenues, earnings and financial position, and the value of, and any dividends payable on, our ADSs in U.S. dollars. To the extent that we need to convert U.S. dollars into RMB for capital expenditures and working capital and other business purposes, appreciation of the RMB against the U.S. dollar would have an adverse effect on the RMB amount we would receive from the conversion. Conversely, a significant depreciation of the Renminbi against the U.S. dollar may significantly reduce the U.S. dollar equivalent of our earnings, which in turn could adversely affect the price of our ADSs, and if we decide to convert RMB into U.S. dollars for the purpose of making payments for dividends on our common shares or ADSs, strategic acquisitions or investments or other business purposes, appreciation of the U.S. dollar against the RMB would have a negative effect on the U.S. dollar amount available to us.

Very limited hedging options are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to adequately hedge our exposure or at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into foreign currency. As a result, fluctuations in exchange rates may have a material adverse effect on your investment.

Governmental control of currency conversion may limit our ability to utilize our revenues effectively and affect the value of your investment.

The PRC government imposes control on the convertibility of the Renminbi into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in Renminbi. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and trade and service-related foreign exchange transactions, can be made in foreign currencies without prior SAFE approval by complying with certain procedural requirements. Therefore, our PRC subsidiaries are able to pay dividends in foreign currencies to us without prior approval from SAFE. However, approval from or registration with appropriate government authorities is required where Renminbi is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies. The PRC government may also at its discretion restrict access to foreign currencies for current account transactions in the future. If the foreign exchange control system prevents us from obtaining sufficient foreign currencies to satisfy our foreign currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

Recently enacted regulations in the PRC may make it more difficult for us to pursue growth through acquisitions, adversely affecting our plans to expand our business or maintain our market share.

Among other things, the M&A Rules established additional procedures and requirements that could make merger and acquisition activities by foreign investors more time-consuming and complex. Such regulation requires, among other things, that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise or a foreign company with substantial PRC operations, if certain thresholds under the Provisions on Thresholds for Prior Notification of Concentrations of Undertakings, issued by the State Council on August 3, 2008, are triggered.

We may grow our business in part by directly acquiring complementary businesses in China. Complying with the requirements of these regulations to complete such transactions could be time-consuming, and any required approval processes, including obtaining approval from the MOFCOM, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

If the custodians or authorized users of controlling non-tangible assets of our company, including our corporate chops and seals, fail to fulfill their responsibilities, or misappropriate or misuse these assets, our business and operations could be materially and adversely affected.

Under PRC law, legal documents for corporate transactions, including contracts such as revenue-sharing contracts with online game developers which are important to our business, are executed using the chops or seal of the signing entity or with the signature of a legal representative whose designation is registered and filed with the relevant branch of the Administration of Industry and Commerce.

Although we usually utilize chops to enter into contracts, the designated legal representatives of each of our PRC subsidiaries and consolidated affiliated entities have the apparent authority to enter into contracts on behalf of such entities without chops and bind such entities. All designated legal representatives of our PRC subsidiaries and consolidated affiliated entities are members of our senior management team who have signed employment agreements with us or our PRC subsidiaries and consolidated affiliated entities under which they agree to abide by various duties they owe to us. In order to maintain the physical security of our chops and chops of our PRC entities, we generally store these items in secured locations accessible only by the authorized personnel in the legal or finance department of each of our subsidiaries and consolidated affiliated entities. Although we monitor such authorized personnel, there is no assurance such procedures will prevent all instances of abuse or negligence. Accordingly, if any of our authorized personnel misuse or misappropriate our corporate chops or seals, we could encounter difficulties in maintaining control over the relevant entities and experience significant disruption to our operations. If a designated legal representative obtains control of the chops in an effort to obtain control over any of our PRC subsidiaries or consolidated affiliated entities, we or our PRC subsidiary and consolidated affiliated entity would need to pass a new shareholder or board resolution to designate a new legal representative and we would need to take legal action to seek the return of the chops, apply for new chops with the relevant authorities, or otherwise seek legal redress for the violation of the representative's fiduciary duties to us, which could involve significant time and resources and divert management attention away from our regular business. In addition, the affected entity may not be able to recover corporate assets that are sold or transferred out of our control in the event of such a misappropriation if a transferee relies on the apparent authority of the representative and acts in good faith.

Our auditor, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.

The independent registered public accounting firm that issues the audit reports included in this annual report, as an auditor of companies that are traded publicly in the United States and a firm registered with PCAOB, is required by the laws of the United States to undergo regular inspections by PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditor is located in China, a jurisdiction where PCAOB is currently unable to conduct inspections without the approval of the PRC authorities, our auditor, like other independent registered public accounting firms operating in China, is currently not inspected by PCAOB. On May 24, 2013, PCAOB announced that it had entered into a Memorandum of Understanding on Enforcement Cooperation with the China Securities Regulatory Commission, or the CSRC, and the Ministry of Finance which establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the United States and China. PCAOB continues to be in discussions with the CSRC and the Ministry of Finance to permit joint inspections in the PRC of audit firms that are registered with PCAOB and audit Chinese companies that trade on U.S. exchanges.

Inspections of other firms that PCAOB has conducted outside of China have identified deficiencies in those firms' audit procedures and quality control procedures, and such deficiencies may be addressed as part of the inspection process to improve future audit quality.

The inability of PCAOB to conduct inspections of independent registered public accounting firms operating in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures, and to the extent that such inspections might have facilitated improvements in our auditor's audit procedures and quality control procedures, investors may be deprived of such benefits.

Additional remedial measures could be imposed on certain PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings instituted by the SEC, as a result of which our financial statements may be determined to not be in compliance with the requirements of the Exchange Act, if at all.

In December 2012, the SEC brought administrative proceedings against the PRC-based affiliates of the Big Four accounting firms, including our independent registered public accounting firm, alleging that they had violated U.S. securities laws by failing to provide audit work papers and other documents related to certain other PRC-based companies under investigation by the SEC. On January 22, 2014, an initial administrative law decision was issued, censuring and suspending these accounting firms from practicing before the SEC for a period of six months. The decision was neither final nor legally effective until reviewed and approved by the SEC, and on February 12, 2014, the PRC-based accounting firms appealed to the SEC against this decision. In February 2015, each of the four PRC-based accounting firms agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC. The settlement requires the firms to follow detailed procedures to seek to provide the SEC with access to such firms' audit documents via the CSRC. If the firms do not follow these procedures or if there is a failure in the process between the SEC and the CSRC, the SEC could impose penalties such as suspensions, or it could restart the administrative proceedings.

In the event that the SEC restarts the administrative proceedings, depending upon the final outcome, listed companies in the United States with major PRC operations may find it difficult or impossible to retain auditors in respect of their operations in the PRC, which could result in financial statements being determined to not be in compliance with the requirements of the Exchange Act, including possible delisting. Moreover, any negative news about the proceedings against these audit firms may cause investor uncertainty regarding PRC-based, United States-listed companies and the market price of our ADSs may be adversely affected.

If our independent registered public accounting firm were denied, even temporarily, the ability to practice before the SEC and we were unable to timely find another registered public accounting firm to audit and issue an opinion on our financial statements, our financial statements could be determined not to be in compliance with the requirements of the Exchange Act. Such a determination could ultimately lead to the delisting of our ordinary shares from the Nasdaq Global Market or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

***Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of the draft PRC Foreign Investment Law and how it may impact the viability of our current corporate structure, corporate governance and business operations.***

The MOFCOM published a discussion draft of the proposed Foreign Investment Law in January 2015 aiming to, upon its enactment, replace the trio of existing laws regulating foreign investment in China, namely, *the Sino-foreign Equity Joint Venture Enterprise Law*, *the Sino-foreign Cooperative Joint Venture Enterprise Law* and *the Wholly Foreign-invested Enterprise Law*, together with their implementation rules and ancillary regulations. The draft Foreign Investment Law embodies an expected PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. The MOFCOM is currently soliciting comments on this draft and substantial uncertainties exist with respect to its enactment timetable, interpretation and implementation. The draft Foreign Investment Law, if enacted as proposed, may materially impact the viability of our current corporate structure, corporate governance and business operations in many aspects.

Among other things, the draft Foreign Investment Law expands the definition of foreign investment and introduces the principle of "actual control" in determining whether a company is considered a foreign-invested enterprise, or an FIE. The draft Foreign Investment Law specifically provides that entities established in China but "controlled" by foreign investors will be treated as FIEs, whereas an entity set up in a foreign jurisdiction would nonetheless be, upon market entry clearance by the Ministry of Commerce, treated as a PRC domestic investor provided that the entity is "controlled" by PRC entities and/or citizens. In this connection, "control" is broadly defined in the draft law to cover the following summarized categories: (i) holding 50% of more of the voting rights of the subject entity; (ii) holding less than 50% of the voting rights of the subject entity but having the power to secure at least 50% of the seats on the board or other equivalent decision making bodies, or having the voting power to exert material influence on the board, the shareholders' meeting or other equivalent decision making bodies; or (iii) having the power to exert decisive influence, via contractual or trust arrangements, over the subject entity's operations, financial matters or other key

aspects of business operations. Once an entity is determined to be an FIE and its investment amount exceeds certain thresholds or its business operation falls within a "negative list," to be separately issued by the State Council in the future, market entry clearance by the MOFCOM or its local counterparts will be required. Otherwise, all foreign investors may make investments on the same terms as domestic investors without being subject to additional approval from the government authorities as mandated by the existing foreign investment legal regime.

The "variable interest entity" structure, or VIE structure, has been adopted by many PRC-based companies, including us, to obtain necessary licenses and permits in the industries that are currently subject to foreign investment restrictions in China. See "Risks Relating to Our Corporate Structure—If the PRC government finds that the structure we have adopted for our business operations does not comply with PRC laws and regulations, or if these laws or regulations or interpretations of existing laws or regulations change in the future, we could be subject to severe penalties, including the shutting down of our platform and our business operations", "Risks Relating to Our Corporate Structure—If our PRC consolidated affiliated entities fail to obtain and maintain the requisite licenses and approvals required under the complex regulatory environment for internet-based businesses in China, our business, financial condition and results of operations may be materially and adversely affected", and "Item 4. Information on the Company—C. Organizational Structure." Under the draft Foreign Investment Law, variable interest entities that are controlled via contractual arrangement would also be deemed as FIEs, if they are ultimately "controlled" by foreign investors. Therefore, for any companies with a VIE structure in an industry category that is on the "negative list," the VIE structure may be deemed legitimate only if the ultimate controlling person(s) is/are of PRC nationality (either PRC companies or PRC citizens). Conversely, if the actual controlling person(s) is/are of foreign nationalities, then the variable interest entities will be treated as FIEs and any operation in the industry category on the "negative list" without market entry clearance may be considered as illegal.

It is likely that we would be considered ultimately controlled by Chinese parties, as our management group, including Mr. David Xueling Li, our co-founder, chief executive officer and director, Mr. Jun Lei, our co-founder and chairman, Mr. Jin Cao, our executive vice president, Mr. Rongjie Dong, our executive vice president, and their respective affiliates, together beneficially own an aggregate of 37.7% of our outstanding shares and 75.9% of the total voting power of our company as of March 31, 2015. However, the draft Foreign Investment Law has not taken a position on what actions shall be taken with respect to the existing companies with a VIE structure, whether or not these companies are controlled by Chinese parties, while it is soliciting comments from the public on this point. Moreover, it is uncertain whether the Internet content and other Internet value-added service industry, in which our variable interest entities operate, will be subject to the foreign investment restrictions or prohibitions set forth in the "negative list" to be issued. If the enacted version of the Foreign Investment Law and the final "negative list" mandate further actions, such as MOFCOM market entry clearance, to be completed by companies with existing VIE structure like us, we face uncertainties as to whether such clearance can be timely obtained, or at all, and our business and financial condition may be materially and adversely affected.

The draft Foreign Investment Law, if enacted as proposed, may also materially impact our corporate governance practice and increase our compliance costs. For instance, the draft Foreign Investment Law imposes stringent ad hoc and periodic information reporting requirements on foreign investors and the applicable FIEs. Aside from investment implementation report and investment amendment report that are required at each investment and alteration of investment specifics, an annual report is mandatory, and large foreign investors meeting certain criteria are required to report on a quarterly basis. Any company found to be non-compliant with these information reporting obligations may potentially be subject to fines and/or administrative or criminal liabilities, and the persons directly responsible may be subject to criminal liabilities.

#### Risks Related to Our ADSs

The trading prices of our ADSs are likely to be volatile, which could result in substantial losses to investors.

The daily closing trading prices of our ADSs ranged from US\$52.05 to US\$95.89 in 2014. The trading price of our ADSs is likely to be volatile and could fluctuate widely due to factors beyond our control. This may happen because of broad market and industry factors, like the performance and fluctuation in the market prices or the underperformance or deteriorating financial results of other similarly situated companies in China that have listed their securities in the United States in recent years. The securities of some of these companies have experienced significant volatility since their initial public offerings, including, in some cases, substantial price declines in the trading prices of their securities. The trading performances of these Chinese companies' securities after their offerings, including companies in internet and social networking businesses, may affect the attitudes of investors toward Chinese companies listed in the United States, which consequently may impact the trading performance of our ADSs, regardless of our actual operating performance. In addition, any negative news or perceptions about inadequate corporate governance practices or fraudulent accounting or other practices at other Chinese companies may also negatively affect the attitudes of investors towards Chinese companies in general, including us, regardless of whether we have engaged in such practices. Furthermore, securities markets may from time to time experience significant price



and volume fluctuations that are not related to our operating performance, which may have a material adverse effect on the market price of our ADSs.

In addition to market and industry factors, the price and trading volume for our ADSs may be highly volatile due to specific factors, including the following:

- variations in our net revenues, earnings and cash flow;
- announcements of new investments, acquisitions, strategic partnerships, or joint ventures;
- announcements of new services and expansions by us or our competitors;
- changes in financial estimates by securities analysts;

- changes in the number of our registered or active users;
- fluctuations in the number of paying users or other operating metrics;
- failure on our part to realize monetization opportunities as expected;
- additions or departures of key personnel;
- release of lock-up or other transfer restrictions on our outstanding equity securities or sales of additional equity securities;
- detrimental negative publicity about us, our competitors or our industry; and
- potential litigation or regulatory proceedings or changes.

Any of these factors may result in large and sudden changes in the volume and price at which our ADSs will trade.

***Provisions of our convertible senior notes could discourage an acquisition of us by a third party.***

In March 2014, we issued an aggregate of US\$400 million 2.25% convertible senior notes due in 2019. Certain provisions of our convertible senior notes could make it more difficult or more expensive for a third party to acquire us. The indentures for these convertible notes define a "fundamental change" to include, among other things: (1) any person or group gaining control of our company; (2) any recapitalization, reclassification or change of our Class A common shares or ADSs as a result of which these securities would be converted into, or exchanged for, stock, other securities, other property or assets or any share exchange, consolidation or merger or similar transaction pursuant to which our Class A common shares or ADSs will be converted into cash, securities or other property; (3) the adoption of any plan relating to the liquidation or dissolution of our company; (4) our ADSs ceasing to be listed on The New York Stock Exchange, The NASDAQ Global Select Market or The NASDAQ Global Market; or (5) any change in or amendment to the laws, regulations and rules in China that prohibits us from operating substantially all of our business operations and prevents us from continuing to derive substantially all of the economic benefits from our business operations. Upon the occurrence of a fundamental change, holders of these notes will have the right, at their option, to require us to repurchase all of their notes or any portion of the principal amount of such notes in integral multiples of US\$1,000. In the event of a fundamental change, we may also be required to issue additional ADSs upon conversion of our convertible notes.

If securities or industry analysts do not publish research or reports about our business, or if they adversely change their recommendations regarding our ADSs, the market price for our ADSs and trading volume could decline.

The trading market for our ADSs will be influenced by research or reports that industry or securities analysts publish about our business. If one or more analysts who cover us downgrade our ADSs, the market price for our ADSs would likely decline. If one or more of these analysts cease to cover us or fail to regularly publish reports on us, we could lose visibility in the financial markets, which, in turn, could cause the market price or trading volume for our ADSs to decline.

The sale or availability for sale, or perceived sale or availability for sale, of substantial amounts of our ADSs could adversely affect their market price.

Sales of substantial amounts of our ADSs in the public market, or the perception that these sales could occur, could adversely affect the market price of our ADSs and could materially impair our ability to raise capital through equity offerings in the future. Our ADSs are freely tradable by persons other than our affiliates without restriction or further registration under the Securities Act of 1933, as amended, or the Securities Act, and shares held by our existing shareholders may also be sold in the public market in the future subject to the restrictions in Rule 144 and Rule 701 under the Securities Act. In addition, common shares subject to our outstanding share-based awards, including options, restricted shares and restricted share units, are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, Rules 144 and 701 under the Securities Act. We may also issue additional options in the future which may be exercised for additional common shares and additional restricted shares and restricted share units which may vest. As of March 31, 2015, we had 1,076,773,104 common shares outstanding. We cannot predict what effect, if any, market sales of securities held by our significant shareholders or any other shareholder or the availability of these securities for future sale will have on the market price of our ADSs.

We may be classified as a passive foreign investment company, or PFIC, for United States federal income tax purposes, which could subject United States investors in our ADSs or common shares to significant adverse United States income tax consequences.

We will be classified as a "passive foreign investment company," or "PFIC" for United States federal income tax purposes for any taxable year, if either (a) 75% or more of our gross income for such year consists of certain types of "passive" income or (b) 50% or more of the average quarterly value of our assets (as determined on the basis of fair market value) during such year produce or are held for the production of passive income. Although the law in this regard is unclear, we treat Guangzhou Huaduo and Beijing Tuda as being owned by us for United States federal income tax purposes, not only because we exercise effective control over the operation of such entities but also because we are entitled to substantially all of their economic benefits, and, as a result, we consolidate their operating results in our consolidated financial statements.

Assuming that we are treated as owning Guangzhou Huaduo and Beijing Tuda for United States federal income tax purposes, although we do not expect to be classified as a PFIC for United States federal income tax purposes for the taxable year ended December 31, 2014, there is a risk that we will become a PFIC for our current taxable year ending December 31, 2015 and future taxable years because of our significant cash balances and because the value of our assets for purposes of the PFIC test will generally be determined by reference to the market price of our ADSs. Accordingly, fluctuations in the market price of our ADSs may cause us to become a PFIC for the current taxable year or future taxable years. The determination of whether we will be or become a PFIC will also be affected by how, and how quickly, we use our liquid assets. Under circumstances where we determine not to deploy significant amounts of cash for active purposes our risk of being classified as a PFIC may substantially increase. It is also possible that the Internal Revenue Service may challenge our classification or valuation of our goodwill and other unbooked intangibles, which may result in our company being or, becoming classified as, a PFIC for the current or future taxable years. The determination of whether we will be or become a PFIC will also depend, in part, upon the nature of our income and assets over time, which are subject to change from year to year. There can be no assurance our business plans will not change in a manner that will affect our PFIC status. Because there are uncertainties in the application of the relevant rules and PFIC status is a fact-intensive determination made on an annual basis, no assurance may be given With respect to our PFIC status for any taxable year.

If we are classified as a PFIC in any taxable year, a U.S. holder (as defined in "Item 10. Additional Information—E. Taxation—Material United States Federal Income Tax Considerations") may incur significantly increased United States income tax on gain recognized on the sale or other disposition of the ADSs or common shares and on the receipt of distributions on the ADSs or common shares to the extent such gain or distribution is treated as an "excess distribution" under the United States federal income tax rules. Further, if we are classified as a PFIC for any year during which a U.S. holder holds our ADSs or common shares, we generally will continue to be treated as a PFIC for all succeeding years during which such U.S. holder holds our ADSs or common shares. Alternatively, U.S. holders of PFIC shares can sometimes avoid the rules described above by making certain elections, including a "mark-to-market" election or electing to treat a PFIC as a "qualified electing fund." However, U.S. holders will not be able to make an election to treat us as a "qualified electing fund" because, even if we were to be or become a PFIC, we do not intend to comply with the requirements necessary to permit U.S. holders to make such election. Each U.S. holder is urged to consult its tax advisor concerning the United States federal income tax considerations related to an investment in our

ADSs or common shares if we are treated as a PFIC for our current taxable year ending 2015 or any future taxable year (including the possibility of making a "mark-to-market" election and the unavailability of an election to treat us as a qualified electing fund). For more information see "Item 10. Additional Information—E. Taxation—Material United States Federal Income Tax Considerations—Passive Foreign Investment Company Rules."

Our dual class common share structure with different voting rights will limit your ability to influence corporate matters and could discourage others from pursuing any change of control transactions that holders of our Class A common shares and ADSs may view as beneficial.

Our common shares are divided into Class A common shares and Class B common shares. Holders of Class A common shares are entitled to one vote per share, while holders of Class B common shares are entitled to ten votes per share, voting together as one class on all matters requiring a shareholders' vote. Each Class B common share is convertible into one Class A common share at any time by the holder thereof. Class A common shares are not convertible into Class B common shares under any circumstances. Upon any transfer of Class B common shares by a holder thereof to any person or entity that is not an affiliate of such holder, such Class B common shares will be automatically and immediately converted into an equal number of Class A common shares.

Due to the disparate voting powers attached to these two classes of common shares, as of March 31, 2015, our management group, including Messrs. David Xueling Li, Jun Lei, Jin Cao and Rongjie Dong and their respective affiliates, beneficially own an aggregate of 37.7% of our outstanding shares representing 75.9% of the total voting power and have considerable influence over all matters requiring a shareholders' vote, including election of directors and significant corporate transactions, such as a merger or sale of our company or our assets. This concentrated control will limit your ability to influence corporate matters and could discourage others from pursuing any potential merger, takeover or other change of control transactions that holders of Class A common shares and ADSs may view as beneficial.

Our articles of association contain anti-takeover provisions that could have a material adverse effect on the rights of holders of our common shares and ADSs.

Our articles of association contain provisions to limit the ability of others to acquire control of our company or cause us to engage in change-of-control transactions. These provisions could have the effect of depriving our shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transaction. For example, our board of directors has the authority, without further action by our shareholders, to issue preferred shares in one or more series and to fix their designations, powers, preferences, privileges, and relative participating, optional or special rights and the qualifications, limitations or restrictions, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences, any or all of which may be greater than the rights associated with our common shares, in the form of ADSs or otherwise. Preferred shares could be issued quickly with terms calculated to delay or prevent a change in control of our company or make removal of management more difficult. If our board of directors decides to issue preferred shares, the price of our ADSs may fall and the voting and other rights of the holders of our common shares and ADSs may be materially and adversely affected.

You may face difficulties in protecting your interests, and your ability to protect your rights through U.S. courts may be limited, because we are incorporated under Cayman Islands law.

We are a company limited by shares incorporated under the laws of the Cayman Islands. Our corporate affairs are governed by our second amended and restated memorandum and articles of association, the Companies Law 2012 (as amended) of the Cayman Islands and the common law of the Cayman Islands. The rights of shareholders to take action against the directors, actions by minority shareholders and the fiduciary responsibilities of our directors to us 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 from the common law of England, the decisions of whose courts are of persuasive authority, but are not binding, 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 precedent in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities laws than the United States. Some U.S. states, such as Delaware, have more fully developed and judicially interpreted bodies of corporate law than the Cayman Islands. In addition, shareholders of a Cayman Islands company may not

have standing to initiate a shareholder derivative action in a federal court of the United States.

Unlike many jurisdictions in the United States, Cayman Islands law does not generally provide for shareholder appraisal rights on an approved arrangement and reconstruction of a company. This may make it more difficult for you to assess the value of any consideration you may receive in a merger or consolidation or to require that the offeror give you additional consideration if you believe the consideration offered is insufficient. Moreover, holders of our ADSs are not entitled to appraisal rights under Cayman Islands law. ADS holders that wish to exercise their appraisal or dissentient rights must convert their ADSs into our Class A common shares by surrendering their ADSs to the depositary and paying the ADS depositary fee.

Shareholders of Cayman Islands exempted companies like us have no general rights under Cayman Islands law to inspect corporate records or to obtain copies of lists of shareholders of these companies. Our directors have discretion under our existing articles of association to determine whether or not, and under what conditions, our corporate records may be inspected by our shareholders, but are not obliged to make them available to our shareholders. This may make it more difficult for you to obtain the information needed to establish any facts necessary for a shareholder motion or to solicit proxies from other shareholders in connection with a proxy contest.

As a result of all of the above, public shareholders may have more difficulty in protecting their interests in the face of actions taken by management, members of the board of directors or controlling shareholders than they would as public shareholders of a company incorporated in the United States.

Judgments obtained against us by our shareholders may not be enforceable in our home jurisdiction.

We are a Cayman Islands company and all of our assets are located outside of the United States. Substantially all of our current operations are conducted in China. In addition, a significant majority of our current directors and officers are nationals and residents of countries other than the United States and substantially all of their assets are located outside the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the United States in the event that you believe that your rights have been infringed under the United States federal securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the Cayman Islands and of China may render you unable to enforce a judgment against our assets or the assets of our directors and officers.

There are uncertainties as to whether Cayman Islands courts would:

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

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 in certain circumstances recognize and enforce a non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits.

The voting rights of holders of ADSs are limited by the terms of the deposit agreement, and you may not be able to exercise your right to vote your Class A common shares.

As a holder of our ADSs, you will only be able to exercise the voting rights with respect to the underlying Class A common shares in accordance with the provisions of the deposit agreement. Under the deposit agreement, you must vote by giving voting instructions to the depositary. Upon receipt of your voting instructions, the depositary will vote the underlying Class A common shares in accordance with these instructions. You will not be able to directly exercise



your right to vote with respect to the underlying shares unless you withdraw the shares from the depositary. Under our second amended and restated memorandum and articles of association, the minimum notice period required for convening a general meeting is at least ten clear days. When a general meeting is convened, you may not receive sufficient advance notice to withdraw the shares underlying your ADSs to allow you to vote with respect to any specific matter. If we ask for your instructions, the depositary will notify you of the upcoming vote and will arrange to deliver our voting materials to you. 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. In addition, the depositary and its agents are not responsible for failing to carry out voting instructions or for their manner of carrying out your voting instructions. This means that you may not be able to exercise your right to vote and you may have no legal remedy if the shares underlying your ADSs are not voted as you requested.

The depositary for our ADSs will give us a discretionary proxy to vote our Class A common shares underlying your ADSs if you do not vote at shareholders' meetings, except in limited circumstances, which could adversely affect your interests.

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

- we have failed to timely provide the depositary with 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

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

The effect of this discretionary proxy is that if you do not vote at shareholders' meetings, you cannot prevent our Class A common shares underlying your ADSs from being voted, except under the circumstances described above. This may make it more difficult for shareholders to influence the management of our company. Holders of our common shares are not subject to this discretionary proxy.

You may not receive dividends or other distributions on our common shares and you may not receive any value for them, if it is illegal or impractical to make them available to you.

The depository of our ADSs has agreed to pay to you the cash dividends or other distributions it or the custodian receives on Class A common shares or other deposited securities underlying our ADSs, after deducting its fees and expenses. You will receive these distributions in proportion to the number of Class A common shares your ADSs represent. However, the depository is not responsible if it decides that it is unlawful or impractical to make a distribution available to any holders of ADSs. For example, it would be unlawful to make a distribution to a holder of ADSs if it consists of securities that require registration under the Securities Act but that are not properly registered or distributed under an applicable exemption from registration. The depository may also determine that it is not feasible to distribute certain property through the mail. Additionally, the value of certain distributions may be less than the cost of mailing them. In these cases, the depository may determine not to distribute such property. We have no obligation to register under U.S. securities laws any ADSs, common shares, rights or other securities received through such distributions. We also have no obligation to take any other action to permit the distribution of ADSs, common shares, rights or anything else to holders of ADSs. This means that you may not receive distributions we make on our common shares or any value for them if it is illegal or impractical for us to make them available to you. These restrictions may cause a material decline in the value of our ADSs.

You may be subject to limitations on transfer of your ADSs.

Your ADSs are transferable on the books of the depository. However, the depository 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 depository 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 depository needs to maintain an exact number of ADS holders on its books for a specified period. The depository may also close its books in emergencies, and on weekends and public holidays. The depository may refuse to deliver, transfer or register transfers of our ADSs generally when our share register or the books of the depository are closed, or at any time if we or the depository thinks that it is advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason in accordance with the terms of the deposit agreement. As a result, you may be unable to

transfer your ADSs when you wish to.

#### ITEM 4. INFORMATION ON THE COMPANY

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

We commenced operations in April 2005 with the establishment of Guangzhou Huaduo in China. Guangzhou Huaduo later became one of our PRC consolidated affiliated entities through the contractual arrangements described below.

We established Dokhi Investments Limited in the British Virgin Islands, or BVI, in July 2006 and changed its name to Duowan Limited in September 2006. In August 2006, we established Double Top Limited, which is wholly owned by Dokhi Investments Limited, in Hong Kong and changed its name to Duowan (Hong Kong) Limited in September 2006. In April 2007, we established Guangzhou Duowan Information Technology Co., Ltd., or Guangzhou Duowan, which was wholly owned by Duowan (Hong Kong) Limited. Guangzhou Duowan entered into a series of contractual arrangements with Guangzhou Huaduo and its shareholders, which were subsequently amended solely to reflect updated shareholder equity interests in Guangzhou Huaduo, through which Guangzhou Duowan exercised effective control over the operations of Guangzhou Huaduo.

In November 2007, we established Duowan Entertainment Corp., or Duowan BVI, in the BVI. In March 2008, we established Huanju Shidai Technology (Beijing) Co., Ltd., formerly known as Duowan Entertainment Information Technology (Beijing) Co., Ltd., or Beijing Huanju Shidai, which is wholly owned by Duowan BVI. Beijing Huanju Shidai purchased all the equity interests in Guangzhou Duowan from Duowan (Hong Kong) Limited in August 2008, and entered into a series of contractual arrangements with Guangzhou Huaduo and its shareholders through which Beijing Huanju Shidai exercises effective control over the operations of Guangzhou Huaduo. Duowan (Hong Kong) Limited was deregistered as a company and ceased to operate in May 2010.

In December 2008, Duowan BVI entered into an agreement with Morningside Technology Investments Limited and two individuals, through which Duowan BVI purchased all the equity interests in NeoTasks Inc. from Morningside Technology Investments Limited.

In March 2009, Beijing Huanju Shidai entered into an agreement with NeoTasks New Age International Media Technology (Beijing) Co., Ltd., or NeoTasks Beijing, through which NeoTasks Beijing was merged into Beijing Huanju Shidai. After the merger and additional capital contribution, Beijing Huanju Shidai became 96.5% held by Duowan BVI, and 3.5% held by NeoTasks Limited (formerly known as Enlight Online Entertainment Limited), a Hong Kong company, which in turn was the shareholder of NeoTasks Beijing before the merger. NeoTasks Limited is 100% owned by NeoTasks Inc., a Cayman Islands company. In August 2009, Guangzhou Duowan was renamed Zhuhai Duowan Information Technology Co., Ltd..

In December 2009, Beijing Huanju Shidai entered into a series of contractual agreements with Beijing Tuda and its shareholders, which were subsequently amended solely to reflect updated shareholder equity interests in Beijing Tuda, through which agreements Beijing Huanju Shidai exercises effective control over the operations of Beijing Tuda.

In December 2010, we established Guangzhou Huanju Shidai, formerly known as Zhuhai Duowan Technology Co., Ltd., which is 100% directly owned by Duowan BVI.

Our current holding company, YY Inc., was incorporated in July 2011 as a limited liability company in the Cayman Islands. The corporate affairs of YY Inc. are governed by the memorandum and articles of association, the Companies Law 2012 (as amended) of the Cayman Islands and the common law of the Cayman Islands. Through a share exchange on September 6, 2011, the shareholders of Duowan BVI exchanged all of their outstanding common and preferred shares in Duowan BVI for common and preferred shares of YY Inc. on a pro rata basis. No additional consideration was paid in connection with the share exchange. As a result, Duowan BVI became a wholly owned subsidiary of YY Inc.

In October 2013, we established Guangzhou Juhui Information Technology Co., Ltd., which is 100% directly owned by Guangzhou Huaduo.

In November 2013, we established Zhuhai Huanju Shidai, which is 100% directly owned by NeoTasks Limited.

In April 2014, we established Guangzhou Huanju Media Co., Ltd., which is 100% directly owned by Guangzhou Huaduo.

In September of 2014, we acquired 100% of the equity interests in Guangzhou Zhuque Information Technology Co., Ltd., which engages in online game development.

In the fourth quarter of 2014, we acquired 100% of the equity interests in Beijing Huanqiu Xingxue Technology Development Co., Ltd. and Beijing Huanqiu Chuangzhi Software Co., Ltd., which operate the online education website Edu24oL.com, an online vocational training and language training platform. In addition, we acquired 100% of the equity interests in Zhengrenqiang and His Partners Education Technology (Beijing) Co., Ltd., a company specializing in providing preparation courses for the International English Language Testing System, or IELTS, which is an English language proficiency test, and Beijing Dubooker Culture Communication Co., Ltd., a language education publisher.

We currently own the domain names of YY.com, Duowan.com, 100.com, Huya.com and Edu24oL.com. Our YY platform, including YY.com, is jointly operated by personnel from Guangzhou Huaduo and Zhuhai Duowan.

YY Inc. completed an initial public offering of 7,800,000 ADSs, representing 156,000,000 Class A common shares, in November 2012. On November 21, 2012, our ADSs were listed on The NASDAQ Stock Market under the symbol "YY." In December 2012, in connection with the initial public offering, we also completed the over-allotment offering of an additional 1,170,000 ADSs, representing 23,400,000 Class A common shares.

In March 2014, we issued an aggregate of US\$400 million 2.25% convertible senior notes due in 2019. Proceeds from the sale of the notes are expected to be used for general corporate purposes, including working capital needs and potential acquisitions of complementary businesses. The notes were offered to qualified institutional buyers pursuant to Rule 144A under the Securities Act and certain non-U.S. persons in compliance with Regulation S under the Securities Act. The notes will be convertible into our ADSs based on an initial conversion rate of 9.0334 of our ADSs per \$1,000 principal amount of notes (which is equivalent to an initial conversion price of approximately US\$110.7 per ADS and represents an approximately 35% conversion premium over the closing trading price of our ADSs on March 18, 2014, which was US\$82.00 per ADS). The conversion rate is subject to adjustment upon the occurrence of certain events. The notes bear interest at a rate of 2.25% per year, payable semiannually in arrears on April 1 and October 1 of each year, beginning on October 1, 2014. The notes will mature on April 1, 2019, unless earlier converted, redeemed for certain tax-related events or repurchased in accordance with their terms.

Our principal executive offices are located at Building 3-08, Yangcheng Creative Industry Zone No. 309 Huangpu Avenue Middle, Tianhe District, Guangzhou 510655, the People's Republic of China. Our telephone number at this address is +(86 20) 2916 2000. Our registered office in the Cayman Islands is located at Codan Trust Company (Cayman) Limited of Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman, KYI-1111, Cayman Islands. Our agent for service of process in the United States is Law Debenture Corporate Services Inc., 400 Madison Avenue, 4th Floor, New York, New York 10017.

See "Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Capital Expenditures" for a discussion of our capital expenditures and divestitures.

## B. Business Overview

### Overview

YY is a revolutionary interactive social platform that engages users in real-time online group activities through voice, video and text on PCs and mobile devices. YY also empowers users to create and organize groups of varying sizes to discover and participate in a wide range of online activities, including music shows, online games, dating shows, live game broadcasting and e-learning. With a capacity to support over one million participants concurrently, YY offers users a more immersive, enriching and engaging entertainment experience through its large social community. YY attracted 117.4 million average monthly active users in the three months ended December 2014.

Founded as an online game web portal in 2005, our company has transformed into a multifaceted social platform in the past decade. In July 2008, YY launched its core product, YY Client, a PC-based free software that allows users to create individual channels for any online live social gathering that covers a broad range of interests and topics. Each

active user spent an average of 48 hours per month on our platform in the three months ended December 31, 2014. To increase the accessibility and usage of YY Client, we introduced a mobile application, Mobile YY, in September 2010 and a browser-based version of our services in October 2012. Mobile YY had 99.6 million downloads in 2014. To accelerate the monetization of our mobile platform, we introduced virtual item purchase functions on Mobile YY in October 2013. We also operate Duowan.com, a leading game media website in China that provides access to and interactive resources for online games. In February 2014, we expanded our original education business by launching a dedicated education platform, 100 Education. To further expand our educational services offering, in the fourth quarter of 2014, we acquired two education businesses, Edu24oL.com, a website providing online professional training, and Zhangrenqiang and His Partners Education Technology (Beijing) Co., Ltd., focusing on English language test preparation.

Our operations rely on proprietary technology and industry know-how. YY is supported by our highly scalable infrastructure throughout China and our proprietary algorithms enabling low latency, low jitter and low loss rates in delivering voice and video data.

While the basic use of our platform is currently free, we monetize our user base through IVAS and online advertising. Currently, we primarily generate IVAS revenues through sales of virtual items for online music and entertainment, online dating and live game broadcasting, and game token for online games. We also generate IVAS revenues through our membership program whereby users pay a fixed fee to enjoy certain privileges and regular bonus packages. We primarily generate online advertising revenues from sales of various forms of advertising on Duowan.com and YY Client. We believe that we will be able to capitalize on the large and highly engaged user base of our platform by exploring additional monetization opportunities and diversifying our revenue sources.

Our total net revenues were RMB820.0 million, RMB1,823.5 million and RMB3,678.4 million (US\$592.8 million) in 2012, 2013 and 2014, respectively. We had a net income of RMB89.2 million, RMB477.7 million and RMB1,064.5 million (US\$171.6 million) in 2012, 2013 and 2014, respectively.

## The YY Platform

### YY Client

Our core product, YY Client, enables users to engage in live interactions online, and we continue to develop and upgrade it to address evolving user needs. YY Client provides access to user-created online social activities groups, which we refer to as channels. YY Client is compatible with most internet-enabled systems, including PCs and mobile interfaces. YY Client is widely accessible to most internet users in China because its voice-enabled features only require a minimal bandwidth of approximately 2 KB per second. YY Client is available to download for free from YY.com, Duowan.com and other internet software download centers.

The first version of YY Client, launched in July 2008, had voice-enabled features that allowed online game players to communicate with large groups of fellow gamers on a real-time basis. Game players typically organize various guilds for players to discuss gaming strategies and communicate with each other in a team setting. Such online guilds, which can consist of up to thousands of players, built their own channels on YY Client to communicate with fellow guild members in real time when playing games online. Gradually, we further developed and tailored YY Client in response to the market need for a platform enabling large groups to gather, meet and socialize in real time online, and turned it into the rich communication social platform that it is today. We introduced live video-enabled channels beginning in late 2011 and have since expanded the use of our video features to include some of our most popular music and entertainment, game broadcasting and education channels, and plan to further expand the availability of video features over time. YY's registered user accounts had reached 861.4 million as of December 31, 2014. YY also had 117.4 million average monthly active users in the three months ended December 2014.

All of the basic social interface features enabled by our YY Client, such as the ability to engage in multi-party voice- and video-enabled communications, are currently available to our users free of charge. In addition, some IVAS are free to users up to a certain threshold. We currently earn revenues from YY Client through sales of IVAS paid through online third party payment systems.

Channels on YY Client—User-created and User-defined



On YY Client, users can create individual channels for any live social gathering covering a broad range of interests and topics. YY Client enables users to create channels to cover new topics and interests, gain a fast growing audience base and emerge as the popular channels.

Currently, the most popular channel topics include the following:

***Music and Entertainment.*** Users gather on YY channels to participate in a range of music and entertainment activities, such as singing, dancing and talk shows. Beginning in March 2011, we started offering various virtual items for sale in our online music and entertainment channels. We have expanded our virtual item offerings, and in turn, revenues, from online music and entertainment. Currently, music and entertainment is the largest contributor to our total revenues.

***Games.*** YY channels are a popular live online communication tool for several major types of online games, such as massive multiplayer online games, web games, first person shooter games and real-time strategy games. Game players gather on YY channels for in-game real-time exchanges and to share game-playing tips, discuss strategies, game walk-throughs and guides, and organize guild-related social events. We also offer more than 200 selected web games on our platform. Since the third quarter of 2014, we have launched a number of exclusive client-based games in the game center of our platform, through which users can purchase in-game virtual items. Most of the online games offered on our platform are developed by third-party game developers..

***Dating.*** Users host and participate dating shows on a virtual stage through live audio communication, during which the participants and the audience can purchase and exchange virtual gifts. The format of our online dating is based on a popular dating TV show in China. Launched in November 2013, it has already become the third largest contributor to our revenues in 2014.

**Game Broadcasting.** Users livestream playthroughs of online games in a casual environment or during competitions. Professional game teams and commentators often attract more viewers, who may show support and appreciation by purchasing and giving virtual items to the commentators.

**Education.** Our users host and participate in live lectures or personal tutoring sessions on a range of subjects using a wide variety of teaching tools we provide, including video, PowerPoint, white board, screen shots and Q&A sessions. The most popular subjects include foreign language education, professional certificate training, such as construction engineering, finance and accounting, and medical training.

**Finance.** Users interested in finance and investment can interact with other users, including financial experts on YY channels. YY channels allow users to discuss investment-related topics, including stock market trends and investment basics.

#### Organization and Management of Channels

To help our users navigate and explore the channels on YY Client, we created online catalogs grouped by topics and common interests for users to browse. Within each group, the channels are then ranked by popularity. These online catalogs are also searchable by keywords, which makes it easier for users looking to explore social groups beyond their usual channels to find and join other channels that touch upon different interest areas.

Each YY channel is set up by one user, who becomes the channel's owner. We provide management tools to each channel owner to tailor such channel to his or her own specific interests, establish housekeeping rules, manage hierarchies and manage daily operations of the channel. Channel owners are usually engaged in the active promotion of their channels, often recruiting like-minded users to help manage, monitor and maintain order within their channels.

Each of our channels can support millions of people concurrently, and to date, the largest online event we hosted attracted approximately 1.4 million peak concurrent users in a single channel. We provide three basic management modes for channel owners to organize the live voice and video-communications within their channels: "queue," "chair" and "free" modes. Typically, channel owners and managers choose the type of management mode for their channels depending on the number of users in their channels and the specific needs of these channels. In queue mode, each user can sign in to line up to speak or broadcast, and can only be heard or seen when his or her turn comes "at the mic." This queue mode is a popular mode for karaoke channels, where users take turns performing live in front of other channel users. In chair mode, only the "chair," meaning the owners or other designated persons, are allowed to speak or broadcast video; the remaining users can listen, watch and respond through typing text on the screen. This mode is often used in channels set up by online game players' guilds, as some of these guilds have thousands of users taking orders from a few leaders, who can speak and direct their team's collective actions while the users are simultaneously signed on to play certain online games. In free mode, any user in the channel can conduct effective voice- and video-enabled communications at any time; this mode is often chosen by channels with a limited number of users, since too many people talking at once would make effective communication impossible. In addition, we

provide channel owners and managers with a broad range of functions to tailor the channels to suit particular needs, such as granting certain privileges to a member who makes particular contributions to the channel or banning certain channel users for inappropriate behavior.

We work closely with channel owners and managers by considering and implementing some of their suggestions and feedback and providing them with the tools they require to manage and promote their channels. We also monitor channels for levels of user activity and periodically shut down inactive ones.

#### Game Center on YY Client

The game center on YY Client currently primarily consists of a game lobby and VIP game access. The game lobby enables users to access various online games without downloading any additional client software. The VIP game access provide our users with access to new games being developed or tested by third party game developers, and afford game developers an opportunity to promote their games among our users as well as solicit user feedback on new games.

We conduct market research regarding trends and demand for online games and various types of in-game virtual items, and often work with third party game developers to develop and offer a wide range of in-game virtual items. We intend to continue to source popular online games to users on YY Client.

#### Web-based YY

We extended our platform to web browsers in October 2012. Web-based YY enables users to conduct real-time interactions through web browsers without requiring any downloads or installations. Web-based YY optimizes YY technology for the web, transcending the limitations of operational systems and enabling real-time communications on the web by simply clicking on a link. To date, approximately 34.1% of our monthly active users access the YY platform through web browsers.

#### Mobile Applications

We develop mobile applications to capture a greater share of the growing number of users that access live online social platforms, internet communications and other internet services through mobile operating systems. While we continue to develop and upgrade our platform, a key focus of our research and development is on Mobile YY, our first and main mobile application that primarily provides users access to our music and entertainment content. In the three months ended December 31, 2014, Mobile YY expanded its average monthly active users to 30.1 million, representing an 80.1% increase from the same period in the prior year. To accelerate monetization of our mobile platform, we introduced virtual item purchase functions to Mobile YY in October 2013.

To better accommodate the increasing demands of our users to access more content on our platform, we developed a number of mobile applications, each of which dedicates to a specific type of content. For instance, we launched YY broadcasting application, which was rebranded to Huya, for live game broadcasting in 2014 and Xunhuan application for online dating in January 2015. We will continue to focus on developing enhanced features for our mobile applications going forward.

#### Online Portals

Duowan.com is a dedicated game media website that provides comprehensive information on online games and other resources for users and online game players. Duowan.com provides comprehensive gaming resources such as updated news and announcements of gaming events and the launch or release of new games, and hosts a text-based discussion forum in which users can discuss their game-playing strategies and interact socially through postings. Duowan.com

was launched in 2005 and had 19.1 million, 37.0 million and 34.3 million average daily unique visitors for the months of December 2012, 2013 and 2014, respectively.

## Technology

We believe we are an industry leader in providing large-scale quality multi-user voice- and video-enabled online services in China, and we intend to continue to update our technology to maintain this leadership position.

## QoS for online multi-media communications

Quality of Service, or QoS, assurance is a key element of any high quality delivery of voice and video data over the internet. For live voice- or video-enabled communications, any data packet loss and jitter, or delay in transmission, is often immediately noticeable to users. We devote significant resources to maintain and develop a creative combination of multiple voice- and voice-over internet protocol, or VOIP, quality assurance mechanisms to minimize data loss and jitter. The mechanisms we employ include but not limited to cloud-based intelligence routing, low-bitrate redundant solution, upstream-forward error correction and adaptive jitter. A special intelligent routing algorithm we designed automatically seeks optimal ways of delivering voice and video data across our cloud-based network, enabling us to provide better QoS even when the QoS levels are lower on certain routes.

We employ computer programs and design and implement a standardized set of measurements to help monitor our service quality. Our system periodically collects, and our team of experts analyzes, data from each of our data centers to evaluate the voice- and video-quality for each user using a systematic standard. We have set up formal procedures to handle different levels of server breakdowns and network-related emergencies, and our team can remotely discover issues and access any server to promptly resolve issues.

#### Large, dedicated cloud-based network infrastructure

Our team of experts developed a cloud-based network infrastructure specifically designed to handle multi-party voice- and video-enabled real-time online interactions. We own over 15,000 servers which are hosted in the data centers we lease from third parties throughout the country as of December 31, 2014. To deliver voice data, we require a limited bandwidth of approximately 2 KB per second, which is easily obtainable. Our cloud-based network infrastructure provides quality data delivery and allows multiple users to interact online from anywhere in China with ease and speed.

Our system is designed for scalability and reliability to support growth in our user base. The number of our servers contributes significantly to our fast streaming speed and reliable services, and can be expanded with comparative ease, given the low cost of renting data centers to host additional servers in any high traffic regions in our network. We believe that our current network facilities and broadband capacity provide us with sufficient capacity to carry out our current operations, and can be expanded to meet additional capacity relatively quickly. The amount of bandwidth we lease is continually expanded to reflect increased peak concurrent user numbers.

#### Content management and monitoring

YY Client, YY.com, Duowan.com and Huya.com all contain user-generated content, which we are required to monitor for compliance with PRC laws and regulations. A team within our data security department helps in enforcing our internal procedures to ensure that the content in our system are in compliance with applicable laws and regulations. They are aided by a program designed to periodically sweep our platform and the data being conveyed in our system for sensitive key words or questionable materials. Content that contains certain keywords are automatically filtered by our program and cannot be successfully posted on our platform. Thus we are able to minimize offending materials on our platform and to remove such materials promptly after they are discovered. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Business—We may be held liable for information or content displayed on, retrieved from or linked to our platform, or distributed to our users, and PRC authorities may impose legal sanctions on us, including, in serious cases, suspending or revoking the licenses necessary to operate our platform."

#### Accumulated experience and data for a proprietary technology platform

Significant time and efforts are required to build and operate an infrastructure such as ours. The technological difficulties which a platform that hosts 10,000 concurrent users faces differ greatly from the difficulties a platform with 100,000 and 1,000,000 concurrent users faces, including many issues to be considered when programming for the platform and planning the infrastructure. Over the years, we have gradually developed an effective system to identify, study and resolve issues that we encounter every day. In addition, our team members have been trained over

the years to anticipate and resolve any issues, having gained significant knowledge from building and maintaining our platform over time.

#### Technology team

As of December 31, 2014, our dedicated technology team consisted of approximately 1,742 employees. Approximately 70 members of our technology team are dedicated to monitoring and maintaining our network infrastructure 24 hours a day, seven days a week. Our technology team checks the voice and video data quality received by various users, the quality of user experience on our platform and the proper functioning of our server equipment in our network, as well as contacting internet data center hosts to fix any issues located through such checks. Having launched and developed our video-enabled technology on an increasing number of channels, our team expects to provide full voice- and video-enabled live social interactions in the future.

#### Marketing and Sales

##### Viral and other marketing for our platform

Historically, we have incurred minimal marketing expenses for our platform and have built a large community of users primarily through viral marketing, with word of mouth referrals and repeat user visits ultimately driven by user experience. While we have significantly benefited from the effects of powerful viral marketing, we recently initiated, and plan to continue, certain marketing activities designed to further promote our platform to a broader range of potential users.

### Advertisers on our platform

As of December 31, 2014, we had a dedicated sales and marketing force of 127 experienced professionals; approximately one fourth of these professionals were in charge of serving advertisers and advertising agencies. Currently, a majority of our sales effort is devoted to maintaining and expanding the level of our advertising revenues from online games, since advertising revenues from online games contributed a substantial majority of our online advertising revenue. We expect our online advertising revenues as a percentage of our total net revenues to decrease in the future as we capitalize on increased monetization opportunities for YY Client and as IVAS revenues continue to increase. The compensation for our sales personnel includes basic monthly salaries and sales commissions based on the advertising revenues that they bring in.

### Services for game developers

We have entered into hosting agreements with a number of game developers. These agreements provide for a mutual exchange of resources between us and the game developers: we provide the communication platform for their games, and in exchange they promote our platform through their game interfaces.

### Seasonality

Our results of operations are subject to seasonal fluctuations. However, seasonal fluctuations have not posed material operational and financial challenges to us, as such periods tend to be brief and predictable.

### Competition

We face competition in several major aspects of our business, particularly from companies that provide online social networking, internet communication and online games. We also compete for online advertising revenues with other internet companies that sell online advertising services in China.

***Social connectivity and communications.*** In relation to voice-enabled communication tools, there are several internet voice communication service providers in China, including iSpeak, Dudu and Tencent's QQtalk, and leading international internet voice communication service providers, such as Skype, that are expanding in the China market. In addition, some other leading Chinese internet companies have announced the launch of internet voice



communication services. We compete with other internet companies that provide real-time voice and video services to Chinese internet users.

We may also face potential competition from global social networking service providers that seek to enter the China market, whether independently or through the formation of alliances with, or acquisition of, PRC domestic internet companies.

**Online music and entertainment.** We compete with several domestic companies in the online music and entertainment market, including 9158.com, 6.cn, and guagua.cn. Additionally, a number of Chinese internet companies have recently entered or announced their intention to enter into the music and entertainment market, such as NetEase, Baidu and Youku.

**Live game broadcasting.** Game broadcasting is a relatively new market. We were one of the first platforms that offered this service in early 2013 and have become the market leader in terms of number of users soon after. However competition in this market has intensified since the second half of 2014 following an inflood of venture capital investment. In order to maintain our market-leading position, we expect to invest heavily in enhancing our product offerings and user experience in this area. Our key competitors in this market are douyutv.com, zhanqi.tv, and 17173.com.

**Online game media and hosting.** We have various competitors in the online game media market in China. Duowan.com's primary competitor among game media websites is 17173.com. For game hosting, our competitors include other major internet companies that host games, such as Tencent, Qihoo 360 and other private companies.

## Research and Development

We believe that our ability to develop internet and mobile online applications and services tailored to respond to the needs of our user base has been a key factor for the success of our business.

As of December 31, 2014, our research and development team consisted of 1,620 members. All of our service programs are designed and developed internally, including various interactive technologies. We expect to continue to develop all of our core technologies in-house.

We currently focus our product development efforts on various areas, including (a) the continued improvement of our audio quality and video-enabled features on our real-time interactive social platform, (b) the ongoing improvement of general user experience on our platform by providing virtual items, additional games and online game add-ons as well as certain members-only special features, and (c) the continued development of Mobile YY. We plan to further invest in our voice and video technology and in developing Mobile YY.

### Intellectual Property

We regard our patents, trademarks, domain names, copyrights, trade secrets, proprietary technologies and similar intellectual property as critical to our success. We seek to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret protection laws in the PRC and other jurisdictions, as well as through confidentiality agreements and procedures with our employees, partners and others. The intellectual property rights we own include: (1) 12 patents relating to our proprietary technology; (2) 137 registered domain names, including YY.com, Duowan.com, 100.com, Chinaduo.com and Edu24oL.com; (3) registered copyrights to 123 software programs developed by us relating to various aspects of our operations, including voice software, games platform, general support and user management; and (4) 209 trademarks and service marks for our brands and logos in China and overseas, including YY and certain Chinese logos relating to Duowan and YY. As of December 31, 2014, we had filed 215 patent applications covering certain proprietary technologies and 277 trademark applications in China and overseas.

### PRC Regulation

Certain areas related to the internet, such as telecommunications, internet information services, connections to the international information networks, internet information security and censorship and online game operations, are covered extensively by a number of existing laws and regulations issued by various PRC governmental authorities, including:

· the Ministry of Industry and Information Technology, or the MIIT;

· the Ministry of Culture, or the MOC;

the General Administration of Press and Publication, or the GAPP;

the State Administration for Radio, Film and Television, or the SARFT;

the National Copyright Administration, or the NCA;

the State Administration for Industry and Commerce, or the SAIC;

the State Council Information Office, or the SCIO;

the Ministry of Commerce, or the MOFCOM;

the Bureau of Protection of State Secrets;

the Ministry of Public Security; and

the State Administration of Foreign Exchange, or the SAFE.

As the online social platform and online game industries are still at an early stage of development in China, new laws and regulations may be adopted from time to time to require new licenses and permits in addition to those we currently have. There are substantial uncertainties on the interpretation and implementation of any current and future Chinese laws and regulations, including those applicable to the online social platform and online game industries. See "D. Risk Factors—Risks Related to Doing Business in China—Uncertainties in the interpretation and enforcement of Chinese laws and regulations could limit the legal protections available to you and us." This section sets forth the most important laws and regulations that govern our current business activities in China and that affect the dividends payment to our shareholders.

*Regulation on Telecommunications Services and Foreign Ownership Restrictions*

The Telecommunications Regulations, which became effective on September 25, 2000, are the core regulations on telecommunications services in China. The Telecommunications Regulations set out basic guidelines on different types of telecommunications business activities, including the distinction between "basic telecommunications services" and "value-added telecommunications services." According to the Catalog of Telecommunications Business (2003 Amendment), implemented on April 1, 2003 and attached to the Telecommunications Regulations, internet information services are deemed a type of value-added telecommunications services. The Telecommunications Regulations require the operators of value-added telecommunications services to obtain value-added telecommunications business operation licenses from MIIT or its provincial delegates prior to the commencement of such services. Under these regulations, if the value-added telecommunications services offered include mobile network information services, the operation license for value-added telecommunications business must include the provision of such services in its covered scope. We currently, through Guangzhou Huaduo, our PRC consolidated affiliated entity, hold an ICP license, a sub-category of the value-added telecommunications business operation license, covering the provision of internet and mobile network information services, issued by the Guangdong branch of the MIIT on February 10, 2012.

The Regulations for the Administration of Foreign-Invested Telecommunications Enterprises, or the FITE Regulations, which took effect on January 1, 2002 and were amended on September 10, 2008, are the key regulations that regulate foreign direct investment in telecommunications companies in China. The FITE Regulations stipulate that the foreign investor of a telecommunications enterprise is prohibited from holding more than 50% of the equity interest in a foreign-invested enterprise that provides value-added telecommunications services, including provision of internet content. Moreover, such foreign investor shall demonstrate a good track record and experience in operating value-added telecommunications services when applying for the value-added telecommunications business operation license from the MIIT.

On July 13, 2006, the MIIT issued the Circular on Strengthening the Administration of Foreign Investment in Value-added Telecommunications Services, or the MIIT Circular 2006, which requires that (a) foreign investors can only operate a telecommunications business in China through establishing a telecommunications enterprise with a valid telecommunications business operation license; (b) domestic license holders are prohibited from leasing, transferring or selling telecommunications business operation licenses to foreign investors in any form, or providing any resource, sites or facilities to foreign investors to facilitate the unlicensed operation of telecommunications business in China; (c) value-added telecommunications service providers or their shareholders must directly own the domain names and registered trademarks they use in their daily operations; (d) each value-added telecommunications service provider must have the necessary facilities for its approved business operations and maintain such facilities in the geographic regions covered by its license; and (e) all value-added telecommunications service providers should improve network and information security, enact relevant information safety administration regulations and set up emergency plans to ensure network and information safety. The provincial communications administration bureaus, as local authorities in charge of regulating telecommunications services, (a) are required to ensure that existing qualified value-added telecommunications service providers will conduct a self-assessment of their compliance with the MIIT Circular 2006 and submit status reports to the MIIT before November 1, 2006; and (b) may revoke the value-added telecommunications business operation licenses of those that fail to comply with the above requirements or fail to

rectify such non-compliance within specified time limits. Due to the lack of any additional interpretation from the regulatory authorities, it remains unclear what impact MIIT Circular 2006 will have on us or the other PRC internet companies with similar corporate and contractual structures.

To comply with such foreign ownership restrictions, we operate our online social platform and online game businesses in China through Guangzhou Huaduo, which is owned by several PRC citizens and Beijing Tuda. Beijing Tuda is owned by Messrs. David Xueling Li, Tony Bin Zhao and Jin Cao. Guangzhou Huaduo and Beijing Tuda are both controlled by Beijing Huanju Shidai through a series of contractual arrangements. See "Item 7. Major Shareholders and Related Party Transactions—B. Related Party—Contractual Arrangements with Beijing Tuda." Moreover, Guangzhou Huaduo is the registered holder of a majority of the domain names, trademarks and facilities necessary for daily operations in compliance with the MIIT Circular 2006. Based on our PRC legal counsel Fangda Partners' understanding of the current PRC laws, rules and regulations, our corporate structure complies with all existing PRC laws and regulations. However, we were further advised by our PRC legal counsel that there are substantial uncertainties with respect to the interpretation and application of existing or future PRC laws and regulations and thus there is no assurance that Chinese governmental authorities would take a view consistent with the opinions of our PRC legal counsel.

### *Internet Information Services*

The Administrative Measures on Internet Information Services, or the ICP Measures, issued by the State Council on September 25, 2000 and amended on January 8, 2011, regulate the provision of internet information services. According to the ICP Measures, "internet information services" refer to services that provide internet information to online users, and are categorized as either commercial services or non-commercial services. Pursuant to the ICP Measures, internet information commercial service providers shall obtain an ICP license, from the relevant local authorities before engaging in the providing of any commercial internet information services in China. In addition, if the internet information services involve provision of news, publication, education, medicine, health, pharmaceuticals, medical equipment and other services that statutorily require approvals from other additional governmental authorities, such approvals must be obtained before applying for the ICP license. Guangzhou Huaduo presently holds the ICP license on internet and mobile network information services issued by the Guangdong branch of the MIIT on February 10, 2012.

Besides, the ICP Measures and other relevant measures also ban the internet activities that constitute publication of any content that propagates obscenity, pornography, gambling and violence, incite the commission of crimes or infringe upon the lawful rights and interests of third parties, among others. If an internet information service provider detects information transmitted on their system that falls within the specifically prohibited scope, such provider must terminate such transmission, delete such information immediately, keep records and report to the governmental authorities in charge. Any provider's violation of these prescriptions will lead to the revocation of its ICP license and, in serious cases, the shutting down of its internet systems.

### *Internet Publication and Cultural Products*

The Tentative Measures for Internet Publication Administration, or Internet Publication Measures, were jointly promulgated by the GAPP and the MIIT on June 27, 2002 and became effective on August 1, 2002. The Internet Publication Measures imposed a license requirement for any company that engages in internet publishing, which means any act by an internet information service provider to select, edit and process content or programs and to make such content or programs publicly available on the internet. The provision of online games is deemed an internet publication activity; therefore, an online game operator must (i) obtain an Internet Publishing License so that it can directly offer its online games to the public in the PRC, or (ii) publish its online games through a qualified press entity by entering into an entrustment agreement.

The Rules for the Administration of Electronic Publication, or the Electronic Publication Rules, was issued by the GAPP on February 21, 2008 and became effective on April 15, 2008. Under the Electronic Publication Rules and other regulations issued by the GAPP, online games are classified as a kind of electronic publication, and publishing of online games is required to be conducted by licensed electronic publishing entities that have been issued standard publication codes. Pursuant to the Electronic Publication Rules, if a PRC company is contractually authorized to

publish foreign electronic publications, it must obtain the approval of, and register the copyright license contract with, the GAPP.

We, through Guangzhou Huaduo, obtained an Internet Publishing License for the publication of online games and mobile phone games on November 7, 2011. For more information on the pre-approval by the GAPP, see "—Regulation on Online Games and Foreign Ownership Restrictions."

*Regulation on Online Games and Foreign Ownership Restrictions*

On June 3, 2010, the MOC promulgated the Provisional Administration Measures of Online Games, or the Online Game Measures, which came into effect on August 1, 2010. The Online Game Measures governs the research, development and operation of online games and the issuance and trading services of virtual currency. It specifies that the MOC is responsible for the censorship of imported online games and the filing of records of domestic online games. The procedures for the filing of records of domestic online games must be conducted with the MOC within 30 days after the commencement date of the online operation of such online games or the occurrence date of any material alteration of such online games.

All operators of online games, issuers of virtual currencies and providers of virtual currency trading services, or Online Game Business Operators, are required to obtain Internet Culture Operation Licenses. An Internet Culture Operation License is valid for three years and in case of renewal, the renewal application should be submitted 30 days prior to the expiry date of such license. An Online Game Business Operator should request the valid identity certificate of game users for registration, and notify the public 60 days ahead of the termination of any online game operations or the transfer of online game operational rights. Online Game Business Operators are also prohibited from (a) setting compulsory matters in the online games without game users' consent; (b) advertising or promoting the online games that contain prohibited content, such as anything that compromise state security or divulges state secrets; and (c) inducing game users to input legal currencies or virtual currencies to gain online game products or services, by way of random draw or other incidental means. It also states that the state cultural administration authorities will formulate the compulsory clauses of a standard online game service agreement, which have been promulgated on July 29, 2010 and are required to be incorporated into the service agreement entered into between the Online Game Business Operators, with no conflicts with the rest of clauses in such service agreements. Guangzhou Huaduo holds a valid Internet Culture Operation License that was last updated in December 2013.

On July 11, 2008, the General Office of the State Council promulgated the Regulation on Main Functions, Internal Organization and Staffing of the GAPP, or the Regulation on Three Provisions. On September 7, 2009, the Central Organization Establishment Commission issued the corresponding interpretations, or the Interpretations on Three Provisions. The Regulation on Three Provisions and the Interpretation on Three Provisions granted the MOC overall jurisdiction to regulate the online gaming industry, and granted the GAPP the authority to issue approvals for the internet publication of online games. Specifically, (a) the MOC is empowered to administrate online games (other than the pre-examination and approval before internet publication of online games); (b) subject to the MOC's overall administration, GAPP is responsible for the pre-examination and approval of the internet publication of online games; and (c) once an online game is launched, the online game will be only administrated and regulated by the MOC. On July 11, 2013, the General Office of the State Council promulgated the Provisions on the Main Responsibilities, Internal Institutions and Staffing of GAPP, or the Three-Decision Provisions, which reiterates the restrictions stipulated in the Regulation on Three Provisions. On November 7, 2011, Guangzhou Huaduo obtained an Internet Publishing License for the publication of online games and mobile phone games. The online games we currently offer are domestically produced games, and are published by third parties qualified to publish online games. As of March 31, 2015, approximately 58% of the online games available on YY Client were filed with the GAPP as electronic publications, and the others were still undergoing the filing process.

On September 28, 2009, the GAPP, the NCA and the National Working Group to Eliminate Pornography and Illegal Publications jointly issued the Circular on Consistent Implementation of the Stipulation on the Three Determinations of the State Council and the Relevant Interpretations of the State Commission for Public Sector Reform and the Further Strengthening of the Pre-approval of Online Games and the Approval and Examination of Imported Online Games, or Circular 13. Circular 13 explicitly prohibits foreign investors from directly or indirectly engaging in online gaming business in China, including through variable interest entity structures, or VIE Structures. Foreign investors are not allowed to indirectly control or participate in PRC operating companies' online game operations, whether (a) by establishing other joint ventures, entering into contractual arrangements or providing technical support for such operating companies; or (b) in a disguised form such as by incorporating or directing user registration, user account management or game card consumption into online gaming platforms that are ultimately controlled or owned by



foreign companies. Circular 13 reiterates that the GAPP is responsible for the examination and approval of the import and publication of online games and states that downloading from the internet is considered a publication activity, which is subject to approval from the GAPP. Violations of Circular 13 will result in severe penalties.

For detailed analysis, see "D. Risk Factors—Risks Related to Our Corporate Structure and Our Industry—We may be adversely affected by the complexity, uncertainties and changes in PRC regulation of internet business and companies."

*Anti-fatigue Compliance System and Real-name Registration System*

On April 15, 2007, in order to curb addictive online game-playing by minors, eight PRC government authorities, including the GAPP, the Ministry of Education, the Ministry of Public Security and the MIIT, jointly issued a circular requiring the implementation of an anti-fatigue compliance system and a real-name registration system by all PRC online game operators. Under the anti-fatigue compliance system, three hours or less of continuous playing by minors, defined as game players under 18 years of age, is considered to be "healthy", three to five hours is deemed "fatiguing", and five hours or more is deemed "unhealthy." Game operators are required to reduce the value of in-game benefits to a game player by half if it discovers that the amount of a time a game player spends online has reached the "fatiguing" level, and to zero in the case of the "unhealthy" level.

To identify whether a game player is a minor and thus subject to the anti-fatigue compliance system, a real-name registration system should be adopted to require online game players to register their real identity information before playing online games. Pursuant to a notice issued by the relevant eight government authorities on July 1, 2011, online game operators must submit the identity information of game players to the National Citizen Identity Information Center, a subordinate public institution of the Ministry of Public Security, for verification as of October 1, 2011.

We have developed and implemented an anti-fatigue and compulsory real-name registration system in all our online games, and will cooperate with the National Citizen Identity Information Center to launch the identity verification system upon the issuance of relevant implementing rules. For game players who do not provide verified identity information, we assume that they are minors under 18 years of age. In order to comply with the anti-fatigue rules, we set up our system so that after three hours of playing our online games, minors only receive half of the virtual items or other in-game benefits they would otherwise earn, and after playing for more than five hours, minors would receive no in-game benefits. These restrictions could limit our ability to increase our online games business among minors. Furthermore, if these restrictions were expanded to apply to adult game players in the future, our online games business could be materially and adversely affected. See "D. Risk Factors—Risks Related to Our Corporate Structure and Our Industry—Intensified government regulation of the internet industry in China could restrict our ability to maintain or increase our user level or the level of user traffic to our YY platform.

#### *Virtual Currency*

On January 25, 2007, the Ministry of Public Security, the MOC, the MIIT and the GAPP jointly issued a circular regarding online gambling which has implications for the issuance and use of virtual currency. To curtail online games that involve online gambling while addressing concerns that virtual currency might be used for money laundering or illicit trade, the circular (a) prohibits online game operators from charging commissions in the form of virtual currency in connection with winning or losing of games; (b) requires online game operators to impose limits on use of virtual currency in guessing and betting games; (c) bans the conversion of virtual currency into real currency or property; and (d) prohibits services that enable game players to transfer virtual currency to other players. To comply with the relevant section of the circular that bans the conversion of virtual currency into real currency or property, in relation to online music and entertainment, our virtual currency currently can only be used by users to exchange into virtual items to be used to show support for performers or gain access to privileges and special features in the channels which are services in nature instead of "real currency or property." Once the virtual currency is exchanged by users for virtual items or the relevant privileged services, the conversion transaction is completed and we immediately cancel the virtual item in our internal system. In the case of virtual items used as gifts to performers, we cancel the virtual items and record corresponding points for the benefit of the performers and the channel owners, which are then used as basis for the revenue-sharing calculation pursuant to arrangements among us, certain popular performers and channel owners.

In February 2007, 14 PRC regulatory authorities jointly issued a circular to further strengthen the oversight of internet cafes and online games. In accordance with the circular, the People's Bank of China, or PBOC, has the authority to regulate virtual currency, including: (a) setting limits on the aggregate amount of virtual currency that can be issued

by online game operators and the amount of virtual currency that can be purchased by an individual; (b) stipulating that virtual currency issued by online game operators can only be used for purchasing virtual products and services within the online games and not for purchasing tangible or physical products; (c) requiring that the price for redemption of virtual currency shall not exceed the respective original purchase price; and (d) banning the trading of virtual currency.

On June 4, 2009, the MOC and the MOFCOM jointly issued a notice to strengthen the administration of online game virtual currency. The Virtual Currency Notice requires businesses that (a) issue online game virtual currency (in the form of prepaid cards and/or pre-payment or prepaid card points), or (b) offer online game virtual currency transaction services to apply for approval from the MOC through its provincial branches within three months after the issuance of the 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, without limitation, mandatory corrective measures and fines.

Under the Virtual Currency Notice, an online game virtual currency transaction service provider means a business providing platform services relating to trading of online game virtual currency among game users. The Virtual Currency Notice further requires an online game virtual currency transaction service provider to comply with relevant e-commerce regulations issued by the MOFCOM. According to the Guiding Opinions on Online Trading (Interim) issued by the MOFCOM on March 6, 2007, online platform services are trading services provided to online buyers and sellers through a computer information system operated by the service provider.

The Virtual Currency Notice regulates, among others, the amount of virtual currency a business can issue, the retention period of user records, the function of virtual currency and the return of unused virtual currency upon the termination of online services. It prohibits online game operators from distributing 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 bans the issuance of virtual currency by game operators to game players through means other than purchases with legal currency. Any business that does not provide online game virtual currency transaction services is required to adopt technical measures to restrict the transfer of online game virtual currency among accounts of different game players.

In addition, the Online Game Measures promulgated in June 2010 further provide that (i) virtual currency may only be used to purchase services and products provided by the online service provider that issues the currency; (ii) the purpose of issuing virtual currency shall not be malicious appropriation of the user's advance payment; (iii) the storage period of online gamers' purchase record shall not be shorter than 180 days; (iv) the types, price and total amount of virtual currency shall be filed with the cultural administration department at the provincial level. The Online Game Measures stipulate that virtual currency service providers may not provide virtual currency transaction services to minors or for online games that fail to obtain the necessary approval or filings, and that such providers should keep transaction records, accounting records and other relevant information for its users for at least 180 days.

#### *Online Music and Entertainment*

On November 20, 2006, the MOC issued Several Suggestions of the MOC on the Development and Administration of Internet Music, or the Suggestions, which became effective on the same date. The Suggestions, among other things, reiterate the requirement for an internet service provider to obtain an Internet Culture Operation License to carry out any business relating to internet music products. In addition, foreign investors are prohibited from operating internet culture businesses. However, the laws and regulations on internet music products are still evolving, and there have not been any provisions clarifying whether music products will be regulated by the Suggestions or how such regulation would be carried out.

On August 18, 2009, the MOC promulgated the Notice on Strengthening and Improving the Content Review of Online Music, or the Online Music Notice. According to the Online Music Notice, only "internet culture operating entities" approved by the MOC may engage in the production, release, dissemination (including providing direct links to music products) and importation of online music products. The content of online music shall be reviewed by or filed with the MOC. Internet culture operating entities should establish a strict self-monitoring system of online music content and set up a special department in charge of such monitoring.

Guangzhou Huaduo holds a valid Internet Culture Operation License covering our provision of online music. More than 99% of the music offered on our websites is sung by grassroots performers along with recorded music. If any music provided through our platform is found to lack necessary filings and/or approvals, we could be requested to

cease providing such music or be subject to claims from third parties or penalties from the MOC or its local branches. See "D. Risk Factors—Risks Related to Our Corporate Structure and Our Industry—If our PRC consolidated affiliated entities fail to obtain and maintain the requisite licenses and approvals required under the complex regulatory environment for internet-based businesses in China, our business, financial condition and results of operations may be materially and adversely affected." Moreover, the unauthorized posting of online music on our platform by third parties may expose us to the risk of administrative penalties and intellectual property infringement lawsuits. See "D. Risk Factors—Risks Related to Our Business—We may be held liable for information or content displayed on, retrieved from or linked to our platform, or distributed to our users, and PRC authorities may impose legal sanctions on us, including, in serious cases, suspending or revoking the licenses necessary to operate our platform" and "PRC Regulation—Intellectual Property Rights—Copyright Law."

In 2011, the MOC greatly intensified its regulation of the provision of online music products. According to the series of Notices on Clearing Online Music Products that are in Violation of Relevant Regulations promulgated by the MOC since January 7, 2011, entities that provide any the following will be subject to relevant penalties or sanctions imposed by the MOC: (a) online music products or relevant services without obtaining corresponding qualifications, (b) imported online music products that have not passed the content review of the MOC or (c) domestically developed online music products that have not been filed with the MOC. Thus far, we believe that we have eliminated from our platform any online music products that may fall into the scope of those prohibited online music products thereunder.

*Online Transmission of Audio-Visual Programs*

The Measures for the Administration of Publication of Audio-Visual Programs through Internet or Other Information Network, or the Audio-Visual Measures, promulgated by the SARFT on July 6, 2004 and put into effect on October 11, 2004, apply to the activities relating to the opening, broadcasting, integration, transmission or download of audio-visual programs using internet or other information network. Under the Audio-Visual Measures, to engage in the business of transmitting audio-visual programs, a license issued by SARFT is required. Foreign invested enterprises are not allowed to carry out such business.

On April 13, 2005, the State Council promulgated the Certain Decisions on the Entry of the Non-state-owned Capital into the Cultural Industry. On July 6, 2005, five PRC governmental authorities, including the MOC, the SARFT, the GAPP, the CSRC and the MOFCOM, jointly adopted the Several Opinions on Canvassing Foreign Investment into the Cultural Sector. According to these regulations, non-state-owned capital and foreign investors are not allowed to engage in the business of transmitting audio-visual programs through information networks.

To further regulate the provision of audio-visual program services to the public via the internet, including through mobile networks, within the territory of the PRC, the SARFT and the MIIT jointly promulgated the Administrative Provisions on Internet Audio-Visual Program Service, or the Audio-Visual Program Provisions, on December 20, 2007, which came into effect on January 31, 2008. Providers of internet audio-visual program services are required to obtain a License for Online Transmission of Audio-Visual Programs issued by SARFT, or complete certain registration procedures with SARFT. In general, providers of internet audio-visual program services must be either state-owned or state-controlled entities, and the business to be carried out by such providers must satisfy the overall planning and guidance catalog for internet audio-visual program service determined by SARFT. In a press conference jointly held by SARFT and MIIT to answer questions relating to the Audio-Visual Program Provisions in February 2008, SARFT and MIIT clarified that providers of internet audio-visual program services who engaged in such services prior to the promulgation of the Audio-Visual Program Provisions are eligible to register their business and continue their operation of internet audio-visual program services so long as those providers did not violate the relevant laws and regulations in the past. On May 21, 2008, SARFT issued a Notice on Relevant Issues Concerning Application and Approval of License for the Online Transmission of Audio-Visual Programs, which further sets out detailed provisions concerning the application and approval process regarding the License for Online Transmission of Audio-Visual Programs. The notice also states that providers of internet audio-visual program services that engaged in such services prior to the promulgation of the Audio-Visual Program Provisions are eligible to apply for the license so long as their violation of the laws and regulations is minor in scope and can be rectified in a timely manner and they have no records of violation during the last three months prior to the promulgation of the Audio-Visual Program Provisions. Further, on March 31, 2009, SARFT promulgated the Notice on Strengthening the Administration of the Content of Internet Audio-Visual Programs, which reiterates the pre-approval requirements for the audio-visual programs transmitted via the internet, including through mobile networks, where applicable, and prohibits certain types of internet audio-visual programs containing violence, pornography, gambling, terrorism, superstition or other similarly prohibited elements.

On March 17, 2010, the SARFT issued the Internet Audio-visual Program Services Categories (Provisional), or the Provisional Categories, which classified internet audio-visual program services into four categories.

Guangzhou Huaduo holds a valid License for Online Transmission of Audio-Visual Programs with the business classification of converging and play-on-demand service for certain kinds of audio-visual programs—literary, artistic and entertaining—as prescribed in the Provisional Categories.

*Production of Radio and Television Programs*

On July 19, 2004, the SARFT issued the Regulations on the Administration of Production of Radio and Television Programs, or the Radio and TV Programs Regulations, which become effective on August 20, 2004. The Radio and TV Programs Regulations require any entities engaging in the production of radio and television programs to obtain a license for such businesses from the SARFT or its provincial branches. Entities with the License for Production and Operation of Radio and TV Programs must conduct their business operations strictly in compliance with the approved scope of production and operations and these entities (except radio and TV stations) must not produce radio and TV programs regarding current political news or similar subjects.

Guangzhou Huaduo holds an effective License for Production and Operation of Radio and TV Programs, issued on October 8, 2011, covering the production, reproduction and publication of broadcasting plays, TV dramas, cartoons (excluding production), special subjects, special columns (excluding current political news category) and entertainment programs.

#### *Regulation on Internet Bulletin Board Services*

On November 6, 2000, the MIIT promulgated the Administrative Measures on Internet Bulletin Board Services, or BBS Measures, which required commercial internet information service providers which provide bulletin boards, discussion forums, chat rooms or similar services, or BBS services, to obtain specific approval from the competent telecommunications authorities. Commercial internet information service providers are also required to conspicuously display their ICP license numbers and the rules of the BBS and inform users of the possible legal liabilities and consequences for posting improper comments. Although the BBS Measures were abandoned in July 2010 by the State Council, certain telecommunication authorities still require online bulletin board services be itemized in ICP license if an ICP license holder intends to provide such services.

#### *Online Education Services*

On July 5, 2000, the Ministry of Education promulgated the Measures for the Administration of Educational Websites and Online Schools. Accordingly, an entity that operates educational websites and online schools is required to obtain prior approval from the competent administrative educational authorities. Educational websites are defined as institutions which establish online information databases by collecting, editing and storing educational information or establish online platform and search tools for educational purposes, and which provide public educational information to website visitors or users through the internet or educational TV stations. These measures also include specific provisions regarding the qualifications and procedures for obtaining the approval for operating educational websites. We currently offer some education-related services on our platform and have obtained approval from relevant authorities to provide online education content on edu.YY.com and 100.com, on January 17, 2013 and January 16, 2014, respectively. In addition, we acquired Edu24oL.com, an online education website in the fourth quarter of 2014, and intend to apply for the approval for Edu24oL.com to provide online education content as its business requires.

#### *Regulation on Advertising Business and Conditions on Foreign Investment*

The SAIC is the primary governmental authority regulating advertising activities in China. Regulations that apply to advertising business primarily include:



Advertisement Law of the People's Republic of China, promulgated by the Standing Committee of the National People's Congress on October 27, 1994 and effective since February 1, 1995;

Administrative Regulations for Advertising, promulgated by the State Council on October 26, 1987 and effective since December 1, 1987; and

Implementation Rules for the Administrative Regulations for Advertising, promulgated by the State Council on January 9, 1988 and amended on December 3, 1998, December 1, 2000 and November 30, 2004, respectively.

According to the above regulations, companies that engage in advertising activities must each obtain, from the SAIC or its local branches, a business license which specifically includes operating an advertising business in its business scope. An enterprise engaging in advertising business within the specifications in its business scope does not need to apply for an advertising operation license, provided that such enterprise is not a radio station, television station, newspaper or magazine publisher or any other entity otherwise specified in the relevant laws or administrative regulations. Enterprises conducting advertising activities without such a license may be subject to penalties, including fines, confiscation of advertising income and orders to cease advertising operations. The business license of an advertising company is valid for the duration of its existence, unless the license is suspended or revoked due to a violation of any relevant laws or regulations.

PRC advertising laws and regulations set certain content requirements for advertisements in China, including, among other things, prohibitions on false or misleading content, superlative wording, socially destabilizing content or content involving obscenities, superstition, violence, discrimination or infringement of the public interest. Advertisers, advertising agencies, and advertising distributors are required to ensure that the content of the advertisements they prepare or distribute is true and in complete compliance with applicable laws. In providing advertising services, advertising operators and advertising distributors must review the supporting documents provided by advertisers for advertisements and verify that the content of the advertisements complies with applicable PRC laws and regulations. Prior to distributing advertisements that are subject to government censorship and approval, advertising distributors are obligated to verify that such censorship has been performed and approval has been obtained. Violation of these regulations may result in penalties, including fines, confiscation of advertising income, orders to cease dissemination of the advertisements and orders to publish an advertisement correcting the misleading information. Where serious violations occur, the SAIC or its local branches may revoke such offenders' licenses or permits for their advertising business operations.

Under the Administrative Regulations on Foreign-Invested Advertising Enterprises, promulgated in 2008, there is no longer any maximum foreign shareholding percentage restriction applicable to foreign-invested advertising enterprises. However, foreign investors are required to have at least three years prior experience of operating an advertising business outside of China as their main business before receiving approval to directly own a 100% interest in an advertising company in China. Foreign investors with at least two years prior experience of operating an advertising business outside China as their main business are allowed to establish a joint venture with domestic advertising enterprises to operate an advertising business in China.

### *Intellectual Property Rights*

#### Software Registration

The State Council and the NCA have promulgated various rules and regulations and rules relating to protection of software in China. According to these rules and regulations, software owners, licensees and transferees may register their rights in software with the SCB or its local branches and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process and registered software rights may be entitled to better protections. For the number of software programs for which we had registered rights as of December 31, 2014, see "Item 4. Information on the Company—B. Business Overview—Intellectual Property."

#### Patents

The National People's Congress adopted the Patent Law of the People's Republic of China in 1984 and amended it in 1992, 2000 and 2008, respectively. A patentable invention, utility model or design must meet three conditions: novelty, inventiveness and practical applicability. Patents cannot be granted for scientific discoveries, rules and methods for intellectual activities, methods used to diagnose or treat diseases, animal and plant breeds or substances obtained by means of nuclear transformation. The Patent Office under the State Intellectual Property Office is responsible for receiving, examining and approving patent applications. A patent is valid for a twenty-year term for an invention and a ten-year term for a utility model or design, starting from the application date. Except under certain specific circumstances provided by law, any third party user must obtain consent or a proper license from the patent owner to use the patent, or else the use will constitute an infringement of the rights of the patent holder. For the number of patents we had and the number of patent applications we made as of December 31, 2014, see "Item 4. Information on the Company—B. Business Overview—Intellectual Property."

### Copyright Law

The Copyright Law of the People's Republic of China, promulgated in 1990 and amended in 2001 and 2010, or the Copyright Law, and its related implementing regulations, promulgated in 2002 and amended in 2013, are the principal laws and regulations governing the copyright related matters. The amended Copyright law covers internet activities, products disseminated over the internet and software products, among the subjects entitled to copyright protections. Registration of copyright is voluntary, and is administrated by the China Copyright Protection Center.

To further clarify some key internet copyright issues, on November 27, 2012, the PRC Supreme People's Court promulgated the Regulation on Several Issues Concerning Applicable Laws on Trial of Civil Disputes over the Infringement of Information Network Transmission Right, or the 2013 Regulation. The 2013 Regulation took effect on January 1, 2013, and replaced the Interpretations on Some Issues Concerning Applicable Laws for Trial of Disputes over Internet Copyright that was initially adopted in 2000 and subsequently amended in 2004 and 2006. Under the 2013 Regulation, where an internet information service provider work in cooperation with others to jointly provide works, performances, audio and video products of which the right holders have information network transmission right, such behavior will constitute joint infringement of third parties' information network transmission right, and the PRC court shall order such internet information service provider to assume joint liability for such infringement. If an internet information service provider can prove that it has only provided network services through automatic access, automatic transmission, data storage space, search functions, links, document sharing technology, etc., and thereby argues that it has not been involved in any alleged joint infringement, the PRC court shall find in favor of such internet information service provider. If an internet information service provider fails to delete, block, disconnect or take other necessary measures, or if it provides technological support or other aid when it knows or should have known of the network user's infringement on the information network transmission right, the PRC court shall find that such aid constitutes contributory infringement. The PRC court shall determine whether an internet information service provider is liable for abetting or contributory infringement according to its findings on the degree of fault of the internet information service provider. The fault of the internet information service provider is determined according to various criteria, including situations where such provider knew or should have known of the network user's infringement against third party's information network transmission right. If an internet information service provider can prove it has adopted fairly reasonable and effective technological measures, and yet still finds it difficult to discover infringement against information network transmission conducted by the network user, the PRC court shall find such provider to be not at fault. Where an internet information service provider promotes popular video and films through setting up a list, directory, index, descriptive paragraph, briefing or other means of recommendation, and the public can download, browse or acquire them through other methods directly from the internet information service provider's webpage, the PRC court may find that such provider knew of the network user's infringement on the information network transmission right of others.

Under the Copyright Law and its implementation rules, anyone infringing upon the copyrights of others is subject to various civil liabilities, which include stopping the infringement, eliminating the damages, apologizing to the copyright owners and compensating the copyright owners for such owners' actual and other losses resulting from such infringement. If the actual loss of the copyright owner is difficult to calculate, the income received by the offender as a result of the copyright infringement shall be deemed to be the actual loss; or if such income is in itself difficult to calculate, the relevant PRC court may decide the amount of the actual loss up to RMB500,000 for each infringement.

To address the problem of copyright infringement related to content posted or transmitted on the internet, the PRC National Copyright Administration and MIIT jointly promulgated the Measures for Administrative Protection of Copyright Related to Internet on April 29, 2005. These measures, which became effective on May 30, 2005, apply to acts of automatically providing services such as uploading, storing, linking or searching works, audio or video products, or other contents through the internet based on the instructions of internet users who publish contents on the internet, or the Internet Content Providers, without editing, amending or selecting any stored or transmitted content. When imposing administrative penalties upon the act which infringes upon any users' right of communication through information networks, the Measures for Imposing Copyright Administrative Penalties, promulgated in 2009, shall be applied.

Where a copyright holder finds that certain internet content infringes upon its copyright and sends a notice to the relevant internet information service operator, the relevant internet information service operator is required to (i) immediately take measures to remove the relevant contents, and (ii) retain all infringement notices for six months and to record the content, display time and IP addresses or the domain names related to the infringement for 60 days. After any content is removed by an internet information service operator according to the notice of a copyright holder, the content provider may deliver a counter-notice to both the internet information service operator and the copyright holder, stating that the removed content does not infringe upon the copyright of other parties. After the delivery of such counter-notice, the internet information service operator may immediately reinstate the removed contents and shall not bear administrative legal liability for such reinstatement.

An internet information service operator may be subject to cease-and-desist orders and other administrative penalties such as confiscation of illegal income and fines, if it is clearly aware of a copyright infringement through the internet or, although not aware of such infringement, it fails to take measures to remove relevant content upon receipt of the copyright owner's notice of infringement and, as a result, damages public interests. Where there is no evidence to indicate that an internet information service operator is clearly aware of the existence of copyright infringement, or the internet information service operator has taken measures to remove relevant contents upon receipt of the copyright owner's notice, the internet information service provider shall not bear the relevant administrative legal liabilities.

On May 18, 2006, the State Council issued the Protection of the Right of Communication through Information Network, which took effect on July 1, 2006 and amended on January 30, 2013. Under this regulation, an internet information service provider may be exempt from indemnification liabilities under the following circumstances:

any internet information service provider that provides automatic internet access service upon instructions from its users or provides automatic transmission service for works, performances and audio-visual products provided by its users are not required to assume indemnification liabilities if (a) it has not chosen or altered the transmitted works, performance and audio-visual products and (b) it provides such works, performances and audio-visual products to the designated users and prevents any person other than such designated users from obtaining access.

any internet information service provider that, for the sake of improving network transmission efficiency, automatically stores and provides to its own users the relevant works, performances and audio-visual products obtained from any other internet information service providers, are not required to assume the indemnification liabilities if (a) it has not altered any of the works, performance or audio-visual products that are automatically stored; (b) it has not affected such original internet information service provider in holding the information about where the users obtain the relevant works, performance and audio-visual products; and (c) when the original internet information service provider revises, deletes or shields the works, performances and audio-visual products, it will automatically revise, delete or shield the same.

any internet information service provider that provides its users with information memory space for such users to provide the works, performances and audio-visual products to the general public via an informational network are not required to assume the indemnification liabilities if (a) it clearly indicates that the information memory space is provided to the users and publicizes its own name, contact person and web address; (b) it has not altered the works, performance and audio-visual products that are provided by the users; (c) it is not aware of or has no reason to know that the works, performances and audio-visual products provided by the users infringe upon the copyrights of others; (d) it has not directly derived any economic benefit from the providing of the works, performances and audio-visual products by its users; and (e) after receiving a notice from the copyright holder, it promptly deletes the allegedly infringing works, performances and audio-visual products pursuant to the relevant regulation.

Since 2005, the NCA, together with certain other PRC governmental authorities, have jointly launched annual campaigns specifically aimed to crack down on internet copyright infringement and piracy in China; these campaigns normally last for three to four months every year. According to the Notice of 2010 Campaign to Crack Down on Internet Infringement and Piracy promulgated by the NCA, the Ministry of Public Security and the MIIT on July 19, 2010, the 2010 campaign mainly targeted internet audio and video programs, literature websites, online games, animation, software and art works related to Shanghai World Expo and Guangzhou Asian Games. During the 2010 campaign, starting from late July to the end of October 2010, the local branches of NCA focused on popular movies and TV series, newly published books, online games and animation, music and software and various illegal activities, including, for example, illegal uploading or transmission of a third party's works without proper license or permission, sales of pirated audio-video and software through e-commerce platforms, providing search links, information storage, web hosting or internet access services for third parties engaging in copyright infringement or piracy of copyrighted works and the infringement by use of mobile media. In serious cases, the operating permits of the websites engaging in illegal activities were revoked, and such websites were ordered to shut down.

We have adopted measures to mitigate copyright infringement risks. For instance, we have established a routine reporting and registration system that is updated on a monthly basis, and we require performers, channel owners and users to acknowledge and agree that (a) they would not perform or upload copyrighted content without proper authorization and (b) that they will indemnify us for any relevant copyright infringement claims in relation to their activities on our platform.

If, despite these precautions, such procedures fail to effectively prevent unauthorized posting or use of copyrighted content or the infringement of other third party rights on YY platform, and the PRC courts find that certain safe harbor exemptions under PRC laws are not applicable to us because, for instance, a court finds that we knew or should have known about such infringement or that we have directly derived economic benefits from allowing such infringement activities on our platform, we may be held jointly and severally liable with the performers, channel owners or other infringement parties in lawsuits initiated by the relevant third party copyright holders or authorized users. Moreover, we may be held directly liable for the infringement activities of such performers or channel owners on YY platform, if the PRC courts view them as our employees or agents, deem us to have control over their activities on our platform and the content they upload or otherwise make available on our platform, and determine that we have knowingly uploaded such infringing contents on our platform. See "D. Risk Factors—Risks Related to Our Business—We may be subject to intellectual property infringement claims or other allegations, which could result in our payment of substantial damages, penalties and fines, removal of relevant content from our website or seeking license arrangements which may not be available on commercially reasonable terms."

#### Domain Name

In September 2002, the CNNIC issued the Implementing Rules for Domain Name Registration setting forth detailed rules for registration of domain names, which was amended on May 29, 2012. On November 5, 2004, the MIIT promulgated the Measures for Administration of Domain Names for the Chinese Internet, or the Domain Name Measures. The Domain Name Measures regulate the registration of domain names, such as the first tier domain name ".cn." On May 28, 2012, the CNNIC issued the Measures on Domain Name Dispute Resolution and relevant implementing rules, pursuant to which the CNNIC can authorize a domain name dispute resolution institution to decide disputes. For the number of domain names we registered as of December 31, 2014, see "Item 4. Information on the Company—B. Business Overview—Intellectual Property."

#### Trademark

The PRC Trademark Law, adopted in 1982 and amended in 1993, 2001 and 2013, with its implementation rules adopted in 2014, protects registered trademarks. The Trademark Office of the SAIC handles trademark registrations and grants a protection term of ten years to registered trademarks. Trademark license agreements must be filed with the Trademark Office for record. For the number of trademarks we had and trademark applications we had made as of December 31, 2014, see "Item 4. Information on the Company—B. Business Overview—Intellectual Property."

#### *Internet Infringement*



On December 26, 2009, the Standing Committee of National People's Congress promulgated the Tort Law of the People's Republic of China, or the Tort Law, which became effective on July 1, 2010. Under the Tort Law, an internet user or an internet service provider that infringes upon the civil rights or interests of others through using the internet assumes tort liability. If an internet user infringes upon the civil rights or interests of another through using the internet, the person being infringed upon has the right to notify and request the internet service provider whose internet services are facilitating the infringement to take necessary measures including the deletion, blocking or disconnection of an internet link. If, after being notified, the internet service provider fails to take necessary measures in a timely manner to end the infringement, it will be jointly and severally liable for any additional harm caused by its failure to act. According to the Tort Law, civil rights and interests include the personal rights and rights of property, such as the right to life, right to health, right to name, right to reputation, right to honor, right of portraiture, right of privacy, right of marital autonomy, right of guardianship, right to ownership, right to usufruct, right to security interests, copyright, patent right, exclusive right to use trademarks, right to discovery, right to equity interests and right of heritage, among others.

### *Regulation of Internet Content*

The PRC government has promulgated measures relating to internet content through a number of governmental agencies, including the MIIT, the MOC and the GAPP. These measures specifically prohibit internet activities, such as the operation of online games, that result in the publication of any content which is found to contain, among others, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise state security or secrets. If an ICP license holder violates these measures, its ICP license may be revoked and its websites may be shut down by the relevant government agencies.

Moreover, 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 in China are required to be registered and filed as software products in accordance with the Administrative Measures on Software Products, promulgated in 2000, and amended in 2009. In addition, pursuant to the Notice on Enhancing the Content Review Work of Online Game Products promulgated by the MOC in 2004, imported online games are subject to content review by the MOC prior to being offered to Chinese internet users.

### *Information Security and Censorship*

Internet content in China is regulated and restricted from a state security standpoint. Internet companies in China are required to complete security filing procedures and regularly update information security and censorship systems for their websites with local public security bureau. The PRC Law on Preservation of State Secrets, which became effective on October 1, 2010 requires an internet information services providers to discontinue disseminating any information that may be deemed to be leaked state secrets and to report such incidents in a timely manner to the state security and public security authorities. Failure to do so in a timely and adequate manner may subject the internet information services providers to liability and certain penalties given by the Ministry of State Security, the Ministry of Public Security and/or the MIIT or their respective local branches.

On December 13, 2005, the Ministry of Public Security promulgated Provisions on Technological Measures for Internet Security Protection, or the Internet Protection Measures, which took effect on March 1, 2006. The Internet Protection Measures requires all internet information services operators to take proper measures including anti-virus, data back-up and other related measures, and keep records of certain information about their users (including user registration information, log-in and log-out time, IP address, content and time of posts by users) for at least 60 days and submit the above information as required by laws and regulations.

The National People's Congress, China's national legislative body, enacted the Decisions on the Maintenance of Internet Security on December 28, 2000, that may subject persons to criminal liabilities in China for any attempt to: (i) gain improper entry to a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak state secrets; (iv) spread false commercial information or (v) infringe upon intellectual property rights.

In 1997, the Ministry of Public Security issued the Administration Measures on the Security Protection of Computer Information Network with Internationally Connections, which prohibit using the internet in ways which, among others, result in a leakage of state secrets or a spread of socially destabilizing content. The Ministry of Public Security has supervision and inspection powers in this regard, and relevant local security bureaus may also have jurisdiction. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

On December 28, 2012, the Standing Committee of the National People's Congress reiterated relevant rules on the protection of internet information by issuing the Decision on Strengthening the Protection of Network Information, or the 2012 Decision. The 2012 Decision distinctly clarified certain relevant obligations of the internet information service provider. For example, the 2012 Decision specifies that the internet information service provider should take relevant technical measures and other necessary actions to prevent the leakage, damage or loss of each user's personal information collected in the internet information service provider's operation activities, and shall take remedial measures when the leakage, damage or loss of the citizen's personal information occurs or may possibly occur. Once it discovers any transmission or disclosure of information prohibited by the relevant laws and regulations, the internet information service provider shall stop transmission of such information, take measures such as elimination, keeping relevant record, and reporting to relevant authorities.

To comply with the above laws and regulations, we have established an internet information security department to implement measures on information filtering. For example, we have adopted a voice monitor system, and installed on our platform various alerts on sensitive words or abnormal activities of users, channels or groups. We also have a dedicated team that maintains 24-hour surveillance on the information posted on our platform, with different categories for monitoring purposes, according to subject and content. We have also established and follow a strict review process and storage system of relevant records which, in combination with various information security measures, have effectively prevented the public dissemination of statutory prohibited information through our websites in the past. We intend to continue to further update our measurements and system and work closely with relevant authorities to avoid any violation of relevant laws and regulations in the future.

### *Privacy Protection*

PRC laws and regulations do not prohibit internet content providers from collecting and analyzing their users' personal information if appropriate authorizations are obtained. We require our users to accept a user agreement whereby they agree to provide certain personal information to us. PRC laws and regulations prohibit internet content providers from disclosing any information transmitted by users through their networks to any third parties without their authorization 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.

### *Regulation of Foreign Currency Exchange and Dividend Distribution*

**Foreign Currency Exchange.** The core regulations governing foreign currency exchange in China are the Foreign Exchange Administration Regulations, as amended in August 2008, or the FEA Regulations. Under the FEA Regulations, the Renminbi is freely convertible for current account items, including the distribution of dividends, interest payments, trade- and service-related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the SAFE is obtained and prior registration with the SAFE is made. On August 29, 2008, SAFE promulgated Circular 142 to regulate the conversion of foreign currency into Renminbi by a foreign-invested enterprise by restricting the ways in which the converted Renminbi may be used. Circular 142 stipulates that the registered capital of a foreign-invested enterprise that has been settled in Renminbi converted from foreign currencies may only be used for purposes within the business scope approved by the applicable governmental authority and cannot be used for equity investments within the PRC. Meanwhile, the SAFE strengthened its oversight of the flow and use of the registered capital of a foreign-invested enterprise settled in Renminbi converted from foreign currencies. The use of such Renminbi capital may not be changed without the SAFE's approval, and may not in any case be repayment of Renminbi loans if the proceeds of such loans have not been used. Violations of Circular 142 may lead to severe penalties including heavy fines. As a result, Circular 142 may significantly limit our ability to transfer the net proceeds from our initial public offering to our other PRC subsidiaries through Beijing Huanju Shidai, our wholly owned subsidiary in China, and thus may adversely affect our business expansion in China. We may not be able to convert the net proceeds into Renminbi to invest in or acquire any other PRC companies, or establish other VIEs in the PRC.

**Dividend Distribution.** The Foreign Investment Enterprise Law, promulgated in 1986 and amended in 2000, and the Administrative Rules under the Foreign Investment Enterprise Law, promulgated in 2001, are the key regulations governing distribution of dividends of foreign-invested enterprises.

Under these regulations, a wholly foreign-invested enterprise in China, or a WFOE, may pay dividends only out of its accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, a WFOE is required to allocate at least 10% of its accumulated profits each year, if any, to statutory reserve funds

unless its reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends. The proportional ratio for withdrawal of rewards and welfare funds for employees shall be determined at the discretion of the WFOE. Profits of a WFOE shall not be distributed before the losses thereof before the previous accounting years have been made up. Any undistributed profit for the previous accounting years may be distributed together with the distributable profit for the current accounting year.

**Circular 37.** Pursuant to SAFE's Notice on Relevant Issues Relating to Domestic Residents' Investment and Financing and Round-Trip Investment through Special Purpose Vehicles, or SAFE Circular 37, issued and effective on July 4, 2014, and its appendixes, PRC residents, including PRC institutions and individuals, must register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interest in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a "special purpose vehicle." SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event.

In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making distributions of profit to the offshore parent and from carrying out subsequent cross-border foreign exchange activities and the special purpose vehicle may be restricted in their ability to contribute additional capital into its PRC subsidiary. Further, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for foreign exchange evasion. These regulations apply to our direct and indirect shareholders who are PRC residents and may apply to any offshore acquisitions and share transfer that we make in the future if our shares are issued to PRC residents. See "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—PRC regulations relating to offshore investment activities by PRC residents may limit our PRC subsidiaries' ability to increase their registered capital or distribute profits to us or otherwise expose us to liability and penalties under PRC law."

We have completed the foreign exchange registration of PRC resident shareholders of Guangzhou Huaduo, as required by SAFE Circular 37, for our financings that were completed before the end of 2010. The SAFE Circular 37 registration in relation to the issuance of common shares to Tiger Global Six YY Holdings was completed on February 6, 2012. Our PRC resident shareholders further updated their SAFE Circular 37 registrations in March 2015 to reflect shareholding changes in our company resulting from our initial public offering

**Stock Option Rules.** The Administration Measures on Individual Foreign Exchange Control were promulgated by the PBOC on December 25, 2006, and their Implementation Rules, issued by the SAFE on January 5, 2007, became effective on February 1, 2007. Under these regulations, all foreign exchange matters involved in employee stock ownership plans and stock option plans participated in by onshore individuals, among others, require approval from the SAFE or its authorized branch. Furthermore, the Notices on Issues concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plans of Overseas Publicly-Listed Companies, or the Stock Option Rules, were promulgated by SAFE on February 15, 2012, that replaced the Application Procedures of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Ownership Plans or Stock Option Plans of Overseas Publicly-Listed Companies issued by SAFE on March 28, 2007. Pursuant to the Stock Option Rules, PRC residents who are granted shares or stock options by companies listed on overseas stock exchanges based on the stock incentive plans are required to register with SAFE or its local branches, and PRC residents participating in the stock incentive plans of overseas listed companies shall retain a qualified PRC agent, which could be a PRC subsidiary of such overseas publicly-listed company or another qualified institution selected by such PRC subsidiary, to conduct the SAFE registration and other procedures with respect to the stock incentive plans on behalf of these participants. Such participants must also retain an overseas entrusted institution to handle matters in connection with their exercise of stock options, purchase and sale of corresponding stocks or interests, and fund transfer. In addition, the PRC agents are required to amend the SAFE registration with respect to the stock incentive plan if there is any material change to the stock incentive plan, the PRC agents or the overseas entrusted institution or other material changes. The PRC agents shall, on behalf of the PRC residents who have the right to exercise the employee share options, apply to SAFE or its local branches for an annual quota for the payment of foreign currencies in connection with the PRC residents' exercise of the employee share options. The foreign exchange proceeds received by the PRC residents from the sale of shares under the stock incentive plans granted and dividends distributed by the overseas listed companies must be remitted into the bank accounts in the PRC opened by the PRC agents before distribution to such PRC residents. In addition, the PRC agents shall file each quarter the form for record-filing of information of the Domestic Individuals Participating in the Stock Incentive Plans of Overseas Listed Companies with SAFE or its local branches.

We and our PRC citizen employees who have been granted share options, restricted shares or restricted share units, or PRC optionees, are subject to the Stock Option Rules. If we or our PRC optionees fail to comply with the Individual Foreign Exchange Rule and the Stock Option Rules, we and/or our PRC optionees may be subject to fines and other legal sanctions. See "D. Risk Factors—Risks Related to Doing Business in China—PRC regulations relating to offshore investment activities by PRC residents may limit our PRC subsidiaries' ability to increase their registered capital or distribute profits to us or otherwise expose us to liability and penalties under PRC law."

In addition, the State Administration for Taxation has issued circulars concerning employee share options, under which our employees working in the PRC who exercise share options will be subject to PRC individual income tax.

Our PRC subsidiaries have obligations to file documents related to employee share options with relevant tax authorities and to withhold individual income taxes of those employees who exercise their share options. If our employees fail to pay or if we fail to withhold their income taxes as required by relevant laws and regulations, we may face sanctions imposed by the PRC tax authorities or other PRC government authorities.

*Regulation on Tax*

PRC Enterprise Income Tax

The PRC enterprise income tax is calculated based on the taxable income determined under the applicable EIT Law and its implementation rules. On March 16, 2007, the National People's Congress of China enacted the New EIT Law, which became effective on January 1, 2008. On December 6, 2007, the State Council promulgated the implementation rules to the New EIT Law, which also became effective on January 1, 2008. The New EIT Law imposes a uniform enterprise income tax rate of 25% on all resident enterprises in China, including foreign-invested enterprises and domestic enterprises, unless they qualify for certain exceptions, and terminates most of the tax exemptions, reductions and preferential treatment available under the previous tax laws and regulations. According to the New EIT Law and relevant regulations, subject to the approval of competent tax authorities, the income tax of an enterprise that has been determined to be a high and new technology enterprise shall be reduced to a preferential rate of 15%.

Moreover, under the New EIT Law, enterprises organized under the laws of jurisdictions outside China with their "de facto management bodies" located within China may be considered PRC resident enterprises and are therefore subject to PRC enterprise income tax at the rate of 25% on their worldwide income. Though the implementation rules of the EIT Law define "de facto management bodies" as "establishments that carry out substantial and overall management and control over the manufacturing and business operations, personnel, accounting, properties, etc. of an enterprise," the only detailed guidance currently available for the definition of "de facto management body" as well as the determination of offshore incorporated PRC tax resident status and its administration are set forth in the Notice Regarding the Determination of Chinese-Controlled Overseas Incorporated Enterprises as PRC Tax Resident Enterprise on the Basis of De Facto Management Bodies, or Circular 82, and the Administrative Measures for Enterprise Income Tax of Chinese-Controlled Offshore Incorporated Resident Enterprises (Trial) or SAT Bulletin No. 45, both issued by the SAT, which provide guidance on the administration as well as determination of the tax residency status of a Chinese-controlled offshore-incorporated enterprise, defined as an enterprise that is incorporated under the law of a foreign country or territory and that has a PRC company or PRC corporate group as its primary controlling shareholder.

According to Circular 82, a Chinese-controlled offshore-incorporated enterprise will be regarded as a PRC tax resident by virtue of having its "de facto management body" in China and will be subject to PRC enterprise income tax on its global income only if all of the following conditions set forth in Circular 82 are met:

the primary location of the day-to-day operational management is in the PRC;

decisions relating to the enterprise's financial and human resource matters are made or are subject to approval by organizations or personnel in the PRC;



the enterprise's primary assets, accounting books and records, company seals and board and shareholder resolutions are located or maintained in the PRC; and

50% or more of voting board members or senior executives habitually reside in the PRC.

In addition, Bulletin No. 45 provides clarification on the resident status determination, post-determination administration, and competent tax authorities. It also specifies that when provided with a copy of PRC resident determination certificate from a resident Chinese-controlled offshore-incorporated enterprise, the payer should not withhold 10% income tax when paying certain PRC-sourced income such as dividends, interest and royalties to the Chinese-controlled offshore-incorporated enterprise.

Although we do not believe that our company should be treated as a PRC resident enterprise for PRC tax purposes, substantial uncertainty exists as to whether we will be deemed to be such by the relevant authorities. In the event that we are considered a PRC resident enterprise, we would be subject to the PRC enterprise income tax at the rate of 25% on our worldwide income. See "D. Risk Factors—Risks Related to Doing Business in China—Under the PRC enterprise income tax law, we may be classified as a PRC "resident enterprise," which could result in unfavorable tax consequences to us and our shareholders and have a material adverse effect on our results of operations and the value of your investment."

In addition, although the New EIT Law provides that dividend income between "qualified resident enterprises" is exempted income, and the Implementation Rules refer to "qualified resident enterprises" as enterprises with "direct equity interest", it is unclear whether dividends we receive from our PRC subsidiaries are eligible for exemption.

According to the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises issued by the PRC State Administration of Taxation on December 10, 2009, with retroactive effect from January 1, 2008, or SAT Circular 698, and the Notice on Several Issues Concerning Enterprise Income Tax for Indirect Share Transfer by Non-PRC Resident Enterprises, issued by the PRC State Administration of Taxation on February 3, 2015, or SAT Circular 7, an "indirect transfer" of assets of a PRC resident enterprise, including equity interests in a PRC resident enterprise, by non-PRC resident enterprises may be re-characterized and treated as a direct transfer of PRC taxable properties, if such transaction arrangement lacks of reasonable commercial purpose and was established for the purpose of reducing, avoiding or deferring PRC enterprise income tax. As a result, gains derived from such indirect transfer may be subject to PRC enterprise income tax, and tax filing or withholding obligations may be triggered, depending on the nature of the PRC taxable properties being transferred. According to SAT Circular 7, "PRC taxable properties" include assets of a PRC establishment or place of business, real properties in the PRC, and equity investments in PRC resident enterprises, in respect of which gains from their transfer by a direct holder, being a non-PRC resident enterprise, would be subject to PRC enterprise income taxes. When determining if there is a "reasonable commercial purpose" of the transaction arrangement, features to be taken into consideration include: whether the main value of the equity interest of the relevant offshore enterprise derives from PRC taxable properties; whether the assets of the relevant offshore enterprise mainly consists of direct or indirect investment in China or if its income mainly derives from China; whether the offshore enterprise and its subsidiaries directly or indirectly holding PRC taxable properties have real commercial nature which is evidenced by their actual function and risk exposure; the duration of existence of the business model and organizational structure; the replicability of the transaction by direct transfer of PRC taxable properties; and the tax situation of such indirect transfer and applicable tax treaties or similar arrangements. In respect of an indirect offshore transfer of assets of a PRC establishment or place of business of a foreign enterprise, the resulting gain is to be included with the annual enterprise filing of the PRC establishment or place of business being transferred, and would consequently be subject to PRC enterprise income tax at a rate of 25%. Where the underlying transfer relates to PRC real properties or to equity investments in a PRC resident enterprise, which is not related to a PRC establishment or place of business of a non-resident enterprise, a PRC enterprise income tax at 10% would apply, subject to available preferential tax treatment under applicable tax treaties or similar arrangements, and the party who is obligated to make the transfer payments has the withholding obligation. Where the payor fails to withhold any or sufficient tax, the transferor shall declare and pay such tax to the competent tax authority by itself within the statutory time limit. Late payment of applicable tax will subject the transferor to default interest. Currently, neither SAT Circular 698 nor SAT Circular 7 applies to transactions of sale of shares by investors through a public stock exchange where such shares were acquired from a transaction through a public stock exchange.

We cannot assure you that the PRC tax authorities will not, at their discretion, adjust any capital gains and impose tax return filing and withholding or tax payment obligations on the transferors and transferees, while our PRC subsidiaries may be requested to assist in the filing. Any PRC tax imposed on a transfer of our shares or any adjustment of such gains would cause us to incur additional costs and may have a negative impact on the value of your investment in us.

#### PRC Business Tax

Pursuant to applicable PRC tax regulations, any entity or individual conducting business in the service industry is generally required to pay a business tax at the rate of 5% on the revenues generated from providing services

prescribed in the aforesaid regulations, transferring intangible assets or selling immovable properties. However, if the services provided are related to technology development and transfer, such business tax may be exempted with approvals from the competent tax authorities. In addition, certain businesses, such as mobile game and online education, are subject to a 3% to 5% business tax on gross revenues generated from providing services and related surcharges before the VAT Pilot Program.

#### Value Added Tax

On January 1, 2012, the State Administration of Taxation officially launched a pilot value added tax ("VAT") reform program ("Pilot Program"), applicable to businesses in selected industries. Taxable income derived from the businesses in the Pilot Program is subject to VAT in lieu of business tax. The Pilot Program initially applied only to transportation industry and "modern service industries" ("Pilot Industries") in Shanghai in 2011 and expanded to eight trial regions (including Beijing and Guangdong province) and nationwide progressively from August to December 2012. The Pilot Industries in Shanghai included industries involving the leasing of tangible movable property, transportation services, research and development and technical services, information technology services, cultural and creative services, logistics and ancillary services, certification and consulting services. Revenues generated by advertising services, a type of "cultural and creative services", are subject to the VAT tax rate of 6%. According to official announcements made by competent authorities in Beijing and Guangdong province, Beijing launched the same Pilot Program on September 1, 2012, and Guangdong province launched it on November 1, 2012. In addition, the Supplementary Notice on Several Tax Policies in Relation to the Scope of VAT-able and Other Matters in the Transportation and Selected Modern Service Sectors under the VAT Reform Pilot Program, Caishui [2012] No. 86, or Circular 86, which was issued in December 2012, further defines the application scope of relevant industries and specifies that, starting from December 1, 2012, website operation services provided by website owners for non-self-owned online games are taxed as "Information System Services," and therefore would also be subject to the VAT tax rate as 6%. Going forward, in Guangdong province, we will pay the pilot VAT instead of business taxes for our advertising activities, operating services for online games not owned by us and for any other parts of our business that are deemed by the competent state tax authorities to be in the scope of the Pilot Industries.

On December 12, 2013, the Ministry of Finance and the SAT issued the Circular on Including the Railway Transportation and Postal Industries in the Pilot Program of Replacing Business Tax with Value-Added Tax, or the Pilot Collection Circular. The scope of certain modern services industries under the Pilot Collection Circular is expanded to cover research and development and technical services, cultural and creative services, and radio, film and television services. In addition, according to the Notice on Including the Telecommunications Industry in the Pilot Program of Levying Value-added Tax in Lieu of Business Tax, which became effective on June 1, 2014, the scope of certain modern services industries under the Pilot Collection Circular is further expanded to cover the telecommunications industry.

#### Cultural Development Fee

According to applicable PRC tax regulations or rules, advertising service providers are generally required to pay a cultural development fee at the rate of 3% on the revenues (a) which are generated from providing advertising services and (b) which are also subject to VAT after the VAT reform program.

#### Dividends Withholding Tax

Under the Old EIT Law that was effective prior to January 1, 2008, dividends paid to foreign investors by foreign-invested enterprises, such as dividends paid to us by Beijing Huanju Shidai or Guangzhou Huanju Shidai, our PRC subsidiaries, were exempt from PRC withholding tax. We are a Cayman Islands holding company and substantially all of our income may come from dividends we receive from our subsidiaries located in the PRC. Pursuant to the New EIT Law and its implementation rules, dividends generated after January 1, 2008 and distributed to us by our PRC subsidiaries are subject to withholding tax at a rate of 10%.

As uncertainties remain regarding the interpretation and implementation of the New EIT Law and its implementation rules, we cannot assure you that, if we are deemed a PRC resident enterprise, any dividends to be distributed by us to our non-PRC shareholders and ADS holders would not be subject to any PRC withholding tax. See "D. Risk Factors—Risks Related to Doing Business in China—Under the PRC enterprise income tax law, we may be classified as a PRC "resident enterprise," which could result in unfavorable tax consequences to us and our shareholders and have a material adverse effect on our results of operations and the value of your investment."

#### *Labor Laws and Social Insurance*

The principle laws that govern employment include:

Labor Law of the People's Republic of China, promulgated by the Standing Committee of the National People's Congress on July 5, 1994, effective since January 1, 1995 and amended on August 27, 2009; and

Labor Contract Law of the People's Republic of China, promulgated by the Standing Committee of the National People's Congress on June 29, 2007 and amended on December 28, 2012.

According to the Labor Law and Labor Contract Law, employers must execute written labor contracts with full-time employees. All employers must compensate their employees with wages equal to at least the local minimum wage standards. All employers are required to establish a system for labor safety and sanitation, strictly comply with state rules and standards and provide employees with workplace safety training. Violations of the PRC Labor Contract Law and the PRC Labor Law may result in the imposition of fines and other administrative penalties. For serious violations, criminal liability may arise.

In addition, employers in China are required to provide employees with welfare schemes covering pension insurance, unemployment insurance, maternity insurance, work-related injury insurance, medical insurance and housing funds.

We have caused all of our full-time employees to enter into written labor contracts with us and have provided and currently provide our employees with the proper welfare and employment benefits.

#### *New M&A Regulations and Overseas Listings*

On August 8, 2006, six PRC governmental agencies jointly promulgated the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the New M&A Rule, which became effective on September 8, 2006, and amended on June 22, 2009. The New M&A Rule requires offshore special purpose vehicles formed to pursue overseas listing of equity interests in PRC companies and controlled directly or indirectly by PRC companies or individuals to obtain the approval of the Chinese Securities Regulatory Commission, or the CSRC, prior to the listing and trading of such special purpose vehicle's securities on any stock exchange overseas.

The application of the M&A Rules remains unclear. Based on the understanding on the current PRC laws, rules and regulations and the M&A Rules of our PRC Legal Counsel, Fangda Partners, prior approval from the CSRC is not required under the M&A Rules for the listing and trading of our ADSs on the Nasdaq Global Market because (a) our PRC subsidiaries, Beijing Huanju Shidai, Guangzhou Huanju Shidai and Zhuhai Huanju Shidai, are foreign-invested enterprises established by foreign enterprises, (b) we did not acquire any equity interest or assets of a PRC domestic company owned by PRC companies or individuals as defined under the M&A Rules, and (c) there is no provision that clearly classifies the contractual arrangements among our PRC subsidiary, Beijing Huanju Shidai, our PRC consolidated affiliated entities and their shareholders as a transaction regulated by the M&A Rules. However, as there has been no official interpretation or clarification of the M&A Rules, we are also advised by our PRC legal counsel that there is uncertainty as to how this regulation will be interpreted or implemented.

Considering the uncertainties that exist with respect to the issuance of new laws, regulations or interpretation and implementing rules, the opinion of Fangda Partners, summarized above, is subject to change. If the CSRC or another PRC regulatory agency subsequently determines that prior CSRC approval was required, we may face regulatory actions or other sanctions from the CSRC or other PRC regulatory agencies.

### C. Organizational Structure

The following diagram illustrates our corporate structure:

Beijing Tuda is our PRC consolidated affiliated entity. Mr. David Xueling Li, our co-founder, chief executive (1) officer and director, Mr. Tony Bin Zhao, and Mr. Jin Cao, our executive vice president, own 97.7%, 1.5% and 0.8% of Beijing Tuda's equity interests, respectively, as of the date of this annual report.

(2) Guangzhou Huaduo is our PRC consolidated affiliated entity. Mr. Jun Lei, our co-founder and chairman, Mr. David Xueling Li, Mr. Tony Bin Zhao, Mr. Jin Cao and Beijing Tuda own approximately 0.44%, 0.5%, 0.04%, 0.02% and 99.0% of Guangzhou Huaduo's equity interests, respectively, as of the date of this annual report.

### D. Property and Equipment

Our principal executive offices are located on premises comprising approximately 11,976 square meters in Guangzhou, China. This facility currently accommodates our management headquarters, principal development, engineering, sales and marketing, human resources and administrative activities. The lease for this Guangzhou facility expires in 2015. We also have a branch office in Beijing focusing on research and development, a branch office in Zhuhai focusing on games related businesses, and a representative office in Shanghai that handles advertising-related matters. We lease these relatively small premises under lease agreements from unrelated third parties, and we plan to renew these leases from time to time as needed.

In August 2014, We entered into an agreement to purchase certain floors of an office building located in Panyu District, Guangzhou, China, comprising approximately 30,574 square meters. We intend to use these premises to support increased headcount associated with the continuing expansion of our Company.

Our servers are hosted in leased internet data centers in different geographic regions in China. The data centers in our network are owned and maintained for us by major domestic internet data center providers. We typically enter into leasing and hosting service agreements that are renewable annually.

We believe that our existing facilities are sufficient for our current needs and we will obtain adequate facilities, principally through leasing, to accommodate our future expansion plans.

See footnotes 11 and 12 to our financial statements for further information about our property and equipment and intangible assets.

#### ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

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

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Item 3. Key Information—D. Risk Factors" and elsewhere in this annual report.

##### A. Operating Results

Overview



We derive our revenues primarily from IVAS and online advertising. We derived 85.7%, 91.0% and 96.0% of our total net revenues from IVAS in 2012, 2013 and 2014, respectively, with online advertising accounting for the remainder of our revenues. Revenues from IVAS are primarily generated through online music and entertainment, online games, online dating, live game broadcasting and other services on our platform. Online advertising revenues are primarily generated from sales of different forms of advertising on Duowan.com and YY Client.

We began our operations in 2005 by launching Duowan.com, a popular online web portal hosting game media content. We have grown significantly in recent years, developing and introducing YY Client in 2008 and extending our services into mobile devices in September 2010 and onto web browsers in October 2012. Our business has also expanded from focusing on providing voice communication services to becoming a multifaceted social entertainment platform. We offer a variety of interactive content on our platform, such as online music shows, live online game streaming, and online dating shows, which give our users a more diverse, immersive, engaging and enriching experience. Our total net revenues increased from RMB820.0 million in 2012 to RMB1,823.5 million in 2013 and to RMB3,678.4 million (US\$592.8 million) in 2014. We had a net income of RMB89.2 million, RMB477.7 million and RMB1,064.5 million (US\$171.6 million) in 2012, 2013 and 2014, respectively.

#### Discussion of Selected Statements of Operations Items

##### Revenues

In the years ended December 31, 2012, 2013 and 2014, we had derived our revenues from IVAS and online advertising. Our IVAS revenues are primarily comprised of revenues from the paying users of online music and entertainment, online games and, to a lesser degree, online dating, live game broadcasting and our membership subscriptions. Our online advertising revenues primarily consist of revenues from the sale of online advertising in various formats primarily on Duowan.com and YY Client. We expect that in the future, as is the case in 2014, an increasing portion of our revenues will be derived from non-game IVAS revenues, including revenues from in-channel virtual items sold on our platform, such as virtual flowers and gifts for use in various channels, as well as other online products and services.

The following table sets forth the principal components of our total net revenues by amount and as a percentage of our total net revenues for the periods presented.

	For the Year Ended December 31,						
	2012		2013		2014		
	RMB	% of total net revenues	RMB	% of total net revenues	RMB	US\$	% of total net revenues
(in thousands, except for percentages)							
<b>Total net revenues:</b> <sup>(1)</sup>							
IVAS:							
Online music and entertainment	286,446	34.9	852,885	46.8	2,109,503	339,990	57.3
Online games	332,287	40.5	602,111	33.0	811,699	130,822	22.1
Other IVAS	83,655	10.2	205,212	11.2	609,823	98,286	16.6
Online advertising	117,643	14.4	163,260	9.0	147,343	23,747	4.0
Total	820,031	100.0	1,823,468	100.0	3,678,368	592,845	100.0

(1) Revenues are presented net of rebates and discounts.

*IVAS revenues.* We generate IVAS revenues from (i) the sales of in-channel virtual items used on our online music and entertainment channels, (ii) the sales of in-game virtual items used for games developed by us or by third parties under revenue-sharing arrangements on our platform and (iii) other revenues, including in-channel virtual items used for online dating and live game broadcasting and membership subscription fees. Users access channels and play online games free of charge, but are charged for purchases of virtual items.

The most significant factors that directly affect our IVAS revenues include the increase in the number of our paying users and ARPU:

*The number of paying users.* We had approximately 2.4 million, 3.2 million and 4.9 million paying users in 2012, 2013 and 2014, respectively. We calculate the number of paying users during a given period as the cumulative number of registered user accounts that have purchased virtual items or other products and services on our platform at least once during the relevant period. We were able to achieve an increase in the number of paying users primarily due to a higher conversion ratio of active users to paying users, and we expect that the number of our paying users will continue to grow in the future as we expand our services and products offerings and further monetize our existing platform.

*ARPU*. Our ARPU for IVAS was approximately RMB296.5, RMB525.2 and RMB726.0 (US\$117.0) in 2012, 2013 and 2014, respectively. ARPU is calculated by dividing our total revenues from IVAS during a given period by the number of paying users for that period. As we begin to generate revenues from an increasing variety of IVAS, our ARPU may fluctuate from period to period due to the mix of IVAS purchased by our paying users.

Other significant factors that directly or indirectly affect our IVAS revenues include:

our ability to increase our popularity by offering new and attractive products and services that allow us to monetize our platform;

our ability to attract and retain a large and engaged user base; and

our ability to attract and retain third party game developers, third party licensee operators, service providers and certain popular performers and channel owners.

We expect that the portion of our revenues from IVAS derived from the sales of non-game virtual items and services will continue to increase as we capitalize on monetization opportunities. We create and offer to users virtual items that can be used on various channels. Users can purchase consumable virtual items from us to show support for their favorite performers or time-based virtual items that provide users with recognized status, such as priority speaking rights or special symbols on the music and entertainment channels. The percentage of our total net revenues attributable to virtual items sold on our online music and entertainment channels increased from 34.9% in 2012 to 46.8% in 2013 and further to 57.3% in 2014.

The online games we currently offer are primarily web games that can be run from an internet browser and require an internet connection to play. We have historically derived a significant portion of our revenues from a limited number of popular online games, primarily through selling in-game virtual items for these games. A majority of our popular online games are developed by third party game developers under revenue-sharing arrangements that typically last one to two years. We derive an increasingly lower percentage of our revenues from online games as a whole, as we expect to monetize other non-game aspects of the YY platform, such as online music and entertainment, online dating and live game broadcasting.

*Online advertising revenues.* We also offer a wide range of online advertising formats and solutions. We enter into advertising contracts with both advertisers and advertising agencies. In 2012, 2013 and 2014, a vast majority of our online advertising revenues were derived from pay-for-time arrangements under which we charge advertisers depending on the duration of display for an advertisement or a series of advertisements.

#### Cost of Revenues

Cost of revenues consists primarily of (i) revenue sharing fees and content costs, (ii) bandwidth costs, (iii) salary and welfare, (iv) depreciation and amortization, (v) payment handling costs, (vi) business tax and surcharges and (vii) share-based compensation. We anticipate that revenue sharing fees and content costs paid to performers, channel owners and content providers will increasingly contribute to our cost of revenues. We expect that our cost of revenues will increase in absolute amount as we further grow our user base and expand our revenue-generating services.

*Revenue sharing fees and content costs.* Our revenue sharing fees and content costs paid to performers, channel owners and content providers increased from RMB109.3 million in 2012 to RMB444.1 million in 2013 and further increased to RMB1,134.0 million (US\$182.8 million) in 2014. We expect our revenue sharing fees and content costs to continue to increase as we continue to expand our IVAS offerings and our user engagement and spending levels increase.

*Bandwidth costs.* Our bandwidth costs increased from RMB145.0 million in 2012, to RMB203.2 million in 2013 and further increased to RMB345.9 million (US\$55.8 million) in 2014. We expect bandwidth costs to continue to increase as our user base continues to expand and as online music and entertainment and other video-related services, such as live game broadcasting, become more popular in the future.

*Salary and welfare.* Our salary and welfare costs increased from RMB50.0 million in 2012 to RMB88.5 million in 2013, and further increased to RMB131.8 million (US\$21.2 million) in 2014. We expect our salary and welfare costs to increase as we continue to hire additional employees in line with the expansion of our business.

*Depreciation and amortization.* Our depreciation and amortization increased from RMB25.8 million in 2012 to RMB37.1 million in 2013, and further increased to RMB59.8 million (US\$9.6 million) in 2014. We expect depreciation and amortization to increase as we continue to expand our operations and purchase servers and other equipment or intangibles directly related to the operating of our platform and business.

*Payment handling costs.* Our payment handling costs increased from RMB22.8 million in 2012 to RMB25.0 million in 2013, and further increased to RMB55.1 million (US\$8.9 million) in 2014. We expect payment handling costs to increase as we continue to grow our paying users base and expand our paid service offerings.

*Business tax and surcharges.* Our business tax and surcharges increased from RMB30.0 million in 2012 to RMB47.8 million in 2013, and further increased to RMB49.2 million (US\$7.9 million) in 2014. We expect the payment of business tax to decrease because our revenue are now subject to VAT instead of business tax, and we expect the payment of surcharges to increase due to the expansion of our business.

*Share-based compensation.* Our share-based compensation allocated to the cost of revenues increased from RMB8.4 million in 2012 to RMB9.9 million in 2013 and further increased to RMB18.0 million (US\$2.9 million) in 2014, primarily due to our business expansion.

## Operating Expenses

Our operating expenses consist of (i) research and development expenses, (ii) sales and marketing expenses and (iii) general and administrative expenses. The following table sets forth the components of our operating expenses for the years indicated, both in absolute amounts and as percentages of our total net revenues. We expect our operating expenses to generally increase in absolute amount and decrease as percentage of total net revenues in the near future.

	For the Year Ended December 31,						
	2012		2013		2014		
	RMB	% of total net revenues	RMB	% of total net revenues	RMB	US\$	% of total net revenues
	(in thousands, except for percentages)						
Operating expenses:							
Research and development expenses	176,725	21.6	267,005	14.6	431,188	69,495	11.7
Sales and marketing expenses	16,954	2.1	24,955	1.4	102,527	16,524	2.8
General and administrative expenses	109,788	13.4	200,554	11.0	223,019	35,944	6.1
Total operating expenses	303,467	37.1	492,514	27.0	756,734	121,963	20.6

## Research and Development Expenses

Research and development expenses consist primarily of salaries and benefits and share-based compensation expenses for research and development personnel and rental expenses and depreciation of office premises and servers utilized by the research and development personnel. Research and development expenses generally increased in the past three years ended December 31, 2014, due to the need for additional research and development personnel to accommodate the growth of our business. We expect our research and development expenses in absolute amount to increase as we intend to retain existing research and development personnel and also hire new ones to, among other things, develop new series of applications for our platform, improve technology infrastructure to further enhance user experience, and further develop enhanced features for mobile devices to reach more users. However, we also expect to be able to leverage on the expertise of our established research and development team and achieve better efficiency.

## Sales and Marketing Expenses

Sales and marketing expenses consist primarily of advertising and promotion expenses, salaries, benefits and commissions for our sales and marketing personnel, and share-based compensation expenses. Our sales and marketing

expenses generally increased over the past three years ended December 31, 2014, primarily reflecting increased marketing and promotional activities and increased numbers of sales and marketing staff. We expect that our sales and marketing expenses will increase in absolute amount as well as a percentage of the total revenue in the near term as we expect to increase our spending on promotional activities, particularly relating to mobile applications and new business initiatives.

#### General and Administrative Expenses

General and administrative expenses consist primarily of salaries and benefits, including share-based compensation for our general and administrative personnel, allowance for doubtful receivables, professional service fees, legal expenses and other administrative expenses. Our general and administrative expenses generally increased over the past three years ended December 31, 2014 as our business expanded, primarily due to the hiring of additional management and administrative staff. We expect our general and administrative expenses to increase in the future as our business grows.

## Share-based Compensation Expenses

Our operating expenses include share-based compensation expenses as follows:

	For the Year Ended December 31,			
	2012	2013	2014	
	RMB	RMB	RMB	US\$
	(in thousands, except for percentages)			
Research and development expenses	35,441	39,587	54,141	8,726
Sales and marketing expenses	884	1,318	2,807	452
General and administrative expenses	55,619	66,331	59,647	9,613
Total	91,944	107,236	116,595	18,791

We grant stock-based award such as, but not limited to, share options, restricted shares, restricted share units and warrants to eligible employees, officers, directors, and non-employee consultants. Awards granted to employees, officers, and directors are initially accounted for as equity-classified awards, which are measured at the grant date fair value of the award and are recognized using the graded vesting method, net of estimated forfeitures, over the requisite service period, which is generally the vesting period. Awards granted to non-employees are initially measured at fair value on the grant date and periodically re-measured thereafter until the earlier of the performance commitment date or the date the service is completed and recognized over the period in which the service is provided.

## Taxation

## Cayman Islands

According to our Cayman Islands counsel, Conyers Dill & Pearman, Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciations and there is no taxation in the nature of inheritance tax or estate duty. 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. 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:

- (1) that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciations shall apply to us or our operations; and
- (2) 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 is for a period of twenty years from August 2, 2011.

British Virgin Islands

Duowan BVI is our wholly owned subsidiary.

As Duowan BVI is a BVI business company subject to the provisions of the BVI Business Companies Act 2004 (as amended), it is exempt from all provisions of the Income Tax Act of the BVI (including with respect to all dividends, interests, rents, royalties, compensation and other amounts payable by Duowan BVI to persons who are not persons resident in the BVI).

Capital gains realized with respect to any shares, debt obligations or other securities of Duowan BVI by persons who are not persons resident in the BVI are also exempt from all provisions of the Income Tax Act of the BVI.

No estate, inheritance, succession or gift tax, rate, duty, levy or other charge is payable by persons who are not persons resident in the BVI with respect to any shares, debt obligations or other securities of Duowan BVI, save for interest payable to or for the benefit of an individual resident in the European Union.

## Hong Kong

The Company's subsidiary registered in Hong Kong is subject to Hong Kong Profits Tax on the taxable income as reported in its respective statutory financial statements adjusted in accordance with relevant Hong Kong tax laws. The applicable tax rate is 16.5% in Hong Kong.

## PRC

Current taxation primarily represented the provision for a state and local corporate income tax, or EIT, for subsidiaries and consolidated affiliated entities operating in the PRC. Prior to January 1, 2008, companies established in the PRC were generally subject to EIT at statutory rates of 30% and 3% respectively. On March 16, 2007, the PRC National People's Congress promulgated the New EIT Law, which became effective on January 1, 2008. These subsidiaries and VIEs are subject to new EIT on their taxable income as reported in their respective statutory financial statements adjusted in accordance with the relevant tax laws and regulations in the PRC. All our PRC entities are subject to EIT at a rate of 25%, with the exception of any preferential treatments they may receive, such as the 15% preferential tax rate that Guangzhou Huaduo can enjoy for the periods reported as a result of its qualification as a high and new technology enterprise. Furthermore, Guangzhou Huanju Shidai has been qualified as a software enterprise since 2013, and is entitled to a two-year exemption from EIT followed by three years at 50% tax reduction starting from 2014, the first profit-making year.

According to a policy promulgated by the state tax bureau of the PRC and effective from 2008 onwards, enterprises engaged in research and development activities are entitled to claim 150% of the research and development expenses so incurred in a year as tax deductible expenses in determining its tax assessable profits for that year, or Super Deduction. Guangzhou Huaduo and Zhuhai Duowan have claimed such Super Deduction for the period reported. In addition, Guangzhou Huanju Shidai and Beijing Huanju Shidai started to claim such Super Deduction since 2013.

In addition, according to the New EIT Law and its implementation rules, foreign enterprises, which have no establishment or place in the PRC but derive dividends, interest, rents, royalties and other income (including capital gains) from sources in the PRC is subject to PRC withholding tax, or WHT, at 10% (a further reduced WHT rate may be available according to the applicable double tax treaty or arrangement). The 10% WHT is applicable to any dividends to be distributed from our PRC subsidiaries and consolidated affiliated entities to us and our subsidiaries outside the PRC. We do not have any present plan to pay out the retained earnings in the PRC subsidiaries and PRC consolidated affiliated entities in the foreseeable future. We currently intend to retain our available funds and any future earnings to operate and expand our business. Accordingly, no such WHT has been accrued.

Our PRC subsidiaries and PRC consolidated affiliated entities are subject to business taxes or value added tax and related surcharges. On January 1, 2012, the State Administration of Taxation officially launched a pilot value added tax reform program, or Pilot Program, applicable to businesses in selected industries. Taxable income derived from the businesses in the Pilot Program is subject to value added tax in lieu of business tax. Prior to the Pilot Program's being applied to our revenue, our advertising revenues earned from external customers were subject to business taxes at 5% for the year ended December 31, 2012, and our IVAS revenue earned from external customers were subject to business taxes of 3% for the years ended December 31, 2012, 2013 and for the first five months of 2014, except that our online games revenue and IVAS revenue began to be subject to VAT of 6% commencing December 2012 and June 2014, respectively. Surcharges are calculated based on 12% of the monthly business taxes and VAT payable for 2012, 2013 and 2014. Business taxes and related surcharges during 2012, 2013 and 2014 were RMB30.0 million, RMB47.8 million and RMB49.2 million (US\$7.9 million), respectively.

For more information on PRC tax regulations, see "PRC Regulation—Regulation on Tax."

### Critical Accounting Policies

We prepare our financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect our reporting of, among other things, assets and liabilities, revenues and expenses. We regularly evaluate these estimates and assumptions based on the most recently available information, our own historical experiences and other factors that we believe to be relevant under the circumstances. Since our financial reporting process inherently relies on the use of estimates and assumptions, our actual results could differ from these estimates. This is especially true with some accounting policies that require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our audited consolidated financial statements because they involve the greatest reliance on our management's judgment.

## Revenue Recognition and Deferred Revenue

We generate revenues from IVAS and online advertising. Revenues from IVAS are generated based on the revenue-sharing with game developers and third party licensee operators for direct purchase and conversion of game tokens, sales of virtual items in online games, online music and entertainment and other channels, and membership subscription fees, as well as other IVAS. Online advertising revenues are primarily generated from sales of different forms of advertising on Duowan.com and YY Client. Revenue is recognized when persuasive evidence of an arrangement exists, service has been rendered, the price is fixed or determinable and collection is reasonably assured. Revenue is deferred until these criteria are met as describe below.

### IVAS

We operate a virtual currency system under which the users can directly purchase virtual currency and virtual items on YY Client's online community channels or pay membership subscription fees via online payment systems provided by third parties including payments using mobile phone, internet debit/credit card and other third party payment systems. The virtual currency can be converted into game tokens that can be used to purchase virtual items in online games (both developed by third parties and self-developed), or used directly to purchase virtual items on YY Client's online community channels or used to pay membership subscription fees. Virtual currency sold but not yet consumed by the purchaser is recorded as "advances from customers" and, upon conversion or being used, is recognized as revenue according to the respective prescribed revenue recognition policies addressed below.

### Online music and entertainment revenue

We create and offer virtual items to be used by users on our online music and entertainment channels that we operate and maintain. The virtual items are offered free of charge or at different specified prices. Online music and entertainment revenue consists of sales of virtual items. Users purchase consumable virtual items from us and present them to performers to show support for their favorite performers or time-based virtual items which provide users with recognized status, such as priority speaking rights or special symbols on the music channels for a specific period of time. In order to attract user traffic, we share a portion of the revenues we derive from such in-channel virtual item sales on online music and entertainment channels with certain popular performers and channel owners, who have entered into revenue sharing arrangements with us. We account for such shared revenues as cost of revenues. Performers and channel owners who do not have such revenue sharing arrangements with us are not entitled to share any revenue derived from the virtual items sold. We do not recognize any revenue from offering free virtual items and do not share any revenue with performers or channel owners when free virtual items are presented to performers by our users. Accordingly, online music and entertainment revenue is recognized for the sale of virtual items sold in online music and entertainment channels immediately if the virtual item is a consumable or, in the case of time-based virtual items, recognized ratably over the period each virtual item is made available to the user, which does not exceed one year. We do not have further obligations to the user after the virtual items are consumed. Virtual items may be

sold individually or bundled into one arrangement. When our users purchase multiple virtual items bundled within the same arrangement, we evaluate such arrangements under ASC 605-25 *Multiple-Element Arrangements*. We identify individual elements under the arrangement and determine if such elements meet the criteria to be accounted for as separate units of accounting. We allocate the arrangement consideration to separate units of accounting based on their relative selling price. The following hierarchy has been followed when determining the relative selling price for each element: (1) vendor specific objective evidence, or VSOE, (2) third party evidence, or TPE, and (3) best estimate of selling price, or BEBP. Given that the VSOE of the selling price cannot be determined, we have adopted a policy to allocate the consideration of the whole arrangement to different virtual item elements based on the TPE of selling price or the BEBP for each virtual item element. We determine the fair values of virtual items sold in a bundle based on similar products sold separately on the YY platform based on the TPE of selling price and determine the fair values of virtual items without similar products sold separately on the YY platform based on the BEBP. The BEBP is generally based on the selling prices of the various elements of a similar nature when they are sold to users on a stand-alone basis. The BEBP may also be based on the estimated stand-alone pricing when the element has not previously been sold on a stand-alone basis. These estimates are generally determined based on pricing strategies, market factors and strategic objectives. We recognize revenue for each virtual item element in accordance with the applicable revenue recognition method.

## Online game revenue

We generate revenues from offering virtual items in online games developed by third parties or our self-developed online games to game players. Historically, the majority of online games revenues for the three years ended December 31, 2012, 2013 and 2014 were derived from third party-developed games.

Users play games through our platform free of charge and are charged for purchases of virtual items including consumable and perpetual items, which can be utilized in the online games to enhance their game-playing experience. Consumable items represent virtual items that can be consumed by a specific user within a specified period of time. Perpetual items represent virtual items that are accessible to the users' accounts over the life of the online games.

We recognize revenue when recognition criteria defined under US GAAP are satisfied. For purposes of determining when the service has been provided to the paying player, we have determined that an implied obligation exists to the paying player to continue providing access to the games such that the users can utilize the virtual items purchased by game tokens. Game players need to log on and access the games through our platform because their game tokens, virtual items, and game history are specific to our game accounts and non-transferable to other platforms. To purchase in-game virtual items, players can either charge their game accounts by purchasing game tokens or virtual currency from our platform, which are convertible into game tokens based on a predetermined exchange rate agreed among the relevant game developers and us.

The proceeds from the purchase of our virtual currency is recorded as "advances from customers", representing prepayments received from users in the form of our virtual currency not yet converted into game specific tokens. Upon the conversion into a game token from our virtual currency or upon the direct purchase of a game token, whichever is applicable, the proceeds will be shared between the relevant game developer and us based on a predetermined contractual ratio. Game tokens are non-refundable and non-exchangeable among different games. Our portion, net of the game developer's entitled consideration, is recorded as deferred revenue and amortized according to the prescribed revenue recognition policies described below. Users typically do not convert the virtual currency into game tokens or purchase the game tokens unless they plan to purchase in-game virtual items soon.

There are two types of third party-developed online games:

Non-exclusive third party-developed games; and

Exclusive third party-developed games

Under the non-exclusive arrangement, game developers license the games to various platforms and we are only one of the platforms. Game developers will receive only revenue shared from us pursuant to the mutually agreed sharing percentage.

Under the exclusive arrangement, game developers only license the game to us as the exclusive licensee. We, as the exclusive licensee, can sub-license the games to other platforms. In addition to the revenue shared with the game developers, we also pay an exclusive license fee to the game developers.

#### Non-exclusive third party-developed games

Pursuant to contracts signed between the game developers and us, revenues from the sale or conversion of game tokens to be used for the purchase of in-game virtual items from online games developed by third parties are shared between the game developers and us based on a pre-agreed ratio for each game. These revenue-sharing contracts typically last one to two years.

The third party-developed games under non-exclusive licensing contracts are maintained and updated by the game developers. We view the game developers to be our customers and consider our responsibilities under our agreements with the game developers to offer certain standard promotions that include providing access to the platform, announcing the new games to users on the platform, and occasional advertising on the YY platform. The determination of whether to record these revenues using gross or net method is based on an assessment of various factors. The primary factors are whether we are acting as the principal in offering services to the game players or as the agent in the transaction, and the specific requirement of each contract. We determined that for third party-developed games, the third party game developers are the principal given the game developers design and develop the web-game services offered, have reasonable latitude to establish prices of game tokens, and are responsible for maintaining and upgrading the game contents and virtual items. Accordingly, We record online games revenue, net of the pre-agreed portion of sharing of the revenues with the game developers.

Given that third party-developed games under non-exclusive licensing contracts are managed and administered by the third party game developers, we do not have access to the data on the consumption details such as when the game token is spent on the virtual items or the types of virtual items (consumable or perpetual items) purchased by each individual game player. However, we maintain historical data on timing of the conversion of its virtual currency into game specific tokens and the amount of purchases of game tokens. We believe that our performance for, and obligation to, the game developers correspond to the game developers' services to the users. We have adopted a policy to recognize revenues relating to game tokens for third party developed games over the estimated user relationship with us on a game-by-game basis, which is approximately one to six months for the periods presented. Future usage patterns may differ from historical usage patterns and therefore the estimated user relationship with us may change in the future.

When we launch a new game, we estimate the user relationship based on other similar types of games in the market until the new game establishes its own history. We consider the game's profile, attributes, target audience, and its appeal to players of different demographics groups in estimating the user relationship period.

The estimated user relationship period is based on data collected from those users who have acquired game tokens. To estimate the user relationship period, we maintain a software system that captures the following information for each user: (a) the frequency that users log into each game via our platform, and (b) the amount and the timing of when the users convert or charge his or her game tokens. We estimate the user relationship period for a particular game to be the date a player purchases or converts from virtual currency to a game token through the date we estimate the user plays the game for the last time. This computation is completed on a user by user basis. Then, the results for all analyzed users are averaged to determine an estimated end user relationship period for each game. Revenues from in-game payments of each month are recognized over the user relationship period estimated for that game.

The consideration of user relationship with each online game is based on our best estimate that takes into account all known and relevant information at the time of assessment. We assess the estimated user relationships on a quarterly basis. Any adjustments arising from changes in the user relationship as a result of new information will be accounted as a change in accounting estimate in accordance with ASC 250 Accounting Changes and Error Corrections.

#### Exclusive third party developed games

Under certain exclusive arrangements, we pay additional license fees to the game developers as we are entitled to an exclusive right to operate third party developed games in specified geographic areas. Based on ASC 350-30-35-6, we have adopted an accounting policy to recognize the exclusive license fee as an intangible asset upon the commercial launch of the related online games. This intangible asset is amortized on a straight-line basis over the shorter of the economic life or license period of the relevant online game.



Pursuant to the exclusive licensing contracts signed between the third party game developers and us, our responsibilities in operating the licensed games vary game-by-game. The determination of whether to record these revenues using gross or net method is based on an assessment of various factors, including but not limited to whether we (i) are the primary obligor in the arrangement; (ii) have latitude in establishing the selling price; (iii) change the product or performs part of the service, (iv) have involvement in the determination of product and service specifications.

For the game license arrangements under which we take primary responsibilities of game operation, including determining distribution and payment channels, providing customer services, hosting game servers, if needed, and controlling game and services specifications and pricing, we consider ourselves to be the principal in these arrangements. Accordingly, we record online games revenues from these third party licensed games on a gross basis. Commission fees paid to distribution channels and payment channels and content fees paid to third party game developers are recorded as cost of revenues.

For the game license arrangements under which our responsibilities are limited to publishing, providing payment solutions and game operating advice, we view the game developers to be our customers and consider ourselves to be the agent in the arrangements. Accordingly, we record online games revenues from these third party licensed games, net of fees paid to third parties upon the provision of service.

Pursuant to the terms and conditions of certain online game exclusive license agreement entered into between the game developers and us, we, as the exclusive licensee, could sublicense a non-exclusive, non-transferable and limited license to any third party without the prior formal consent of game developers. Under the non-exclusive and non-transferable limited license, the sub-licensee cannot further license the game to other platforms. We received monthly revenue-based royalty payments from all sub-licensees. We view the third-party licensee operators as our customers and recognize revenues on a net basis, as we do not have the primary responsibility for fulfillment and acceptability of the game services.

Similar to other online games, the exclusive third party developed games are free to play and players can pay for virtual items for better in-game experience. For exclusive third party games, the consumption details can be provided by third party developers or we have access to such data. Therefore, we recognize revenues based on item-based model: (1) for consumable items, the revenue is recognized immediately upon consumption; (2) for perpetual items, the revenue is recognized ratably over the user relationship period of a specific game as described. The determination of user relationship period is the same as what is described in “Non-exclusive third party developed games” above.

#### Self-developed games

Revenues derived from self-developed games are recorded on a gross basis as we act as a principal to fulfill all obligations. We do not maintain information on consumption details of in-game virtual items, and only have limited information related to the frequency of log-ons for our self-developed games. Given that certain historical data is not available, we use the user relationship of third party games with similar popularity, gaming experience and sales to determine the estimated period of user relationship for our self-developed games.

#### Other IVAS revenue

Other IVAS revenue mainly represents revenue from membership subscription fees and revenue from the sale of other items on the YY platform. We launched our membership program where subscription members can have enhanced user privileges when using YY Client. The membership fee is collected up-front from each subscriber. The receipt of the revenue is initially recorded as deferred revenue, and revenue is recognized ratably over the period the subscription services are rendered. Unrecognized portion beyond 12 months from the balance sheet date is classified as long-term deferred revenue.

Revenue from sales of virtual items in various channels is recognized on item basis, which is consistent with the revenue recognition policies in our online music and entertainment revenue stream.

#### Advertising revenues

Advertising revenues are derived principally from advertising arrangements where the advertisers pay to place their advertisements on Duowan.com and YY Client in different formats over a particular period of time. Such formats generally include but are not limited to banners, text-links, videos, logos, and buttons. Advertisements on our platform are generally charged on the basis of duration, and advertising contracts are signed to establish the fixed price and the advertising services to be provided. Where collectability is reasonably assured, advertising revenues from advertising contracts are recognized ratably over the contract period of display.

We enter into advertising contracts directly with advertisers or third party advertising agencies that represent advertisers. A typical contract term would range from one to three months. Both third party advertising agencies and direct advertisers are generally billed at the end of the display period and payments are due usually within six months.

Where our customers purchase multiple advertising spaces with different display periods in the same contract, we allocate the total consideration to the various advertising elements based on relative selling price method and recognize revenue for the different elements over their respective display periods. We determine the fair values of different advertising elements based on our best estimate of selling prices of each advertisement within the contract, taking into consideration our standard price list and historical discounts granted. We recognize revenue on the elements delivered and defer the recognition of revenue for the fair value of the undelivered elements until the remaining obligations have been satisfied. Where all of the elements within an arrangement are delivered uniformly over the agreement period, the revenues are recognized on a straight line basis over the contract period.

### Transactions with third party advertising agencies

For contracts entered into with third party advertising agencies, the third party advertising agencies will in turn sell the advertising services to advertisers. Revenue is recognized ratably over the contractual period of display based on the following criteria:

- there is persuasive evidence that an arrangement exists—we enter into framework and execution agreements with the advertising agencies, specifying price, advertising content, format and timing;

- price is fixed or determinable—the price charged to the advertising agencies are specified in the agreements, including relevant discount and rebate rates;

- services are rendered—we recognize revenue ratably as the elements are delivered over the contract period of display; and

- collectability is reasonably assured—we assess the credit history of each advertising agency before entering into any framework and execution agreements. If the collectability from the agencies is assessed is not reasonably assured, we recognize revenue only when the cash is received and all the other revenue criteria are met.

We provide sales incentives in the forms of discounts and rebates to third party advertising agencies based on purchase volume. As the advertising agencies are viewed as the customers in these transactions, revenue is recognized based on the price charged to the agencies, net of sales incentives provided to the agencies. Sales incentives are estimated and recorded at the time of revenue recognition based on the contracted rebate rates and estimated sales volume based on historical experience.

### Transactions with advertisers

We also enter into advertisement contracts directly with advertisers. Under these contracts, similar to transactions with third party advertising agencies, we recognize revenue ratably as the elements are delivered over the contractual periods of display. The terms and conditions, including price, are fixed according to the relevant advertising contract. We also perform a credit assessment of all advertisers prior to entering into contracts. Revenue is recognized based on the amount charged to the advertisers, net of discounts.

### Advances from customers and deferred revenue

Advances from customers primarily consist of (i) prepayments from users in the form of our virtual currency that are not yet consumed or converted into game tokens, and upon the consumption or conversion, are recognized as revenue according to the prescribed revenue recognition policies described above, (ii) prepayments from sub-licensees for obtaining operation rights of certain online games over a period of time, and (iii) prepayments from advertising agencies and advertisers. Deferred revenue primarily consists of the unamortized revenue from game tokens, prepaid subscriptions under the membership program and unamortized revenue from virtual items in our various channels on the YY platform, where there is still an implied obligation to be provided by us which will be recognized as revenue when all of the revenue recognition criteria are met.

#### Accounts receivable, net

Accounts receivable are presented net of allowance for doubtful accounts. We use specific identification in providing for bad debts when facts and circumstances indicate that collection is doubtful and a loss is probable and estimable. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowance would be required.

We maintain an allowance for doubtful accounts which reflects our best estimate of amounts that potentially will not be collected. We determine the allowance for doubtful accounts on an individual basis taking into consideration various factors, including, but not limited to, historical collection experience, credit-worthiness of the debtors and the age of the individual receivables balance. Additionally, we make specific bad debt provisions based on any specific knowledge we have acquired that might indicate that an account is uncollectible. The facts and circumstances of each account may require us to use substantial judgment in assessing its collectability.

## Consolidation

Our consolidated financial statements include the financial statements of our company, our subsidiaries, variable interest entities ("VIEs") and VIE's subsidiaries for which we or our subsidiaries are the primary beneficiaries. All transactions and balances among our company, subsidiaries, VIEs and VIE's subsidiaries have been eliminated upon consolidation.

A subsidiary is an entity in which our company, directly or indirectly, controls more than one half of the voting power, has the power to appoint or remove the majority of the members of the board of directors or to cast a majority vote at each meeting of directors, or has the power to govern the financial and operating policies of the investee under a statute or agreement among the entity's shareholders or equity holders.

A VIE is an entity in which our company, or one of our subsidiaries, through contractual agreements, bears the risks of, and enjoys the rewards normally associated with ownership of the entity, and therefore our company or one of our subsidiaries is the primary beneficiary of the entity. In determining whether our company or our subsidiaries are the primary beneficiary, we considered whether we have the power to direct activities that are significant to the VIE's economic performance, and also our obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

Foreign ownership of internet-based businesses is subject to significant restrictions under current PRC laws and regulations. We conduct our operations in China primarily through a series of contractual arrangements entered into among Beijing Huanju Shidai, our PRC subsidiary, Guangzhou Huaduo and Beijing Tuda, as well as Guangzhou Huaduo and Beijing Tuda's shareholders. Based on our evaluations of the relationships between us and Beijing Tuda and Guangzhou Huaduo, the economic benefit flow of contractual arrangements made with them, as well as the controls conferred to us through these contractual arrangements enacted, we consider, through Beijing Huanju Shidai, we exercise effective control over Guangzhou Huaduo and Beijing Tuda, receive substantially all of their economic benefits and residual returns, and absorb substantially all the risks and expected losses from these two companies as if we were their sole shareholder. We also have an exclusive option to purchase all of the equity interests in each of Beijing Tuda and Guangzhou Huaduo when and if PRC law permits so and also the exclusive right to require any nominee shareholder of Beijing Tuda or Guangzhou Huaduo to transfer its interest in them to any person designated by us. For a detailed description of these contractual arrangements, see "Item 7. Major Shareholders and Related Party Transactions—B. Related Party—Contractual Arrangements with Beijing Tuda." Based on our evaluation, we consider each of Beijing Tuda and Guangzhou Huaduo to be our VIE. Beijing Huanju Shidai, our wholly owned subsidiary in China, is the primary beneficiary of our VIEs; therefore, we consolidate the results of Beijing Tuda and Guangzhou Huaduo in our consolidated financial statements under U.S. GAAP.

As advised by our PRC counsel, Fangda Partners, the contractual arrangements among Beijing Huanju Shidai and Beijing Tuda and its shareholders and the contractual arrangements among Beijing Huanju Shidai and Guangzhou

Huaduo and its shareholders, governed by PRC law, are valid, binding and enforceable, and do not violate PRC laws currently in effect. However, as advised by our PRC legal counsel, because of the substantial uncertainties involved, if such contracts are held to be unenforceable, or if there are changes in PRC laws and regulations that affect our ability to control Beijing Tuda and Guangzhou Huaduo, we may be precluded from consolidating these companies in the future. See "Item 3. Key Information—D. Risk Factors—Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of draft PRC Foreign Investment Law and how it may impact the viability of our current corporate structure, corporate governance and business operations."

#### Share-based compensation

We awarded a number of share-based compensation to our employees and non-employees (such as consultants), which include share options, restricted shares and restricted share units granted to employees and non-employees, share-based awards granted to our chief executive officer and chairman and share-based awards granted in relation to our acquisition of NeoTasks Inc. The details of these share-based awards and the respective terms and conditions are described in "Share-based compensation" in Note 23 to our audited consolidated financial statements for the years ended December 31, 2012, 2013 and 2014, which are included elsewhere in this annual report on Form 20-F.

## Share options

Options were initially accounted for as equity-classified awards because there are no explicit repurchase rights specified in the award documents and the number of shares of our common shares issued under these awards are fixed and determined at the time of grants. All options to employees and non-employees are measured based on the grant date fair value of the award and recognized as compensation expense based on the graded-vesting method, net of estimated forfeitures, over the requisite service period, with a corresponding impact reflected in additional paid-in capital. The options to non-employees are re-measured at each reporting date using the fair value as at each period end. The compensation expense is recognized using the graded-vesting method. Upon the completion of the initial public offering, the share options granted to a non-employee were remeasured at the stock price of our common share. All share options granted to the non-employee were exercised in 2013.

## Restricted shares

Restricted shares issued to our employees are measured based on the grant date fair value of the award and recognized as compensation expense based on the graded-vesting method, net of estimated forfeitures, over the requisite service period, with a corresponding impact reflected in additional paid-in capital. The fair value of restricted shares was based on the fair value of our underlying common shares on the grant date.

We account for restricted shares issued to non-employees are measured at fair value at the date the services are completed. These awards are re-measured at each reporting date using the fair value as at each period end until the measurement date. The compensation expenses is recognized using the graded vesting method.

We are required to estimate forfeiture at the time of grant and revise those estimated in subsequent periods if actual forfeitures differ from those estimates. Historical data was used to estimate pre-vesting forfeitures and record share-based compensation expenses only for those awards that we expect to vest.

The following table sets forth certain information regarding the restricted shares granted to our employees and non-employees at different dates.

Grant Date	Restricted Shares Granted	Fair Value Per Common Share as of the Grant Date (US\$)	Type/Methodology of Valuation
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January 1, 2010	23,686,542	0.1590	Retrospective/ GTM <sup>(1)</sup>
February 1, 2010	4,257,335	0.1875	Retrospective/ GTM <sup>(1)</sup>
April 1, 2010	2,000,000	0.2721	Retrospective/ GTM <sup>(1)</sup>
July 1, 2010	20,060,000	0.4666	Retrospective/ GTM <sup>(1)</sup>
October 1, 2010	500,000	0.6988	Retrospective/ GTM <sup>(1)</sup>
January 1, 2011	10,846,800	0.9362	Retrospective/ Backsolve <sup>(2)</sup>

(1) GTM denotes the guideline transaction method under the market approach based on the enterprise value to revenue multiples of our own equity transactions close to the valuation date.

(2) Backsolve denotes the back solve method under the market approach based on our own equity transactions as of the valuation date.

#### Restricted share units

Restricted share units issued to our employees are measured based on the grant date fair value of the award and recognized as compensation expense based on the graded-vesting method, net of estimated forfeitures, over the requisite service period, with a corresponding impact reflected in additional paid-in capital. The fair value of restricted shares was based on the fair value of our underlying common shares on the grant date.

We are required to estimate forfeiture at the time of grant and to revise those estimates in subsequent periods if actual forfeitures differ with those estimates. Historical data was used to estimate pre-vesting forfeitures and record share-based compensation expenses only for those awards that we expect to vest.

The following table sets forth certain information regarding the restricted share units granted to our employees in 2012, 2013 and 2014 with share and per share information.

Grant Date	Restricted Shares Granted	Fair Value Per Common Share as of the Grant Date (US\$)	Type/Methodology of Valuation
January 1, 2012	1,668,000	1.0869	Contemporaneous/ DCF <sup>(1)</sup>
March 31, 2012	6,597,921	1.1153	Contemporaneous/ DCF <sup>(1)</sup>
July 15, 2012	533,000	1.1284	Contemporaneous/ DCF <sup>(1)</sup>
September 1, 2012	6,151,300	1.1146	Contemporaneous/ DCF <sup>(1)</sup>
September 30, 2012	650,000	1.1437	Contemporaneous/ DCF <sup>(1)</sup>
November 7, 2012	195,000	0.5250	Contemporaneous/ Stock price <sup>(2)</sup>
November 21, 2012	2,500,000	0.5250	Contemporaneous/ Stock price <sup>(2)</sup>
March 31, 2013	1,009,000	0.8450	Contemporaneous/ Stock price <sup>(2)</sup>
April 18, 2013	43,489	0.7855	Contemporaneous/ Stock price <sup>(2)</sup>
April 30, 2013	26,943,500	0.8720	Contemporaneous/ Stock price <sup>(2)</sup>
May 23, 2013	120,000	1.2065	Contemporaneous/ Stock price <sup>(2)</sup>
July 19, 2013	1,802,000	1.8090	Contemporaneous/ Stock price <sup>(2)</sup>
October 1, 2013	50,000	2.4045	Contemporaneous/ Stock price <sup>(2)</sup>
November 1, 2013	48,000	2.4875	Contemporaneous/ Stock price <sup>(2)</sup>
February 1, 2014	330,000	3.1230	Contemporaneous/Stock price <sup>(2)</sup>
April 1, 2014	660,000	4.0920	Contemporaneous/Stock price <sup>(2)</sup>
April 30, 2014	220,000	2.8680	Contemporaneous/Stock price <sup>(2)</sup>
May 1, 2014	800,000	3.0110	Contemporaneous/Stock price <sup>(2)</sup>
June 16, 2014	292,500	3.5035	Contemporaneous/Stock price <sup>(2)</sup>
June 20, 2014	6,009,695	3.5560	Contemporaneous/Stock price <sup>(2)</sup>
October 30, 2014	1,600,400	3.9525	Contemporaneous/Stock price <sup>(2)</sup>

DCF denotes the discounted cash flow method under the income approach which explicitly recognizes that the business enterprise value as of the valuation date is developed by discounting future net cash flow to the present value at a rate that reflects both the current return requirements of the market and the risks inherent in the specific investment.

Upon the completion of the initial public offering, the fair values of restricted share units are based on stock price of our company on grant dates. The fair values of restricted share units granted on November 7, 2012 are based on initial public offering price as the grant date is close to the initial public offering date.

Share-based awards granted to chief executive officer and chairman

On February 23, 2010, Mr. David Xueling Li and Mr. Jun Lei, our co-founder, chairman and director, were granted 13,369,813 and 29,678,483 restricted shares, which vested immediately and over a four-year period (50% after the second anniversary and 25% each year thereafter), respectively. These restricted shares are subject to a performance condition which relates to the number of peak concurrent users on YY Client. Such performance condition was met as of December 31, 2010.

We recognized these awards as employee share-based compensation Awards using fair value of the awards on the grant date. The compensation expense for the restricted shares held by Mr. David Xueling Li was fully recognized and the compensation expense for the restricted shares held by Mr. Jun Lei was recognized over the requisite service period using the graded vesting method. Upon the completion of the initial public offering, defined as an "Accelerated Event", the restricted shares granted to the Chairman was fully vested and all remaining compensation expenses were recognized immediately.

The fair value of the share-based awards above was determined at the respective grant dates by us with the assistance of an independent valuation company.

#### Acquisition

We apply the purchase method of accounting to account for our acquisitions. We determine the acquisition date based on the date at which all required licenses are transferred to us and we obtained control of the acquiree.

Purchase consideration generally consists of cash, contingent consideration and equity securities. In estimating the fair value of equity compensation, we consider both income and market approach and selected the methodology that is most indicative of our fair value in an orderly transaction between market participants as of the measurement date. Under the market approach, we utilize publicly-traded comparable company information to determine the revenue and earnings multiples that are used to value our equity securities. Under the income approach, we determine the fair value of our equity securities based on the estimated future cash flow discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk and the rate of return an outside investor would expect to earn. We base the cash flow projections on forecasted cash flows derived from the most recent annual financial forecast using a terminal value based on the perpetuity growth model.

In estimating the fair value of the contingent consideration recognized on the acquisition date, we consider the trinomial tree model. Under this model, we perform a scenario analysis and calculate the fair value of the contingent consideration based on the net present value of the total contingent payments under each scenario and the expected probability of each scenario.

The identifiable assets acquired and liabilities and contingent liabilities assumed in a business acquisition are measured initially at the fair value at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable net assets acquired is recorded as goodwill.

We are responsible for determining the fair value of the equity issued, assets acquired, liabilities assumed and intangibles identified as of the relevant acquisition date. Post-acquisition expenses are charged to general and administrative expenses directly.

#### Goodwill

Goodwill represents the amount by which the cost of acquired net assets in a business acquisition exceeds the fair value of the net identifiable assets on the date of purchase. Goodwill is carried at cost less accumulated impairment losses. Goodwill is allocated to the reporting units that are expected to benefit from the business combination in which the goodwill arises for the purpose of impairment testing. If the carrying value of the reporting unit exceeds its fair value, an impairment loss is recorded to the extent that the carrying value of goodwill exceeds its fair value. We have determined that the reporting units for testing goodwill impairment are the operating segments that constitute a business for which discrete financial information is available and for which management regularly reviews the operating results. We currently have one reporting unit.

Estimating fair value is performed by utilizing various valuation techniques, with the primary technique being the discounted cash flow method. There are inherent limitations in any estimation technique and a minor change in the assumption could result in a significant change in its estimate of fair value, thereby increasing or decreasing the amounts of our consolidated assets, shareholders' equity and net income or loss.

We perform an impairment test on October 1 of each year or whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable.

#### Intangible assets

Intangible assets that are acquired in business acquisitions are recognized apart from goodwill if the intangible assets arise from contractual or other legal rights, or are separately identifiable if the intangible assets do not arise from contractual or other legal rights.

The costs of determinable-lived intangible assets are amortized to expense over their estimated life and stated at cost (fair value at acquisition) less accumulated amortization. The value of indefinite-lived intangible assets is not amortized, but tested for impairment annually on October 1 of each year, or whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. We reassess indefinite-lived intangible assets at each reporting period to determine whether events or circumstances continue to support an indefinite useful life.

#### Impairment of investment, long-lived assets and intangible assets

The carrying amounts of investment, long-lived assets and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is evaluated by a comparison of the carrying amount of assets to future undiscounted net cash flows expected to be generated by the assets. Such assets are considered to be impaired if the sum of the expected undiscounted cash flow is less than carrying amount of the assets. The impairment to be recognized is measured by the amount by which the carrying amounts of the assets exceed the fair value of the assets. RMB0.6 million of impairment of intangible assets was recognized for the year ended December 31, 2012, RMB0.9 million of impairment of an investment was recognized for the year ended December 31, 2013 and RMB4.0 million (US\$0.6 million) of impairment of an investment and RMB5.7 million (US\$0.9 million) of impairment of intangible assets were recognized for the year ended December 31, 2014.

## Taxation and uncertain tax positions

Current income tax is provided on the basis of income for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes. In accordance with the regulations of the relevant tax jurisdictions, deferred income taxes are accounted for using the liability approach which requires the recognition of income taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our financial statements or tax returns. Deferred income taxes are determined based on the differences between the financial reporting and tax basis of assets and liabilities and are measured using the currently enacted tax rates and laws. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of operations in the period that includes the enactment date.

We currently have deferred tax assets resulting from net operating loss carryforwards and deductible temporary differences, all of which are available to reduce future tax payable in our significant tax jurisdictions. The largest component of our deferred assets are the temporary differences generated by our PRC subsidiary and VIE due to recognition of the deferred revenue. In assessing whether such deferred tax assets can be realized in the future, we need to make judgments and estimates on the ability of each of our PRC subsidiary and VIE to generate taxable income in the future years. To the extent that we believe it is more likely than not that some portion or the entire amount of deferred tax assets will not be realized, we established a total valuation allowance to offset the deferred tax assets. As of December 31, 2012, 2013 and 2014, a total valuation allowance of RMB4.2 million, RMB22.2 million and RMB24.4 million (US\$3.9 million), respectively, was recognized against deferred tax assets. If we subsequently determine that all or a portion of the temporary differences are more like than not to be realized, the valuation allowance will be released, which will result in a tax benefit in our consolidated statements of operations.

We adopted the guidance on accounting for uncertainty in income taxes on January 1, 2008. The guidance prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Guidance was also provided on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. Significant judgment is required in evaluating our uncertain tax positions and determining the relevant provision for income taxes. The adjustment to the opening balance of retained earnings as of January 1, 2008 as a result of the implementation of the guidance was zero. The interest and penalties associated with tax positions for the years ended December 31, 2012, 2013 and 2014 was zero. As of December 31, 2012, 2013 and 2014, we had no significant unrecognized uncertain tax positions.

## Foreign currency

We use Renminbi as our reporting currency. The functional currency of our company, incorporated in the Cayman Islands, and our subsidiaries incorporated in the British Virgin Islands and Hong Kong is U.S. dollars, while the functional currency of the other entities is Renminbi. In the consolidated financial statements, the financial information of our company and our subsidiaries which use U.S. dollars as their functional currency have been translated into Renminbi. Assets and liabilities are translated at the exchange rates on the balance sheet date, equity amounts are translated at historical exchange rates, and revenues, expenses, gains and losses are translated using the average rate for the year. Translation adjustments arising from these are reported as other comprehensive income or loss in the statements of operations and comprehensive loss.

Foreign currency transactions denominated in currencies other than functional currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are re-measured at the applicable rates of exchange in effect at that date. Foreign exchange gains and losses resulting from the settlement of such transactions and from re-measurement at year-end are recognized in foreign currency exchange gains (losses), net in the consolidated statements of operations and comprehensive income (loss).

### ***Convertible Bonds***

In accordance with ASC subtopic 470-20, the convertible debts are initially carried at the principal amount of the convertible debts. Related debts issuance cost, are subsequently amortized using effective interest method as adjustments to interest expense from the debt issuance date to its first put date. Convertible debts are classified as a current liability if they are or will be callable by us or puttable by the debt holders within one year from the balance sheet date, even though liquidation may not be expected within that period.

## Results of Operations

The following table sets forth a summary of our consolidated results of operations for the years indicated. Our business has grown rapidly since our inception, and our limited operating history makes it difficult to predict future operating results. We believe that period-to-period comparisons of results of operations should not be relied upon as indicative of future performance.

	For the Year Ended December 31,						
	2012		2013		2014		
	RMB	% of total net revenues	RMB	% of total net revenues	RMB	US\$	% of total net revenues
Total net revenues <sup>(1)</sup>	820,031	100.0	1,823,468	100.0	3,678,368	592,845	100.0
IVAS:							
Online music and entertainment	286,446	34.9	852,885	46.8	2,109,503	339,990	57.3
Online games	332,287	40.5	602,111	33.0	811,699	130,822	22.1
Others	83,655	10.2	205,212	11.2	609,823	98,286	16.6
Online advertising	117,643	14.3	163,260	9.0	147,343	23,747	4.0
Cost of revenues	(416,133)	(50.7)	(881,999)	(48.4)	(1,849,149)	(298,029)	(50.3)
Gross profit	403,898	49.3	941,469	51.6	1,829,219	294,816	49.7
Operating expenses							
Research and development expenses	(176,725)	(21.6)	(267,005)	(14.6)	(431,188)	(69,495)	(11.7)
Sales and marketing expenses	(16,954)	(2.1)	(24,955)	(1.4)	(102,527)	(16,524)	(2.8)
General and administrative expenses	(109,788)	(13.4)	(200,554)	(11.0)	(223,019)	(35,944)	(6.1)
Total operating expenses	(303,467)	(37.0)	(492,514)	(27.0)	(756,734)	(121,963)	(20.6)
Other income	2,465	0.3	27,078	1.5	6,319	1,018	0.2
Operating income	102,896	12.5	476,033	26.1	1,078,804	173,871	29.3
Other non-operating income	—	—	—	—	36,714	5,917	1.0
Gain on disposal of an equity investment	651	0.1	—	—	999	161	0.0
Gain on disposal of a cost investment	2,351	0.3	—	—	—	—	—
Foreign currency exchange (losses) gains, net	(4,153)	(0.5)	29,555	1.6	(10,399)	(1,676)	(0.3)
Interest expense	—	—	—	—	(56,607)	(9,123)	(1.5)
Interest income	16,316	2.0	60,221	3.3	164,969	26,588	4.5
Income before income tax expenses	118,061	14.4	565,809	31.0	1,214,480	195,738	33.0
Income tax expenses	(29,041)	(3.5)	(89,951)	(4.9)	(154,283)	(24,866)	(4.2)
Income before share of income in equity method investments, net of income taxes	89,020	10.9	475,858	26.1	1,060,197	170,872	28.8



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Share of income in equity method investment, net of income taxes	157	0.0	1,869	0.1	4,275	689	0.1
Net income attributable to YY Inc.	89,177	10.9	477,727	26.2	1,064,472	171,561	28.9

(1) Net of rebates and discounts.

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

**Net Revenues.** Our net revenues increased by 101.7% from RMB1,823.5 million in 2013 to RMB3,678.4 million (US\$592.8 million) in 2014. This increase was primarily due to the increased contribution of revenues from online music and entertainment and increases in our online game revenues as well as other sources including our online dating, live game broadcasting and membership program, partially offset by a decrease in our online advertising revenues.

**IVAS revenues.** Our IVAS revenues, which consisted of revenues from online music and entertainment, online games as well as other sources, increased by 112.7% from RMB1,660.2 million in 2013 to RMB3,531.0 million (US\$569.1 million) in 2014. The overall increase primarily reflected an increase in the number of paying users and, to a lesser extent, an increase in ARPU. Our number of paying users increased from approximately 3.2 million in 2013 to 4.9 million in 2014. Our ARPU for IVAS increased from RMB525.2 in 2013 to RMB726.0 (US\$117.0) in 2014. The increase in paying users and ARPU were primarily due to (a) our ability to offer new and attractive products and services that allow us to monetize our platform; (b) our ability to attract and retain a large and engaged user base through hosting an increasing number of events and activities; and (c) our ability to attract third party game developers, third party licensee operators, service providers and certain popular performers and channel owners.

Revenues from online music and entertainment increased by 147.3% from RMB852.9 million for 2013 to RMB2,109.5 million (US\$340.0 million) for 2014. In addition to the increase in the number of paying users and ARPU, the increase in revenues from online music and entertainment was also due to the increasing popularity of online music and entertainment. Our paying users for online music and entertainment increased from approximately 1,748,000 for 2013 to 2,964,000 for 2014. The increasing popularity of online music and entertainment is primarily due to the increased number of activities we hosted.

Revenues from online games increased by 34.8% from RMB602.1 million in 2013 to RMB811.7 million (US\$130.8 million) in 2014. This increase was primarily attributable to an increase in the attractiveness of our online game platform and the popularity of the online games we offer. Our paying users for online games increased from approximately 1,308,000 for 2013 to 1,558,000 for 2014. The number of online games we operated as of December 31, 2013 was 126 as compared to 210 as of December 31, 2014.

Other IVAS revenues, which primarily consisted of revenues from online dating, live game broadcasting and membership subscription fees, increased by 197.2% from RMB205.2 million in 2013 to RMB609.8 million (US\$98.3 million) in 2014. This increase was primarily due to an increase in the number of users who subscribed to our membership program and an increase in the popularity of online dating and live game broadcasting.

*Online advertising revenues.* Our online advertising revenues decreased by 9.7% from RMB163.3 million in 2013 to RMB147.3 million (US\$23.7 million) in 2014. This decrease was primarily due to the ending of our contractual agreements with NetEase.

**Cost of Revenues.** Our cost of revenues increased by 109.7% from RMB882.0 million in 2013 to RMB 1,849.1 million (US\$ 298.0 million) in 2014. The increase in our cost of revenues was due in large part to an increase in our revenue sharing fees and content costs, which consist of the payments to performers, channel owners and content providers, which amounted to RMB1,134.0 million (US\$182.8 million) in 2014, representing a 155.4% increase from RMB444.1 million in 2013. This increase in revenue sharing fees and content costs was primarily due to higher levels of user engagement and spending as well as an increasing number of emerging new business lines in different categories. Bandwidth costs increased 70.2% from RMB203.2 million in 2013 to RMB345.9 million (US\$55.8 million) in 2014 to support our growing business operations. In addition, salary and welfare costs increased 49.0% from RMB88.5 million in 2013 to RMB131.8 million (US\$21.2 million) in 2014, mainly due to our hiring of additional employees to serve our rapidly expanding user base.

**Operating Expenses.** Our operating expenses increased by 53.6% from RMB492.5 million in 2013 to RMB756.7 million (US\$122.0 million) in 2014, primarily due to an increase in sales and marketing expenses as well as research and development expenses, which was associated with the expansion of our market shares, continuing growth of our business operations, our commitment to research and development and the advancements in our technology development.

*Research and development expenses.* Our research and development expenses increased by 61.5% from RMB267.0 million in 2013 to RMB431.2 million (US\$69.5 million) in 2014. This increase was primarily due to an increase in the number of our research and development staff, especially engineers, which accounts for approximately 56.1% of our total number of employees in 2014.

*Sales and marketing expenses.* Our sales and marketing expenses increased by 310.8% from RMB25.0 million in 2013 to RMB102.5 million (US\$16.5 million) in 2014. This increase was primarily due to an increase in our spending on marketing and promotional activities we hosted and an increase in salaries and other benefits for our sales and marketing personnel, which was in turn mainly driven by an increase in the number of our sales and marketing personnel.

*General and administrative expenses.* Our general and administrative expenses increased by 11.2% from RMB200.6 million in 2013 to RMB223.0 million (US\$35.9 million) in 2014. This increase was associated with the general growth of our business, partially offset by an increase in operating leverage associated with the our overall business expansion.

*Foreign Currency Exchange Gains (Losses).* We had net foreign currency exchange losses of RMB10.4 million (US\$1.7 million) in 2014, compared to a net foreign currency exchange gains of RMB29.6 million in 2013. Such losses were primarily caused by the fact that in 2014, we re-converted a portion of the proceeds from our initial public offering from Renminbi back into U.S. dollars, and U.S. dollar appreciated against RMB in 2014; bank charges incurred in relation to such conversion also contributed to our loss. Our initial public offering proceeds were initially denominated in U.S. dollars before we converted them into Renminbi in the fourth quarter of 2012.

**Interest Income.** Our interest income increased from RMB60.2 million in 2013 to RMB165.0 million (US\$26.6 million) in 2014. This increase was primarily due to higher levels of cash on hand and short-term deposits, partly as a result of depositing cash generated from our operations, and the proceeds from our issuance of convertible senior notes in March 2014.

**Income Tax Expenses.** We recorded income tax expenses of RMB154.3 million (US\$24.9 million) in 2014 compared to RMB90.0 million in 2013. This increase was primarily due to the higher income before income tax expenses recorded by certain of our PRC subsidiaries and consolidated affiliated entities.

**Net Income.** As a result of the foregoing, we had a net income of RMB1,064.5 million (US\$171.6 million) in 2014 as compared to a net income of RMB477.7 million in 2013.

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

**Net Revenues.** Our net revenues increased by 122.4% from RMB820.0 million in 2012 to RMB1,823.5 million (US\$301.2 million) in 2013. This increase was primarily due to the increased contribution of revenues from online music and entertainment and increases in our online game revenues as well as other sources including our membership program and live game broadcasting, and to a lesser extent, an increase in our online advertising revenues.

**IVAS revenues.** Our IVAS revenues, which consisted of revenues from online music and entertainment, online games as well as other sources, increased by 136.4% from RMB702.4 million in 2012 to RMB1,660.2 million (US\$274.2 million) in 2013. The overall increase primarily reflected an increase in the number of paying users and, to a lesser extent, an increase in ARPU. Our number of paying users increased from approximately 2.4 million in 2012 to 3.2 million in 2013. Our ARPU for IVAS increased from RMB296.5 in 2012 to RMB525.2 (US\$86.8) in 2013. The increase in paying users and ARPU were primarily due to (a) our ability to offer new and attractive products and services that allow us to monetize our platform; (b) our ability to attract and retain a large and engaged user base through hosting an increasing number of events and activities; and (c) our ability to attract third party game developers, service providers and certain popular performers and channel owners.

Revenues from online music and entertainment increased by 197.7% from RMB286.4 million for 2012 to RMB852.9 million (US\$140.9 million) for 2013. In addition to the increase in the number of paying users and ARPU, the increase in revenues from online music and entertainment was also due to the increasing popularity of online music and entertainment. Our paying users for online music and entertainment increased from approximately 845,000 for 2012 to 1,748,000 for 2013. The increasing popularity of online music and entertainment is primarily due to the increased number of activities we hosted.

Revenues from online games increased by 81.2% from RMB332.3 million in 2012 to RMB602.1 million (US\$99.5 million) in 2013. This increase was primarily attributable to an increase in the attractiveness of our online game platform and the popularity of the online games we offer. Our paying users for online games increased from approximately 966,000 for 2012 to 1,308,000 for 2013. The number of online games we operated as of December 31, 2012 was 73 as compared to 126 as of December 31, 2013.

Other IVAS revenues, which primarily consisted of revenues from membership subscription fees and live game broadcasting, increased by 145.3% from RMB83.7 million in 2012 to RMB205.2 million (US\$33.9 million) in 2013. This increase was primarily due to an increase in the number of users who subscribed to our membership program and an increase in the popularity of live game broadcasting.

*Online advertising revenues.* Our online advertising revenues increased by 38.8% from RMB117.6 million in 2012 to RMB163.3 million (US\$27.0 million) in 2013. This increase was primarily due to the increasing popularity of Duowan.com and YY Client.

**Cost of Revenues.** Our cost of revenues increased by 112.0% from RMB416.1 million in 2012 to RMB882.0 million (US\$145.7 million) in 2013. The increase in our cost of revenues was due in large part to an increase in our revenue sharing fees and content costs, which consist of the payments to performers, channel owners and content providers, which amounted to RMB444.1 million (US\$73.4 million) in 2013, representing a 306.4% increase from RMB109.3 million in 2012. This increase in revenue sharing fees and content costs was primarily due to higher levels of user engagement and spending. We also incurred a non-recurring cost in 2013 due to our partnership with Hunan Satellite Television Station in the *2013 Happy Boy Show*. Bandwidth costs increased 40.1% from RMB145.0 million in 2012 to RMB203.2 million (US\$33.6 million) in 2013 to support our growing business operations. In addition, salary and welfare costs increased 76.9% from RMB50.0 million in 2012 to RMB88.5 million (US\$14.6 million) in 2013, mainly due to our hiring of additional employees to serve our rapidly expanding user base.

**Operating Expenses.** Our operating expenses increased by 62.3% from RMB303.5 million in 2012 to RMB492.5 million (US\$81.4 million) in 2013, primarily due to an increase in general and administrative expenses as well as research and development expenses, which was associated with the general growth of our business operations, our commitment to research and development and the advancements in our technology development.

**Research and development expenses.** Our research and development expenses increased by 51.1% from RMB176.7 million in 2012 to RMB267.0 million (US\$44.1 million) in 2013. This increase was primarily due to an increase in salaries and other benefits for research and development personnel, which was in turn mainly driven by an increase in the number of our research and development staff, especially engineers, which accounts for approximately 53.9% of our total number of employees in 2013.

**Sales and marketing expenses.** Our sales and marketing expenses increased by 47.2% from RMB17.0 million in 2012 to RMB25.0 million (US\$4.1 million) in 2013. This increase was primarily due to an increase in salaries and other benefits for sales and marketing personnel and an increase in our spending on promotional activities we hosted.

**General and administrative expenses.** Our general and administrative expenses increased by 82.7% from RMB109.8 million in 2012 to RMB200.6 million (US\$33.1 million) in 2013. This increase was primarily due to an increase in salaries and other benefits for general and administrative personnel, which was in turn mainly driven by an increase in the number of our general and administrative staff. In addition, share-based compensation allocated to general and administrative expenses increased from RMB55.6 million in 2012 to RMB66.3 million (US\$11.0 million) in 2013.

**Foreign Currency Exchange Gains (Losses).** We had net foreign currency exchange gains of RMB29.6 million (US\$4.9 million) in 2013, compared to a net foreign currency exchange losses of RMB4.2 million in 2012. This increase was primarily due to the fact that the proceeds from our initial public offering were converted from U.S. dollars into Renminbi in the fourth quarter of 2012 and Renminbi appreciated against U.S. dollars in 2013.

**Interest Income.** Our interest income increased from RMB16.3 million in 2012 to RMB60.2 million (US\$9.9 million) in 2013. This increase was primarily due to higher levels of cash on hand and short-term deposits, partly as a result of depositing cash generated from our operations, and a portion of the proceeds from our initial public offering in November 2012.

**Income Tax Expenses.** We recorded income tax expenses of RMB29.0 million in 2012 compared to RMB90.0 million (US\$14.9 million) in 2013. This increase was primarily due to the higher income before income tax expenses recorded by certain of our PRC subsidiaries and consolidated affiliated entities.

**Net Income.** As a result of the foregoing, we had a net income of RMB477.7 million (US\$78.9 million) in 2013 as compared to a net income of RMB89.2 million in 2012.

#### Inflation

Since our inception, inflation in China has not materially impacted our results of operations. According to the National Bureau of Statistics of China, the change of consumer price index in China was 2.6%, 2.6% and 2.0% in 2012, 2013 and 2014, respectively. Although we have not in the past been materially affected by inflation since our inception, we can provide no assurance that we will not be affected in the future by higher rates of inflation in China.

## Recently Issued Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board, or FASB, issued ASU No. 2014-08, "*Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*", or the ASU 2014-08. The new guidance changes the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Additionally, ASU 2014-08 requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. ASU 2014-08 is effective for us in the first quarter of fiscal 2015. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We are in the process of evaluating the impact of the standard on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*", or the ASU 2014-09. ASU 2014-09 will eliminate transaction-specific and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principle-based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. The ASU also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. Entities can transition to the standard either retrospectively or as a cumulative effect adjustment as of the date of adoption. We are in the process of evaluating the impact of the standard on our consolidated financial statements.

In June 2014, under ASC 718, Compensation — Stock Compensation, the FASB issued "*Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period.*" These amendments apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target could be achieved and still be eligible to vest in the award if and when the performance target is achieved. For all entities, the amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. We are in the process of evaluating the impact of the standard on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" ("ASU 2014-15"). Pursuant to ASU 2014-15, in connection with preparing financial statements for each annual and interim reporting



period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We are in the process of evaluating the impact of the standard on our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, "*Consolidation (Topic 810): Amendments to the Consolidation Analysis*", or the ASU 2015-02. ASU 2015-02 focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The ASU simplifies consolidation accounting by reducing the number of consolidation models from four to two. In addition, the new standard simplifies the FASB Accounting Standards Codification and improves current guidance by: (i) placing more emphasis on risk of loss when determining a controlling financial interest; (ii) reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a VIE; and (iii) changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The ASU will be effective for periods beginning after December 15, 2015, for public companies. For private companies and not-for-profit organizations, the ASU will be effective for annual periods beginning after December 15, 2016; and for interim periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. We are in the process of evaluating the impact of the standard on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest - Imputation of Interest (Subtopic 835-30)” (“ASU 2015-03”). To simplify presentation of debt issuance costs, ASU 2015-03 requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs would not be affected by the amendments in ASU 2015-03. For public business entities, ASU 2015-03 will be effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. We are in the process of evaluating the impact of the standard on our consolidated financial statements.

## B. Liquidity and Capital Resources

### Cash Flows and Working Capital

In recent years, we have financed our operations primarily through cash flows from operations, the proceeds from our initial public offering in November 2012 and the proceeds from our convertible senior notes offering in March 2014. We expect to require cash to fund our ongoing operational needs, particularly our revenue sharing fees and content costs, salaries and benefits, bandwidth costs and potential acquisitions or strategic investments. We believe that our current cash and cash equivalents and the anticipated cash flow from operations will be sufficient to meet our anticipated working capital requirements and capital expenditures needs for the next 12 months. However, we may require additional cash resources due to changing business conditions or other future developments, including any investments or acquisitions we may decide to selectively pursue. If our existing cash resources are insufficient to meet our requirements, we may seek to sell equity or equity-linked securities, debt securities or borrow from banks.

In March 2014, we issued an aggregate of US\$400.0 million 2.25% convertible senior notes due in 2019. The net proceeds from the sale of the notes were US\$390.8 million and will be used for general corporate purposes. As of December 31, 2014, the total carrying value of these notes were US\$400.0 million. The notes bear interest at a rate of 2.25% per year, payable semiannually in arrears on April 1 and October 1 of each year, and such notes will mature on April 1, 2019 unless earlier converted, redeemed for certain tax-related events or repurchased in accordance with their terms. We are not subject to any financial covenants or other significant restrictions under the notes. We duly paid an interest of US\$4.7 million on these convertible senior notes on October 1, 2014 as such interest became due.

As of December 31, 2012, 2013 and 2014, we had RMB504.7 million, RMB729.6 million and RMB475.0 million (US\$76.6 million), respectively, in cash and cash equivalents.

As of December 31, 2014, our subsidiaries, VIEs, and VIE’s subsidiaries located in the PRC held cash and cash equivalents in the amount of RMB387.0 million (US\$62.4 million). We would need to accrue and pay withholding taxes if we were to distribute funds from our subsidiaries in the PRC to our offshore subsidiaries. We do not intend to

repatriate such funds in the foreseeable future, as we plan to use existing cash balance in the PRC for general corporate purposes.

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

	For the Year Ended December 31,			US\$
	2012	2013	2014	
	RMB	RMB	RMB	
	(in thousands)			
Net cash provided by operating activities	356,852	891,173	1,301,351	209,740
Net cash used in investing activities	(498,504)	(659,603)	(3,954,055)	(637,278)
Net cash provided by (used in) financing activities	522,740	(5,687 )	2,402,762	387,255
Net increase (decrease) in cash and cash equivalents	381,088	225,883	(249,942 )	(40,283 )
Cash and cash equivalents at the beginning of the year period	128,891	504,702	729,598	117,590
Effect of exchange rates change on cash and cash equivalents	(5,277 )	(987 )	(4,628 )	(746 )
Cash and cash equivalents at the end of the year period	504,702	729,598	475,028	76,561

## Operating Activities

Net cash used in or generated from operating activities consists primarily of our net loss or income mitigated by non-cash adjustments, such as share-based compensation, depreciation of property and equipment and deferred taxes, and adjusted by changes in operating assets and liabilities, such as accounts receivable and accrued liabilities, prepayments and other assets, account payables and deferred revenue.

Net cash provided by operating activities amounted to RMB1,301.4 million (US\$209.7 million) for the year ended December 31, 2014, primarily resulting from RMB3,988.2 million (US\$642.8 million) of cash revenues we received from the sale of IVAS and advertisements, partially offset by our sales-related cash outflow of RMB1,533.6 million (US\$247.2 million), which mainly consisted of the amounts due to third party game developers under revenue sharing arrangements, distributions under arrangements with certain performers and channel owners, payment collection costs and business taxes, our employee salaries and welfare payments of RMB651.5 million (US\$105.0 million), our payments for the lease of bandwidth of RMB327.2 million (US\$52.7 million) and our general operating costs of RMB174.5 million (US\$28.1 million).

Net cash provided by operating activities amounted to RMB891.2 million for the year ended December 31, 2013, primarily resulting from RMB2,225.4 million of cash revenues we received from the sale of IVAS and advertisements, partially offset by our sales-related cash outflow of RMB665.1 million, which mainly consisted of the amounts due to third party game developers under revenue sharing arrangements, distributions under arrangements with certain performers and channel owners, payment collection costs and business taxes, our employee salaries and welfare payments of RMB317.6 million, our payments for the lease of bandwidth of RMB197.5 million and our general operating costs of RMB154.0 million.

Net cash provided by operating activities amounted to RMB356.9 million for the year ended December 31, 2012, primarily resulting from RMB996.4 million of cash revenues we received from the sale of IVAS and advertisements, partially offset by our employee salaries and welfare payment of RMB244.3 million, our sales-related cash outflow of RMB169.7 million, which mainly consisted of the amounts due to third party game developers under revenue sharing arrangements, distributions under arrangements with certain popular performers and channel owners on our online music and entertainment, payment collection costs and business taxes, our payments for the lease of bandwidth of RMB135.4 million and our general operating costs of RMB90.1 million.

## Investing Activities

Net cash used in investing activities largely reflects placements of short-term deposits, purchases of property and equipment and other non-current assets in connection with the expansion and upgrade of our technology

infrastructure, and our acquisitions of and investments in certain companies.

Net cash used in investing activities amounted to RMB3,954.1 million (US\$637.3 million) in the year ended December 31, 2014. Net cash used in investing activities primarily resulted from the placement of short-term deposits of RMB5,343.9 million (US\$861.3 million), payments of an aggregate RMB 510.3 million (US\$82.3 million) for other non-current assets, mainly consisting of prepayments for certain floors of an office building, payments of RMB178.5 million (US\$28.8 million) for the purchase of property and equipment, which mainly consisted of the purchase of servers, and cash paid for certain acquisitions and strategic investments of RMB259.4 million (US\$41.8 million), partially offset by the maturity of short-term deposits in various banks in the amount of RMB2,550.1 million (US\$411.0 million).

Net cash used in investing activities amounted to RMB659.6 million in the year ended December 31, 2013. Net cash used in investing activities primarily resulted from the placement of short-term deposits of RMB1,529.1 million, payments of RMB55.6 million for the purchase of property and equipment, which mainly consisted of the purchase of servers, and cash paid for certain strategic investments of RMB58.1 million, partially offset by the maturity of short-term deposits in various banks in the amount of RMB996.0 million.

Net cash used in investing activities amounted to RMB498.5 million in the year ended December 31, 2012. Net cash used in investing activities primarily resulted from the placement of short-term deposits of RMB1,040.3 million, consideration of RMB11.7 million paid in connection with an acquisition, and payments of RMB60.9 million for the purchase of property and equipment, which mainly consisted of the purchase of servers to serve our expanded user base and, to a lesser extent, the purchase of office furniture and other office set-up related costs, partially offset by the maturity of term deposits in various banks in the amount of RMB615.3 million.

## Financing Activities

Net cash provided by financing activities was RMB2,402.8 million (US\$387.2 million) in 2014, primarily attributable to the net proceeds of RMB2,402.6 million (US\$387.2) million from the issuance of 2.25% convertible senior note due 2019, issued in March 2014.

Net cash used in financing activities was RMB5.7 million in 2013, primarily attributable to a portion of the listing expenses of RMB5.8 million.

Net cash provided by financing activities was RMB522.7 million in 2012, primarily attributable to the proceeds of RMB550.6 million from our initial public offering in November 2012, partially offset by a portion of the listing expenses of RMB 27.8 million.

## Capital Expenditures

We made capital expenditures of RMB79.4 million, RMB72.2 million and RMB744.7 million (US\$120.0 million) in 2012, 2013 and 2014, respectively. Our capital expenditures are primarily used to purchase office space, computers, servers, office furniture, operating rights for licensed games, software, domain names and other assets. To support increased headcounts associated with our continuing expansion, we entered into an agreement on August 7, 2014 to purchase certain floors of an office building in Guangzhou, China for a total consideration of RMB479.2 million. We expect to incur additional capital expenditures in 2015 for the refurbishment of the abovementioned office space.

## C. Research and Development, Patents and Licenses, Etc.

In order to support the kind of multi-user, real-time online voice and video communications on a scale necessary for our platform, we build and develop our own network infrastructure. See "Item 4. Information on the Company—B. Business Overview—Research and Development" for a description of the research and development aspect of our business and "Item 4. Information on the Company—B. Business Overview—Intellectual Property" for a description of the protection of our intellectual property.

Research and development expenses consist primarily of salaries and benefits for research and development personnel and rental and depreciation of office premises and servers utilized by the research and development personnel.

Research and development expenses greatly increased in the past three years ended December 31, 2014, due to the need for additional research and development personnel to accommodate the rapid growth of our business. We expect our research and development expenses in absolute amount to increase as we intend to retain existing research and development personnel and also hire new ones to, among other things, develop new series of applications for our platform, improve technology infrastructure to further enhance user experience, and further develop enhanced features for Mobile YY to reach more users. We incurred RMB176.7 million, RMB267.0 million and RMB431.2 million (US\$69.5 million) of research and development expenses in 2012, 2013 and 2014, respectively.

#### D. Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events since the beginning of our fiscal year 2014 that are reasonably likely to have a material effect on our net revenues, income from operations, profitability, liquidity or capital resources, or that would cause the disclosed financial information to be not necessarily indicative of future operating results or financial condition.

#### E. Off-Balance Sheet Arrangements

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholders' (deficit)/equity, or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

F. Tabular Disclosure of Contractual Obligations

The following table sets forth our contractual obligations as of December 31, 2014:

	Payment Due by Period				
	Total	Less than 1 year	1-2 years	3-5 years	More than 5 years
Operating lease obligations <sup>(1)</sup>					
(in RMB)	40,230	29,413	8,315	2,502	-
Long-term borrowing <sup>(2)</sup>					
(in US\$)	440,500	9,000	9,000	422,500	-

(1) Operating lease obligations refer to the lease of offices under operating lease agreements, where a significant portion of the risks and rewards of ownership are retained by the lessor. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the period of the lease, including any free lease periods.

(2) Long-term borrowing includes principle and interests that are derived from our 2.25% convertible senior notes due 2019, presuming that no conversion and repurchase would occur.

Our operating lease obligations increased from December 31, 2013 to December 31, 2014 primarily because we entered into some new leases in 2014.

Other than the obligations set forth above, we did not have any other long-term debt obligations, operating lease obligations, purchase obligations or other long-term liabilities as of December 31, 2014.

G. Safe Harbor

See "Forward Looking Statements" on page 2 of this annual report.



## 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 the date of this annual report. There are no family relationships among any of the directors or executive officers of our company.

Directors and Executive Officers	Age	Position/Title
Jun Lei	46	Chairman of the Board and Director
David Xueling Li	41	Chief Executive Officer and Director
Qin Liu	43	Director
Jenny Hong Wei Lee	43	Independent Director
Peter Andrew Schloss	55	Independent Director
Peng T. Ong	52	Independent Director
Richard Weidong Ji	48	Independent Director
David Tang	61	Independent Director
Rongjie Dong	39	Executive Vice President
Jin Cao	43	Executive Vice President
Eric He	55	Chief Financial Officer

*Mr. Jun Lei* is our co-founder and has been our chairman since our inception. Mr. Lei is a co-founder and the chairman of Kingsoft Corporation Limited, a China-based software and online games company listed on the Stock Exchange of Hong Kong, and served as its chief executive officer from October 1998 to December 2007. Mr. Lei is the chairman of Cheetah Mobile Inc., which was listed on Nasdaq in May, 2014. In 2010, Mr. Lei co-founded and has since then served as the chairman of Xiaomi Corporation, a smartphone and mobile internet company in China. From April 2000 to March 2005, Mr. Lei co-founded and served as chairman of Joyo.com which, during his tenure, was sold to Amazon, becoming Amazon China. Since November 2003, Mr. Lei has served on the board of directors of Wuhan University. In addition, Mr. Lei is active in private investments and currently serves as a director or advisor in several privately held companies that he founded or invested in. Mr. Lei received his bachelor's degree in computer science from Wuhan University in 1991.

*Mr. David Xueling Li* is our co-founder and has been our chief executive officer since our inception. Mr. Li is primarily responsible for our overall management, major decision-making and strategic planning, including research and development. Before founding our company, Mr. Li worked at Netease.com, Inc. from July 2003 to April 2005 and served as its chief editor. In 2000, Mr. Li founded CFP.cn, a website that provided a copyright trading platform for journalists and amateur photographers. Mr. Li received a bachelor's degree in philosophy from Renmin University of China in 1997.

*Mr. Qin Liu* has been a director of our company since June 2008. Mr. Liu has been a director of Morningside China TMT Fund I, L.P. since its formation in 2008, where he is primarily responsible for managing early-stage investments in the internet, wireless, media, entertainment and consumer services sectors in China. He also serves as a director in several non-public portfolio companies of the fund. From 2000 through 2008, Mr. Liu worked at Morningside IT Management Services (Shanghai) Co., Ltd. and established its print media business and served as publisher of *The Bund*, an upscale lifestyle weekly publication. Mr. Liu received a master's degree in business administration, or MBA, from China Europe International Business School in 1999 and a bachelor's degree in electrical engineering from Beijing Science & Technology University in 1993.

*Ms. Jenny Hong Wei Lee* has served as our director since December 2009. Ms. Lee is currently a director of Pactera Technology International Ltd., a leading China-based provider of outsourced information technology and research and development services, which was formerly listed on the NASDAQ Global Select Market and subsequently privatized in 2014. She is also a director and a member of the audit committee of 21Vianet Group, Inc., a leading China-based carrier-neutral Internet data center services provider, which is listed on the NASDAQ Global Select Market. In addition, Ms. Lee serves as a managing director of Granite Global Ventures III L.L.C., which is a general partner of Granite Global Ventures III L.P. and GGV III Entrepreneurs Fund L.P. From 2002 to 2005, Ms. Lee served as a vice president of JAFCO Asia. Ms. Lee received her bachelor's degree in electrical engineering in 1994 and master's degree in engineering in 1995 from Cornell University. Ms. Lee also has an MBA degree from Kellogg School of Management at Northwestern University in 2001.

*Mr. Peter Andrew Schloss* has served as our independent director since November 20, 2012. Mr. Schloss is a partner at Phoenix Media Fund L.P., a private equity fund established by Phoenix Television Group, a company listed on the Stock Exchange of Hong Kong, to invest in media and culture-related companies in China. Mr. Schloss has been serving as an independent director and the audit committee chairman of Giant Interactive Group Inc., an NYSE-listed company, since 2007. From 2008 to 2012, Mr. Schloss served as the chief executive officer of Allied Pacific Sports Network Limited, a leading internet and wireless provider of live and on-demand sports programs in Asia. Prior to joining Allied Pacific Sports Network Limited, Mr. Schloss worked at TOM Online Inc., serving as the chief financial officer from 2003 to 2005, as an executive director from 2004 to 2007 and as the chief legal officer from 2005 to 2007. Mr. Schloss received a bachelor's degree in political science and a juris doctor degree from Tulane University.

*Mr. Peng T. Ong* has served as our independent director since November 20, 2012. Mr. Ong is a managing director of Monk's Hill Ventures. Prior to founding Monk's Hill Ventures, he was a partner at GSR Ventures. Mr. Ong is a director of the Media Development Authority of Singapore. In addition, he is a trustee of the Singapore University of

Technology and Design and sits on the strategic advisory board of the Chancellor of the University of Illinois. Mr. Ong was an independent director of Singapore Telecommunications Limited through July 2013 and chairs SingTel's group enterprise advisory committee. He was an independent director of the National Research Foundation of Singapore from 2009 to 2013. He served as chairman of Infocomm Investments Pte Ltd, a venture capital fund in Singapore, from 2006 to 2013. Mr. Ong founded Interwoven Inc. (acquired by Autonomy Corporation plc., now part of Hewlett-Packard) and served as its president and chief executive officer from 1995 to 1997 and its chairman from 1995 to 2002. Mr. Ong also founded Ecentuate Inc. which became the foundation of the IBM Singapore Software Lab after being acquired by IBM. In addition, Mr. Ong co-founded Match.com (now part of IAC/InterActiveCorp) and served in various engineering and management positions at Illustra Information Technologies, Inc. (now Informix Corporation, part of IBM), Sybase Inc. (now SAP America, Inc.) and Gensym Corporation. Mr. Ong Peng received a bachelor's degree in electrical engineering from University of Texas at Austin and a master's degree in computer science from University of Illinois at Urbana-Champaign.

*Mr. Richard Weidong Ji* has served as our independent director since May 2013. Mr. Ji is the cofounder and managing partner of All-Stars Investment Limited, which focuses on investing in Internet technology leaders and consumer brands that help enhance the lives of Chinese consumers. From 2005 to 2012, Mr. Ji served as managing director and head of Asia-Pacific Internet/media investment research at Morgan Stanley Asia Limited. During his time with Morgan Stanley, Mr. Ji was consistently rated as one of the top internet analysts covering the Chinese internet according to the Institutional Investor and Greenwich Associates' annual surveys. Over Mr. Ji's career, he has received many awards from reputable publications and research groups including the Financial Times, South China Morning Post, Asiamoney, Absolute Return & Alpha magazine and iResearch Consulting Group. Mr. Ji holds a doctor of sciences degree in biological science from Harvard University, an MBA from the Wharton School of Business at the University of Pennsylvania and a Bachelor of Science from Fudan University in China. He also serves as an independent director of 58.com.

*Mr. David Tang* has served as our independent director since May 2013. Mr. Tang currently serves as a managing director of Nokia Growth Partners, a global venture capital firm that specializes in investing in mobile technologies and mobile businesses. From 2011 to 2012, Mr. Tang was the vice president of the European Union Chamber of Commerce in China, vice chairman of the China Association of Enterprises with Foreign Investments, and vice chairman of the Beijing International Chamber of Commerce. Mr. Tang has spent nearly a decade with the Nokia group, having served as the vice chairman of Nokia (China) Investment Co., Ltd. and chairman of Nokia Telecommunications Ltd. where he was responsible for government relations, strategic partnerships, corporate development, and sustainability. Prior to serving in those roles, he was the vice chairman and vice president of sales for Nokia in the greater China region from 2005 to 2009. Mr. Tang has also held executive positions in other leading global technology firms such as Apple, AMD, 3Com, DEC, and AST. Mr. Tang received his bachelor's degree in Computer Science and Engineering from California State University at Long Beach and a master's degree in Business from California State University at Fullerton.

*Mr. Rongjie Dong* has been the president of the technology department of Guangzhou Huaduo since October 2006 and is currently our executive vice president. Prior to joining us, he served as product manager and head of the technology department of 163.com from 2000 to 2006. Mr. Dong received his bachelor's degree in computer hardware from Beijing Information Engineering Institute (now known as Beijing Information Science and Technology University) in 1999.

*Mr. Jin Cao* has been the vice president of Guangzhou Duowan since 2008 and is currently our executive vice president. From June 2005 to October 2008, he served as the president of NeoTasks Inc. From January 2000 to February 2006, he served as the chief representative of FATWIRE Corp. From August 1995 to August 1997, he was a senior programmer for the China Aviation and Space Authority (CASA). He founded niba.com, an online video streaming company, in 2006. Mr. Cao received a bachelor's degree in industrial engineering from Tianjin University in 1995 and a master's degree in industrial engineering from University of Cincinnati in 1999.

*Mr. Eric He* has been our chief financial officer since August 2011. He currently also serves as an independent director of MOL Global, Inc. (NASDAQ: MOLG) and 51job (Nasdaq: JOBS). Prior to joining us, Mr. He served as

the chief financial officer of Giant Interactive Group, Inc., an NYSE-listed company, from March 2007 to August 2011. He served as the chief strategy officer of Ninetowns Internet Technology Group from 2004 to 2007. From 2002 to 2004, he served as a private equity investment director for AIG Global Investment Corp (Asia) Ltd. Mr. He received a bachelor's degree in accounting from National Taipei University and an MBA degree from the Wharton School of Business at the University of Pennsylvania. Mr. He is a Certified Public Accountant and Chartered Financial Analyst in the United States.

#### B. Compensation of Directors and Executive Officers

For the fiscal year ended December 31, 2014, we paid an aggregate of RMB10.3 million (US\$1.7 million) in cash, including salaries and bonuses, to our directors and executive officers. For details on the share incentive grants to our directors and officers, see "—Share Incentive Plans." For the fiscal year ended December 31, 2014, we made contributions for our directors and executive officers for their pension insurance, medical insurance, housing fund, unemployment and other statutory benefits as required by PRC laws in an aggregate amount of RMB0.3 million (US\$0.1 million). We did not set aside or accrue any other pension or retirement benefits for our directors and executive officers for the fiscal year ended December 31, 2014.

#### Employment Agreements

We have entered into employment agreements with our senior executive officers. We may terminate a senior executive officer's employment for cause at any time without remuneration for certain acts of the officer, such as being convicted of any criminal conduct, any act of gross or willful misconduct or any serious, willful, grossly negligent or persistent breach of any employment agreement provision, or engaging in any conduct which may make the continued employment of such officer detrimental to our company. We may also terminate a senior executive officer's employment by giving three months' prior written notice. A senior executive officer may terminate his or her employment at any time by giving three months' written notice, provided that such notice may only be given by the officer any time after the third anniversary of his or her employment.

Each senior executive officer has agreed to hold all information, know-how and records in any way connected with the business of our company, including, without limitation, all formulae, designs, specifications, drawings, data, operations and testing procedures, manuals and instructions and all customer and supplier lists, sales information, business plans and forecasts and all technical or other expertise and all computer software of our company, in strict confidence during and after his or her employment. Each officer also agrees that we shall own all the intellectual property developed by such officer during his or her employment.

#### Share Incentive Plans

We have adopted two share incentive plans, namely, the 2009 Scheme and the 2011 Plan. The purpose of these two share incentive plans is to attract and retain personnel by linking the personal interests of the members of the board, officers, employees and consultants to the success of our business and by providing such individuals with an incentive for outstanding performance. As of March 31, 2015, options to purchase 3,510,745 common shares, 20,184,033 restricted shares and 47,023,736 restricted share units were outstanding under the 2009 Scheme and the 2011 Plan.

#### 2009 Employee Equity Incentive Scheme

We adopted the 2009 Scheme in December 2009. In September 2011, YY Inc. assumed all the rights and obligations of Duowan Entertainment Corp. under all share-based compensation previously issued by Duowan Entertainment Corp., including under the relevant award agreement and under the 2009 Scheme, if applicable, and undertook to issue its own common shares upon the exercise of any share-based compensation awards previously issued by Duowan Entertainment Corp., subject to compliance with the terms and conditions of the relevant award agreements and the 2009 Scheme, if applicable.

Under the 2009 Scheme, the maximum number of shares in respect of which options or restricted shares may be granted is 120,020,001.

The following paragraphs summarize the terms of the 2009 Scheme.

***Types of Awards.*** The following briefly describe the principal features of the various awards that may be granted under the 2009 Scheme.

**Options.** Options provide for the right to purchase a specified number of our common shares at a specified price and usually will become exercisable at the discretion of our plan administrator in one or more installments after the grant date. The option exercise price may be paid, subject to the discretion of the plan administrator, in cash or check, in our common shares which have been held by the option holder for such period of time as may be required to avoid adverse accounting consequences, in other property with value equal to the exercise price, through a broker-assisted cashless exercise, or by any combination of the foregoing.

**Restricted Shares.** A restricted share award is the grant of our common shares which are subject to certain restrictions and may be subject to risk of forfeiture. Unless otherwise determined by our plan administrator, a restricted share is nontransferable and may be forfeited or repurchased by us upon termination of employment or service during a restricted period. Our plan administrator may also impose other restrictions on the restricted shares, such as limitations on the right to vote or the right to receive dividends.

**Plan Administration.** Our board or a committee of one or more members of our board duly authorized for the purpose of the 2009 Scheme can act as the plan administrator.

**Award Agreement.** Options or restricted shares granted under the 2009 Scheme are evidenced by an award agreement that sets forth the terms, conditions and limitations for each grant.

**Option Exercise Price.** The exercise price in respect of any option shall be fixed by reference to the date upon which the option (or the relevant part thereof) is granted, and shall be, at the election of the plan administrator, (a) the latest valuation price per share certified by a third party valuer prior to the date of grant of the relevant option (or relevant part thereof) or (b) the latest price per share at which we have issued any shares prior to the date of grant of the relevant option (or relevant part thereof).

**Eligibility.** We may grant awards to our employees, officers and directors or consultants to our members.

**Term of the Awards.** The 2009 Scheme shall be valid and effective for a period of ten years from the date of effectiveness. The term of each option or restricted share grant shall be ten years from the date of the grant.

**Vesting Schedule.** In general, the plan administrator determines the vesting schedule, which is set forth in the award agreement.

**Transfer Restrictions.** Awards for options or restricted shares may not be transferred in any manner by the award holders and may be exercised only by such holders, subject to limited exceptions. Restricted shares may not be transferred during the period of restriction.

**Termination.** The plan administrator may at any time terminate the operation of the 2009 Scheme.

Prior to the adoption of the 2009 Scheme, we granted certain share options to our employees pursuant to certain share option agreements which carried substantially the same terms and conditions with those stipulated in the 2009 Scheme.

#### 2011 Share Incentive Plan

We adopted the 2011 Plan in September 2011.

Under the 2011 Plan, the maximum number of common shares reserved for issuance under the plan is 43,000,000, plus an annual increase of 20,000,000 on the first day of each fiscal year, beginning in 2013, or such smaller number of common shares as determined by our board of directors.

The following paragraphs summarize the terms of the 2011 Plan.



**Types of Awards.** The following briefly describe the principal features of the various awards that may be granted under the 2011 Plan.

**Options.** Options provide for the right to purchase a specified number of our common shares at a specified price and usually will become exercisable at the discretion of our plan administrator in one or more installments after the grant date. The option exercise price may be paid, subject to the discretion of the plan administrator, in cash or check, in our common shares which have been held by the option holder for such period of time as may be required to avoid adverse accounting consequences, in other property with value equal to the exercise price, through a broker-assisted cashless exercise, or by any combination of the foregoing.

**Restricted Shares.** A restricted share award is the grant of our common shares which are subject to certain restrictions and may be subject to risk of forfeiture. Unless otherwise determined by our plan administrator, a restricted share is nontransferable and may be forfeited or repurchased by us upon termination of employment or service during a restricted period. Our plan administrator may also impose other restrictions on the restricted shares, such as limitations on the right to vote or the right to receive dividends.

**Restricted Share Units.** A restricted share unit award is the grant of the right to receive a common share at a future date and may be subject to forfeiture. Our plan administrator has the discretion to set performance objectives or other vesting criteria that will determine the number or value of restricted share units to be granted. Unless otherwise determined by our plan administrator, a restricted share unit is nontransferable and may be forfeited or repurchased by us upon termination of employment or service during a restricted period. Our plan administrator, at the time of grant, specifies the dates on which the restricted share units become fully vested.

**Plan Administration.** Our board or a committee of one or more members of our board duly authorized for the purpose of the 2011 Plan can act as the plan administrator.

**Award Agreement.** Options, restricted shares or restricted shares units granted under the 2011 Plan are evidenced by an award agreement that sets forth the terms, conditions and limitations for each grant.

**Option Exercise Price.** The exercise price in respect of any option shall be determined by the plan administrator and set forth in the award agreement which may be a fixed or variable price related to the fair market value of the shares. The exercise price per share subject to an option may be amended or adjusted in the absolute discretion of the plan administrator, the determination of which shall be final, binding and conclusive.

**Eligibility.** We may grant awards to our employees, consultants or directors.

**Term of the Awards.** The 2011 Plan shall be valid and effective for a period of ten years from the date of effectiveness. The term of each option grant shall not exceed ten years from the date of the grant.

**Vesting Schedule.** In general, the plan administrator determines the vesting schedule, which is set forth in the award agreement.

**Transfer Restrictions.** Awards for options, restricted shares or restricted share units may not be transferred in any manner by the award holders and may be exercised only by such holders, subject to limited exceptions. Restricted shares may not be transferred during the period of restriction.

**Termination.** The plan administrator may at any time terminate the operation of the 2011 Plan.

The following table summarizes, as of March 31, 2015, the outstanding options granted to our executive officers, directors and other individuals as a group.

	Common Shares Underlying Options Awarded	Exercise Price (US\$/Share)	Date of Grant	Date of Expiration
Rongjie Dong	*	0.004898	January 1, 2008	December 31, 2016
	*	0.005510	January 1, 2008	December 31, 2017
	*	0.006735	January 1, 2009	December 31, 2018
Other Individuals as a Group	10	—	January 1, 2008	December 31, 2015
	634,051	0.005510	January 1, 2008	December 31, 2017
	2,596,714	0.006735	January 1, 2009	December 31, 2018
Total	3,510,745			

\* The aggregate number of common shares underlying the outstanding options held by this individual is less than 1% of our total outstanding shares.

The following table summarizes, as of March 31, 2015, the outstanding restricted shares granted to our executive officers, directors and other individuals as a group.

Name	Restricted Shares Granted	Date of Grant
Jin Cao	*	February 1, 2010
Rongjie Dong	*	January 1, 2010
Other Individuals as a Group	9,331,238	January 1, 2010
	638,601	February 1, 2010
	5,303,940	July 1, 2010
	250,000	October 1, 2010
	4,234,520	January 1, 2011
Total	20,184,033	

\* The aggregate number of common shares underlying the outstanding restricted shares held by each of these individuals is less than 1% of our total outstanding shares.

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The following table summarizes, as of March 31, 2015, the outstanding restricted share units granted to our executive officers, directors and other individuals as a group.

Name	Common Shares Underlying Restricted Share Units Granted	Date of Grant
David Xueling Li	*	April 30, 2013
	*	June 20, 2014
Jenny Hong Wei Lee	*	November 7, 2012
	*	June 16, 2014
Peter Andrew Schloss	*	November 7, 2012
	*	June 16, 2014
Peng T. Ong	*	November 7, 2012
	*	June 16, 2014
Richard Weidong Ji	*	May 23, 2013
	*	June 16, 2014
David Tang	*	May 23, 2013
	*	June 16, 2014
Eric He	*	September 16, 2011
	*	November 21, 2012
	*	April 30, 2013
Jin Cao	*	April 30, 2013
	*	July 19, 2013
Rongjie Dong	*	April 30, 2013
	*	July 19, 2013
	*	June 20, 2014
Other Individuals as a Group	2,381,820	September 16, 2011
	511,140	January 1, 2012
	2,697,389	March 31, 2012
	283,320	July 15, 2012
	4,938,510	September 1, 2012
	30,780	September 30, 2012
	514,220	March 31, 2013
	13,249	April 18, 2013
	15,019,920	April 30, 2013
	1,164,340	July 19, 2013
	19,420	October 1, 2013
	40,000	November 1, 2013
	228,940	February 1, 2014
	480,000	April 1, 2014
	150,000	April 30, 2014
	800,000	May 1, 2014
	35,000	June 16, 2014
4,981,588	June 20, 2014	
1,135,400	October 30, 2014	
960,000	March 16, 2015	
Total	47,023,736	

\*The aggregate number of common shares underlying the outstanding restricted share units, or RSUs, held by each of these individuals is less than 1% of our total outstanding shares.

### C. Board Practices

Our board of directors currently consists of eight directors. A director is not required to hold any shares in our company to qualify to serve as a director. A director may vote with respect to any contract, proposed contract, or arrangement in which he or she is materially interested. A director may exercise all the powers of the company to borrow money, mortgage its business, property and uncalled capital, and issue debentures or other securities whenever money is borrowed or as security for any obligation of the company or of any third party. See "Item 6. Directors, Senior Management and Employees—B. Compensation of Directors and Executive Officers" for a description of the employment agreements we have entered into with our senior executive officers.

#### Committees of the Board of Directors

We have established an audit committee, a compensation committee and a corporate governance and nominating committee under the board of directors. We have adopted a charter for each of the three committees. Each committee's members and functions are described below.

**Audit Committee.** Our audit committee consists of Mr. Peter Andrew Schloss, Mr. Peng T. Ong and Mr. Richard Weidong Ji, and is chaired by Mr. Schloss. We have determined that each of Mr. Schloss, Mr. Ong and Mr. Ji satisfies the "independence" requirements of Rule 5605(c)(2) of the Listing Rules of the Nasdaq Global Market and meet the independence standards under Rule 10A-3 under the Securities Exchange Act of 1934, as amended. We have determined that Mr. Schloss qualifies as an "audit committee financial expert." The audit committee oversees our accounting and financial reporting processes and the audits of the financial statements of our company. The audit committee is responsible for, among other things:

· selecting the independent registered public accounting firm and pre-approving all auditing and non-auditing services permitted to be performed by the independent registered public accounting firm;

· reviewing with the independent registered public accounting firm any audit problems or difficulties and management's response;

· reviewing and approving all proposed related party transactions, as defined in Item 404 of Regulation S-K under the Securities Act;

· discussing the annual audited financial statements with management and the 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 any material control deficiencies;

· annually reviewing and reassessing the adequacy of our audit committee charter;

· meeting separately and periodically with management and the independent registered public accounting firm; and

· reporting regularly to the board.

**Compensation Committee.** Our compensation committee consists of Mr. Jun Lei, Ms. Jenny Hong Wei Lee and Mr. David Tang, and is chaired by Mr. Lei. We have determined that each of Ms. Lee and Mr. Tang satisfies the "independence" requirements of Rule 5605(c)(2) of the Listing Rules of the Nasdaq Global Market. The compensation committee assists the board in reviewing and approving the compensation structure, including all forms of compensation, relating to our directors and executive officers. Our directors may not be present at any committee meeting during which their compensation is deliberated upon. The compensation committee is responsible for, among other things:

reviewing the total compensation package for our executive officers and making recommendations to the board with respect to it;

approving and overseeing the total compensation package for our executives other than the three most senior executives;

- reviewing the compensation of our directors and making recommendations to the board with respect to it;

periodically reviewing and approving any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, and employee pension and welfare benefit plans; and

selecting compensation consultant, legal counsel or other adviser only after taking into consideration all factors relevant to that person's independence from management.

***Corporate Governance and Nominating Committee.*** Our nominating committee consists of Mr. Peng T. Ong, Mr. Qin Liu and Mr. Peter Andrew Schloss, and is chaired by Mr. Ong. We have determined that each of Mr. Ong and Mr. Schloss satisfies the "independence" requirements of Rule 5605(c)(2) of the Listing Rules of the Nasdaq Global Market. The nominating committee assists the board in selecting individuals qualified to become our directors and in determining the composition of the board and its committees. The nominating committee is responsible for, among other things:

recommending nominees to the board for election or re-election to the board, or for appointment to fill any vacancy on the board;

reviewing annually with the board the current composition of the board with regards to characteristics such as independence, age, skills, experience and availability of service to us;

selecting and recommending to the board the names of directors to serve as members of the audit committee and the compensation committee, as well as of the nominating committee itself; and

monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

#### Duties of Directors

Under Cayman Islands law, our directors have a common law duty of loyalty to act honestly 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.

#### Terms of Directors and Officers

Our officers are elected by and serve at the discretion of the board. Our directors are not subject to a term of office and hold office until such time as they are removed from office by special resolution of all shareholders. A director will be removed from office automatically if, among other things, the director (1) becomes bankrupt or makes any arrangement or composition with his creditors; or (2) dies or is found by our company to be of unsound mind.

#### D. Employees

The following table sets forth the numbers of our employees, categorized by function, as of December 31, 2014:

Functions	Number of Employees
Management	23



Customer services and operations	825
Engineering and maintenance	122
Research and development	1,620
Sales and marketing	127
General and administration	172
Total	2,889

We had a total of 1,298, 1,751 and 2,889 employees as of December 31, 2012, 2013 and 2014, respectively.

We have developed a corporate culture that encourages initiative, technical superiority and self-development. In addition, we periodically evaluate our employees' performance and provide them with training sessions tailored to each job function to enhance performance and service quality.

As required by regulations in China, we participate in various employee social security plans that are organized by municipal and provincial governments, including pension, unemployment insurance, childbirth insurance, work-related injury insurance, medical insurance and housing insurance. We are required under PRC law to make contributions to employee benefit plans at specified percentages of the salaries, bonuses and certain allowances of our employees, up to a maximum amount specified by the local government from time to time. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes.

E. Share Ownership

Class A Common Shares

As of March 31, 2015, we had 649,420,408 Class A common shares outstanding. In addition, as of March 31, 2015, we have granted, and have outstanding, options to purchase a total of 3,510,745 Class A common shares, 20,184,033 restricted shares and 47,023,736 restricted share units to our directors, executive officers, other employees and consultants. For information regarding the Share Incentive Plans, see "Item 6.B. Compensation of Directors and Executive Officers."

Class B Common Shares

As of March 31, 2015, we had 427,352,696 Class B common shares outstanding.

Beneficial Ownership

The following table sets forth information concerning the beneficial ownership of our common shares as of March 31, 2015, by:

· each of our directors and executive officers; and

· each person known to us to beneficially own more than 5% of our common shares.

Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, we have included shares that the person has the right to acquire or that would become unrestricted shares within 60 days after March 31, 2015, the most recent practicable date, including through the exercise of any option, warrant, or other right or the conversion of any other security. These shares, however, are not included in the computation of the percentage ownership of any other person.

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The calculations in the table below assume that there were 649,420,408 Class A common shares outstanding and 427,352,696 Class B common shares as of March 31, 2015.

	Class A Common Shares Beneficially Owned(1)		Class B Common Shares Beneficially Owned(2)		Total Common Shares Beneficially Owned		Total Voting Power(5)
	Number	%	Number	%	Number(3)	%(4)	%
Directors and Executive Officers:*							
Jun Lei <sup>(6)</sup>	-	-	192,741,483	45.1	192,741,483	17.9	39.2
David Xueling Li <sup>(7)</sup>	17,052,875	2.6	175,241,483	41.0	192,294,358	17.8	35.9
Qin Liu <sup>(8)</sup>	40,164,320	6.2	-	-	40,164,320	3.7	0.8
Jenny Hong Wei Lee <sup>(9)</sup>	19,122,920	2.9	40,833,340	9.6	59,956,260	5.6	8.7
Peter Andrew Schloss	**	**	**	**	**	**	**
Peng T. Ong	**	**	**	**	**	**	**
Richard Weidong Ji	**	**	**	**	**	**	**
David Tang	**	**	**	**	**	**	**
Rongjie Dong <sup>(10)</sup>	10,119,985	1.6	1,575,000	0.4	11,694,985	1.1	0.5
Jin Cao	**	**	**	**	**	**	**
Eric He	**	**	**	**	**	**	**
All directors and executive officers as a group	99,029,080	15.2	410,868,516	96.2	509,897,596	47.2	85.4
Principal Shareholders:							
Top Brand Holdings Limited <sup>(11)</sup>	-	-	192,741,483	45.1	192,741,483	17.9	39.2
YYME Limited <sup>(12)</sup>	16,000,000	2.5	175,241,483	41.0	191,241,483	17.8	35.9
Granite Global Ventures <sup>(13)</sup>	19,052,920	2.9	40,833,340	9.6	59,886,260	5.6	8.7

Notes:

Except for Mr. Jun Lei, Mr. Qin Liu, Ms. Jenny Hong Wei Lee, Mr. Peter Andrew Schloss, Mr. Peng T. Ong, \*Mr. Richard Weidong Ji, Mr. David Tang and Mr. Rongjie Dong, the business address of our directors and executive officers is c/o Building 3-08, Yangcheng Creative Industry Zone, No. 309 Huangpu Avenue Middle, Tianhe District, Guangzhou, 510655, PRC.

\*\* The aggregate number of common shares beneficially owned by each of these individuals is less than 1% of our total outstanding shares.

For each person and group included in this column, percentage ownership is calculated by dividing the number of Class A common shares beneficially owned by such person or group, including shares that such person or group (1) has the right to acquire within 60 days of March 31, 2015, by the sum of (i) 649,420,408, which is the total number of Class A common shares outstanding as of March 31, 2015, and (ii) the number of Class A common shares that such person or group has the right to acquire within 60 days of March 31, 2015.

For each person and group included in this column, percentage ownership is calculated by dividing the number of  
(2) Class B common shares beneficially owned by such person or group by 427,352,696, being the total number of Class B common shares outstanding as of March 31, 2015.

(3) Represents the sum of Class A and Class B common shares beneficially owned by such person or group.

For each person and group included in this column, percentage ownership is calculated by dividing the number of  
(4) total common shares beneficially owned by such person or group, by the sum of the number of common shares outstanding and the number of common shares such person or group has the right to acquire upon exercise of the stock options or warrants within 60 days after March 31, 2015.

(5) For each person or group included in this column, the percentage of total voting power represents voting power based on both Class A and Class B common shares held by such person or group with respect to all of our outstanding Class A and Class B common shares as one class. Each holder of Class A common shares is entitled to one vote per share. Each holder of our Class B common shares is entitled to ten votes per share on all matters requiring a shareholders' vote. Our Class B common shares are convertible at any time by the holder into Class A common shares on a one-for-one basis, whereas Class A common shares are not convertible into Class B common shares under any circumstances.

Representing 192,741,483 Class B common shares held by Top Brand Holdings Limited, a BVI company wholly  
(6) owned and controlled by Mr. Jun Lei. The business address of Mr. Lei is Juanshitiandi Tower A, 12th Floor, Chaoyang District, Beijing 100102, PRC.

Representing (i) 16,000,000 Class A common shares represented by ADSs, (ii) 175,241,483 Class B common  
(7) shares held by YYME Limited, a BVI company wholly owned and controlled by Mr. David Xueling Li and (iii) 1,052,875 Class A common shares underlying the options and restricted shares granted to Mr. David Xueling Li that are to be vested in 60 days.

Representing 40,164,320 Class A common shares represented by ADSs held by Morningside China TMT Fund  
(8) I, L.P. Mr. Qin Liu is a director of our company appointed by Morningside China TMT Fund I, L.P. The business address of Mr. Liu is No. 5, Lane 249, Anfu Road, Shanghai 200031, PRC.

Representing (i) 18,748,060 Class A common shares represented by ADSs and 40,179,740 Class B common shares  
(9) held by Granite Global Ventures III L.P., (ii) 304,860 Class A common shares represented by ADSs and 653,600 Class B common shares held by GGV III Entrepreneurs Fund L.P. and (iii) 70,000 restricted share units granted to Ms. Jenny Hong Wei Lee that have been fully vested and to be vested within 60 days. The business address of Ms. Lee is Unit 3501-3504, Two IFC, 8 Century Avenue, Pudong District, Shanghai 200120, PRC.

(10) Representing (i) 9,730,740 Class A common shares represented by ADSs held by Green Leaf Global Limited,  
(ii) 1,575,000 Class B common shares held by Green Leaf Global Limited and (iii) 389,245 Class A common

shares underlying the options and restricted shares granted to Mr. Rongjie Dong that have been fully vested and to be vested within 60 days. The business address of Mr. Dong is 4th floor, Youhua Business Center, Yingbin North Road, Xiangzhou District, Zhuhai 519080, PRC.

(11) Representing 192,741,483 Class B common shares held by Top Brand Holdings Limited, a BVI company wholly owned and controlled by Mr. Jun Lei. The business address of Top Brand Holdings Limited is c/o Jun Lei, Juanshitiandi Tower A, 12th Floor, Chaoyang District, Beijing 100102, PRC.

(12) Representing (i) 16,000,000 Class A common shares represented by ADSs and (ii) 175,241,483 Class B common shares held by YYME Limited, a BVI company wholly owned and controlled by Mr. David Xueling Li. The business address of YYME Limited is c/o David Xueling Li, Building 3-08, Yangcheng Creative Industry Zone, No. 309 Huangpu Avenue Middle, Tianhe District, Guangzhou, 510655, PRC.

(13) Representing (i) 18,748,060 Class A common shares represented by ADSs and 40,179,740 Class B common shares held by Granite Global Ventures III L.P. and (ii) 304,860 Class A common shares represented by ADSs and 653,600 Class B common shares held by GGV III Entrepreneurs Fund L.P. Each of Granite Global Ventures III L.P. and GGV III Entrepreneurs Fund L.P. is controlled by Granite Global Ventures L.L.C., its sole general partner. Scott B. Bonham, Hany M. Nada, Thomas K. Ng, Jixun Foo, Glenn Solomon, Jenny Hong Wei Lee, Fumin Zhuo and Jessie Jin are managing directors of Granite Global Ventures III L.L.C. and are deemed to share the voting and investment power over such shares held by Granite Global Ventures L.L.C. The business address of each of Granite Global Ventures III L.P. and GGV III Entrepreneurs Fund L.P. is 2494 Sand Hill Road, Suite 100, Menlo Park, CA 94025, USA.

As of March 31, 2015, 1,076,773,104 of our common shares were issued and outstanding, including 427,352,696 Class B common shares and 649,420,408 Class A common shares. Based on a review of the register of members maintained by our Cayman Islands corporate administrator, we believe that as of March 31, 2015, 40,833,340 Class B common shares and 649,420,408 Class A common shares (excluding shares being held in reserve by our depository for the exercise/vesting of the share incentive awards we issue) representing approximately 64.1% of our total outstanding shares were held by three record holders in the United States; all of the 649,420,408 Class A common shares were held of record by Deutsche Bank Trust Company Americas, the depository of our ADS program. The number of beneficial owners of our ADSs in the United States is likely to be much larger than the number of record holders of our common shares in the United States. None of our existing shareholders have different voting rights from other shareholders in the same class. See "Item 6. Directors, Senior Management and Employees—B. Compensation of Directors and Executive Officers—Employee Agreements" for a description of the employment agreements we have entered into with our senior executive officers.

Our common shares are divided into Class A common shares and Class B common shares. Holders of Class A common shares are entitled to one vote per share, while holders of Class B common shares are entitled to ten votes per share.

We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

Please refer to "Item 6. Directors, Senior Management and Employees—E. Share Ownership."

B. Related Party Transactions

Contractual Arrangements

The PRC government extensively regulates foreign ownership of, and the licensing and permit requirements pertaining to, companies that provide internet-based services such as our YY platform. To comply with these restrictions, we conduct our operations primarily through Beijing Huanju Shidai's contractual arrangements with Beijing Tuda, Guangzhou Huaduo and their respective shareholders.

Contractual Arrangements with Beijing Tuda

The following is a summary of the currently effective contracts among our subsidiary, Beijing Huanju Shidai, our PRC consolidated affiliated entity, Beijing Tuda, and the shareholders of Beijing Tuda.

Agreements that transfer economic benefits to us

Exclusive Business Cooperation Agreement

Under the exclusive business cooperation agreement between Beijing Huanju Shidai and Beijing Tuda, as amended, Beijing Huanju Shidai has the exclusive right to provide to Beijing Tuda technology support, business support and consulting services related to Beijing Tuda's business, the scope of which is to be determined by Beijing Huanju Shidai from time to time. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Beijing Tuda to Beijing Huanju Shidai is up to 100% of the net profit of Beijing Tuda, and the timing and amount of the fee payments shall be determined at the sole discretion of Beijing Huanju Shidai. The term of this agreement will expire in 2039 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai has sole discretion to terminate the agreement at any time by providing 30 days' prior written notice to Beijing Tuda, while neither Beijing Tuda nor its shareholders are entitled to terminate the agreement.

#### Exclusive Technology Support and Technology Services Agreement

Under the exclusive technology support and technology services agreement between Beijing Huanju Shidai and Beijing Tuda, as amended, Beijing Huanju Shidai has the exclusive right to provide to Beijing Tuda technology support and technology services related to all technologies needed for its business. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Beijing Tuda to Beijing Huanju Shidai is 10% of Beijing Tuda's gross revenues. The term of this agreement will expire in 2029 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai has sole discretion to terminate the agreement at any time by providing 30 days' prior written notice to Beijing Tuda, while neither Beijing Tuda nor its shareholders are entitled to terminate the agreement.

#### Agreements that provide us effective control over Beijing Tuda

#### Powers of Attorney

Under the irrevocable powers of attorney executed by each shareholder of Beijing Tuda, each such shareholder appointed Beijing Huanju Shidai as its attorney-in-fact to exercise such shareholders' rights in Beijing Tuda, including, without limitation, the power to vote on its behalf on all matters of Beijing Tuda requiring shareholder approval under PRC laws and regulations and the articles of association of Beijing Tuda. Each power of attorney will remain in force until the shareholder ceases to hold any equity interest in Beijing Tuda.

### Exclusive Option Agreement

Under the exclusive option agreement between Beijing Huanju Shidai, each of the shareholders of Beijing Tuda and Beijing Tuda, each of the shareholders irrevocably granted Beijing Huanju Shidai or its designated representative(s) an exclusive option to purchase, to the extent permitted under PRC law, all or part of his or its equity interests in Beijing Tuda. Beijing Huanju Shidai or its designated representative(s) have sole discretion as to when to exercise such options, either in part or in full. Without Beijing Huanju Shidai's prior written consent, Beijing Tuda's shareholders shall not sell, transfer, mortgage or otherwise dispose their equity interests in Beijing Tuda. The term of this agreement is ten years and may be extended at Beijing Huanju Shidai's sole discretion.

### Equity Interest Pledge Agreement

Under the equity interest pledge agreement between Beijing Huanju Shidai and the shareholders of Beijing Tuda, the shareholders of Beijing Tuda have pledged all of their equity interests in Beijing Tuda to Beijing Huanju Shidai to guarantee the performance by Beijing Tuda and its shareholders' performance of their respective obligations under the exclusive business cooperation agreement, exclusive option agreement, exclusive technology support and technology services agreement and powers of attorney. If Beijing Tuda or its shareholders breach their contractual obligations under those agreements, Beijing Huanju Shidai, as the pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests. This pledge became effective on the date the pledged equity interests were registered with the competent administration for industry and commerce and will remain effective until the pledgors are no longer the shareholders of Beijing Tuda.

### Contractual Arrangements with Guangzhou Huaduo

In 2014, we received service fees of RMB363.1 million (US\$58.5 million) from Guangzhou Huaduo. The following is a summary of the currently effective contracts among Beijing Huanju Shidai, Guangzhou Huaduo and the shareholders of Guangzhou Huaduo.

Agreements that transfer economic benefits to us

### Exclusive Business Cooperation Agreement



Under the exclusive business cooperation agreement between Beijing Huanju Shidai and Guangzhou Huaduo, as amended, Beijing Huanju Shidai has the exclusive right to provide to Guangzhou Huaduo technology support, business support and consulting services related to Guangzhou Huaduo's business, the scope of which is to be determined by Beijing Huanju Shidai from time to time. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Guangzhou Huaduo to Beijing Huanju Shidai is up to 100% of the net profit of Guangzhou Huaduo, and the timing and amount of the fee payments will be determined at the sole discretion of Beijing Huanju Shidai. The term of this agreement will expire in 2038 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai has sole discretion to terminate the agreement at any time by providing 30 days' prior written notice to Guangzhou Huaduo, while neither Guangzhou Huaduo nor its shareholders are entitled to terminate the agreement.

#### Exclusive Technology Support and Technology Services Agreement

Under the exclusive technology support and technology services agreement between Beijing Huanju Shidai and Guangzhou Huaduo, as amended, Beijing Huanju Shidai has the exclusive right to provide to Guangzhou Huaduo technology support and technology services related to all technologies needed for its business. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Guangzhou Huaduo to Beijing Huanju Shidai is 10% of Guangzhou Huaduo's gross revenues. The term of this agreement will expire in 2028 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai has sole discretion to terminate the agreement at any time by providing 30 days' prior written notice to Guangzhou Huaduo, while neither Guangzhou Huaduo nor its shareholders are entitled to terminate the agreement.

Agreements that provide us effective control over Guangzhou Huaduo

#### Powers of Attorney

Under the irrevocable powers of attorney executed by each shareholder of Guangzhou Huaduo, each such shareholder appointed Beijing Huanju Shidai as its attorney-in-fact to exercise such shareholders' rights in Guangzhou Huaduo, including, without limitation, the power to vote on its behalf on all matters of Guangzhou Huaduo requiring shareholder approval under PRC laws and regulations and the articles of association of Guangzhou Huaduo. Each power of attorney will remain in force until the shareholder ceases to hold any equity interest in Guangzhou Huaduo.

#### Exclusive Option Agreement

Under the exclusive option agreement between Beijing Huanju Shidai, each of the shareholders of Guangzhou Huaduo and Guangzhou Huaduo, each of the shareholders irrevocably granted Beijing Huanju Shidai or its designated representative(s) an exclusive option to purchase, to the extent permitted under PRC law, all or part of his or its equity interests in Guangzhou Huaduo. Beijing Huanju Shidai or its designated representative(s) have sole discretion as to when to exercise such options, either in part or in full. Without Beijing Huanju Shidai's prior written consent, Guangzhou Huaduo's shareholders shall not sell, transfer, mortgage or otherwise dispose their equity interests in Guangzhou Huaduo. The term of this agreement is ten years and may be extended at Beijing Huanju Shidai's sole discretion.

#### Equity Interest Pledge Agreement

Under the equity interest pledge agreement between Beijing Huanju Shidai and the shareholders of Guangzhou Huaduo, the shareholders of Guangzhou Huaduo have pledged all of their equity interests in Guangzhou Huaduo to Beijing Huanju Shidai to guarantee the performance by Guangzhou Huaduo and its shareholders' performance of their respective obligations under the exclusive business cooperation agreement, exclusive option agreement, exclusive technology support and technology services agreement and powers of attorney. If Guangzhou Huaduo and/or its shareholders breach their contractual obligations under those agreements, Beijing Huanju Shidai, as the pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests. The pledge became effective on the date the pledged equity interests were registered with the competent administration for industry and commerce and will remain effective until the pledgors are no longer the shareholders of Guangzhou Huaduo.

#### Transactions with Affiliates

In July 2010, Guangzhou Huaduo entered into a loan agreement with Zhuhai Daren Computer Technology Co., Ltd., or Zhuhai Daren, and the shareholders of Zhuhai Daren, pursuant to which Guangzhou Huaduo agreed to provide interest-free loans of up to RMB2.0 million in the aggregate to Zhuhai Daren. The amount and timing of drawdown on the loan is at Zhuhai Daren's option. Guangzhou Huaduo holds 30% equity interest in Zhuhai Daren. Zhuhai Daren borrowed RMB1.5 million in 2010 from Guangzhou Huaduo and RMB0.5 million in 2011. As of December 31, 2013, Zhuhai Daren had repaid the loan in full.

Guangzhou Huaduo and Zhuhai Daren had entered into a series of cooperation agreements, under which Guangzhou Huaduo and Zhuhai Daren agreed to cooperate with respect to the operation of certain online games developed by Zhuhai Daren. In the years ended December 31, 2012, 2013 and 2014, the aggregate online game revenues shared from Zhuhai Daren was RMB7.5 million, RMB24.5 million and RMB25.6 million (US\$4.1 million), respectively.

In 2010 and 2011, Guangzhou Huaduo and Guangzhou Shanghang Information Technical Co., Ltd., or Guangzhou Shanghang, entered into certain server co-location agreements, under which Guangzhou Shanghang provides Guangzhou Huaduo with bandwidth and server co-location services in different cities in China. In addition, Guangzhou Huaduo and Guangzhou Shanghang entered into two content delivery network acceleration service agreements, under which Guangzhou Shanghang provides content delivery network acceleration services to Guangzhou Huaduo. Guangzhou Shanghang is 28% owned by Mr. Jun Lei, our co-founder and chairman, including approximately 7% beneficially owned by Mr. David Xueling Li, our chief executive officer and director. In the years ended December 31, 2012, 2013 and 2014, the bandwidth service that Guangzhou Huaduo received from Guangzhou Shanghang amounted to RMB11.8 million, RMB21.3 million and RMB42.5 million (US\$6.8 million), respectively.

Kingsoft Corporation, or Kingsoft, through third party advertising agencies, has in the past placed advertisements on Duowan.com and YY Client, and we expect that Kingsoft may continue to do so in the future. We indirectly derived revenues through such third party advertising agencies from Kingsoft in each of the years ended December 31, 2012, 2013 and 2014, which amounted to RMB6.0 million, RMB2.0 million and RMB0.4 million (US\$0.1 million), respectively. In September 2013, Guangzhou Huaduo entered into series of intangible assets purchasing agreements with Kingsoft to acquire patent right and patent application right for certain software, with a total consideration of RMB6.0 million. Mr. Jun Lei, our co-founder and chairman, is currently chairman, non-executive director and minority shareholder of Kingsoft.

In January 2011, Guangzhou Huaduo entered into an agreement to invest RMB1.0 million in Zhuhai Qi Ao Yacht Club Co., Ltd., or Zhuhai Qi Ao, which was 100% owned by Mr. Lei. Zhuhai Qi Ao provides professional services and facilities for yacht owners in China. In 2012, we disposed of our 10.0% equity interest in Zhuhai Qi Ao in exchange for a payment of RMB1.0 million from Mr. Lei.

In February 2011, Guangzhou Huaduo entered into an agreement to invest RMB2.5 million in Zhuhai JinShan Kuaikuai Technology Co., Ltd., or JinShan Kuaikuai, which was 100% indirectly owned by Kingsoft. Upon such investment, we own 20.8% of JinShan Kuaikuai while Kingsoft indirectly owns 62.5% of JinShan Kuaikuai, with the remaining 16.7% equity interest owned by a third party. JinShan Kuaikuai provides online game technological research services in China.

In 2011 and 2012, Guangzhou Huaduo entered into series of loan agreements with Zhuhai Lequ Technology Co., Ltd., or Zhuhai Lequ, pursuant to which Guangzhou Huaduo provided interest-free loans to Zhuhai Lequ by RMB0.3 million and RMB1.2 million in 2011 and 2012, respectively. Repayment of RMB0.5 million and RMB1.0 million (US\$0.2 million) had been made in 2012 and 2013, respectively. In March 2012 and 2013, Beijing Tuda invested RMB1.0 million and RMB1.0 million (US\$0.2 million) respectively, and then held a 86.96% equity interest in total in, Zhuhai Lequ. We had reduced our equity holding in Zhuhai Lequ to 13.33% by transferring 73.63% of equity interest we held to its founders as of December 31, 2013. We had further reduced our equity holding in Zhuhai Lequ to 10.57% by the disposal of 2.76% of the equity interest to Chengdu Xishanju Entertainment Technology Co., Ltd., a subsidiary of Kingsoft, for a cash consideration of RMB1.6 million (US\$0.3 million) in September, 2014. In 2013, Guangzhou Huaduo and Zhuhai Lequ entered into a cooperation agreement, under which Guangzhou Huaduo and Zhuhai Lequ agreed to cooperate with respect to the operation of certain online games developed by Zhuhai Lequ and the aggregate online game revenues shared from Zhuhai Lequ was RMB5.1 million and RMB2.6 million (US\$0.4 million) in 2013 and 2014, respectively.

In July 2012, we sold our equity interest in Shenzhen Yingpeng Information Technology Co., Ltd. to Xiaomi Corporation for a cash consideration of RMB2.0 million. In 2013, Zhuhai Duowan and Xiaomi Corporation, entered into certain advertising arrangements where Xiaomi Corporation placed its advertisements on Duowan.com and YY Client in different formats over a particular period of time. We directly derived revenues from Xiaomi Corporation of RMB1.2 million in 2013 and nil in 2014, respectively. Mr. Lei Jun, our co-founder and chairman, is currently the chairman of Xiaomi Corporation.

In November 2013 and March 2014, Guangzhou Huaduo invested RMB7.0 million and RMB15.0 million (US\$2.4 million) respectively, in Guangzhou Kuyou Information Technology Co., Ltd., or Guangzhou Kuyou. Guangzhou Huaduo currently holds a 20% equity interest in Guangzhou Kuyou. In 2014, Guangzhou Huaduo and Guangzhou Kuyou entered into a series of cooperation agreements, under which Guangzhou Huaduo and Guangzhou Kuyou agreed to cooperate with respect to the exclusive operation of certain online games developed by Guangzhou Kuyou. The aggregate online game revenues shared from Guangzhou Kuyou was RMB37.0 million (US\$6.0 million) in 2014 and the purchase of operating rights for licenced games was RMB6.8 million (US\$1.1 million).

In September 2014, Guangzhou Huaduo invested RMB6.0 million in Shenzhen Qingdou Network Technology Co., Ltd., or Shenzhen Qingdou. Guangzhou Huaduo holds 12% equity interest in Shenzhen Qingdou with significant influence over its management and operating policies. Shenzhen Qingdou borrowed RMB1.0 million (US\$0.2 million) in 2014 from Guangzhou Huaduo. As of December 31, 2014, Shenzhen Qingdou had repaid the loan in full.

In September 2014, Guangzhou Huaduo invested RMB3.0 million in Guangzhou Muyou Network Technology Co., Ltd., or Guangzhou Muyou. Guangzhou Huaduo holds 15% equity interest in Guangzhou Muyou with significant influence over its management and operating policies. Guangzhou Muyou borrowed RMB0.5 million (US\$0.1 million) in 2014 from Guangzhou Huaduo, and had repaid the loan in full as of December 31, 2014.

In October 2014, we entered into an agreement to inject our free voice-over IP service, Weihui, into Bigo Technology Pte. Limited, or Bigo, a company set up and controlled by our chief executive officer, Mr. David Xueling Li. Following two independent third-party valuation assessments and a capital injection from other investors of Bigo, including Mr. Li, we retained a 27.8% ownership stake in Bigo. We had paid daily operating expenses of RMB61.0 million (US\$9.8 million) on behalf of Bigo in November and December. Bigo had repaid the amount in full as of the report date.

In December 2013, we made a minority interest investment in Agora, Inc., a company founded by Mr. Tony Bin Zhao, who had served as our director and chairman of our technology committee from December 2009 to March 2015.

### Registration Rights

We have granted certain registration rights to our shareholders. Set forth below is a description of the registration rights granted under the agreement.

***Demand Registration Rights.*** At any time following May 20, 2013, upon a written request from the holders of at least 25% of the registrable securities held by our then preferred shareholders, we shall file a registration statement on a form other than Form F-3 covering the offer and sale of the registrable securities held by the requesting shareholders and other holders of registrable securities who choose to participate in the offering, if the offering covers at least 20% of the then outstanding registrable securities or if the reasonable anticipated offering price to the public, net of selling expenses, would exceed US\$10.0 million. Registrable securities include, among others, our common shares not previously sold to the public and common shares issued or issued upon conversion of the preferred shares.

However, we are not obligated to proceed with a demand registration if we have, within any six-month period, already effected a registration under the Securities Act pursuant to the exercise of the holders' demand registration rights. We have the right to defer filing of a registration statement for up to 90 days if our board of directors determines in good faith that the filing of a registration statement would be materially detrimental to us, but we cannot exercise the deferral right more than once in any 12-month period.

***Form F-3 Registration Rights.*** When we are eligible for registration on Form F-3, upon a written request from any holders of the registrable securities held by our then preferred shareholders, we shall file a registration statement on Form F-3 covering the offer and sale of the registrable securities.

We are not obligated to effect a Form F-3 registration, among other things, if we have, within any six-month period, already effected a registration under the Securities Act pursuant to the exercise of the holders' Form F-3 registration rights, or the dollar amount of securities to be sold is of an aggregate price to the public of less than US\$1.0 million. We have the right to defer filing of a registration statement for up to 90 days if our board of directors, including a majority of the directors appointed by the preferred shareholders and Tiger Global Six YY Holdings, determines in good faith that the filing of a registration statement would be materially detrimental to us, but we cannot exercise the deferral right more than once in any 12-month period.

***Piggyback Registration Rights.*** If we propose to file a registration statement for a public offering of our common shares on a form that would be suitable only for registrable securities, we must offer holders of registrable securities an opportunity to include in that registration all or any part of their registrable securities. The underwriters of any underwritten offering have the right to limit the number of shares with registration rights to be included in the registration statement, subject to certain limitations.

***Expenses of Registration.*** We will pay all expenses relating to any demand, Form F-3, or piggyback registration.

***Termination of Obligations.*** We shall have no obligation to effect any demand, Form F-3, or piggyback registration (a) five years after our initial public offering, (b) if, in the opinion of counsel to us satisfactory to the holder, all such registrable securities proposed to be sold by a holder may then be sold under Rule 144 or another similar exemption under the Securities Act in one transaction without exceeding the volume limitations thereunder or (c) upon a liquidation event.

## Employment Agreements

See "Item 6. Directors, Senior Management and Employees—B. Compensation of Directors and Executive Officers—Employee Agreements" for a description of the employment agreements we have entered into with our senior executive officers.

## Share Incentives

See "Item 6. Directors, Senior Management and Employees—B. Compensation of Directors and Executive Officers" for a description of share-based compensation awards we have granted to our directors, officers and other individuals as a group.

See Note 25 to our financial statements for further information about our related party transactions.

## C. Interests of Experts and Counsel

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. Consolidated Statements and Other Financial Information

See "Item 18. Financial Statements."

## Legal Proceedings



We have initiated a lawsuit against Beijing Wonderad Advertisement Co., Ltd., one of our advertisement agents, in Guangzhou in February 2014, claiming for the unpaid advertisement fee and liquidated damages for late payment in the aggregate amount around RMB84 million, which has come to the enforcement procedure. Also, Guangzhou NetEase Computer System Co., Ltd. has initiated a lawsuit against us in Guangzhou in December 2014, claiming the infringement of its rights of reproduction concerning the online game of *Fantasy Westward Journey* in the amount of RMB100 million. Although we believe that the claim is unjustified and commercially motivated, if the outcome of the proceeding is unfavourable to us, we may suffer considerable damage to our financial position and reputation. In addition, we have initiated a lawsuit against Guangzhou Douyu Network Technology Co., Ltd., in Guangzhou in February 2015, claiming for the copyright infringement and unfair competition in an amount of RMB20 million. Apart from the aforesaid lawsuits, we are not currently a party to any pending material litigation or other legal proceeding and are not aware of any pending or threatened litigation or other legal proceeding that may have a material adverse impact on our business or operations. However, we may be subject to various legal proceedings and claims that are incidental to our ordinary course of business. Regardless of the outcome, legal or administrative proceedings or claims may have an adverse impact on us because of defense and settlement costs, diversion of management attention and other factors.

#### Dividend Policy

We have not paid dividend in the past and do not have any present plan to pay any dividend in the foreseeable future. We currently intend to retain most, if not all, of our available funds and any future earnings to operate and expand our business.

We are a holding company incorporated in the Cayman Islands. We may receive dividends from our PRC subsidiary for our cash requirements, including any payment of dividends to our shareholders. PRC regulations may restrict the ability of our PRC subsidiary to pay dividends to us. See "Item 3. Key information—D. Risk Factors—Risks Related to Our Corporate Structure and Our Industry—Our PRC subsidiaries and PRC consolidated affiliated entities are subject to restrictions on paying dividends or making other payments to us, which may restrict our ability to satisfy our liquidity requirements" and "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Regulation of Foreign Currency Exchange and Dividend Distribution."

Our board of directors has complete discretion on whether to distribute dividends, subject to the approval of our shareholders. Even if our board of directors decides to pay dividends, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that the board of directors may deem relevant. If we pay any dividends, we will pay our ADS holders to the same extent as holders of our Class A common shares, subject to the terms of the deposit agreement, including the fees and expenses payable thereunder. See "Item 12. Description of Securities Other than Equity Securities—D. American Depositary Shares." Cash dividends on our Class A common shares, if any, will be paid in U.S. dollars.

B. Significant Changes

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

ITEM 9. THE OFFER AND LISTING

A. Offering and Listing Details

See "—C. Markets" and "Item 12. Description of Securities other than Equity Securities—D. American Depositary Shares." We have a dual-class common share structure in which Class A common shares have different voting rights from Class B common shares. Class B common shares are each entitled to ten votes, whereas Class A common shares are each entitled to one vote. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our ADSs—Our dual class common share structure with different voting rights will limit your ability to influence corporate matters and could discourage others from pursuing any change of control transactions that holders of our Class A common shares and ADSs may view as beneficial."

B. Plan of Distribution

Not applicable.

C. Markets

Our ADSs, each representing twenty Class A common shares, have been listed on the Nasdaq Global Market since November 21, 2012 and trade under the symbol "YY". The following table provides the high and low trading prices for our ADSs on the NASDAQ Global Market for the periods indicated.

Trading Price	
High	Low
US\$	US\$

## Annual Highs and Lows

Fiscal Year 2012 (from November 21, 2012)	15.27	10.50
Fiscal Year 2013	56.75	13.06
Fiscal Year 2014	96.39	50.00
Quarterly Highs and Lows		
First Fiscal Quarter of 2013	20.89	13.06
Second Fiscal Quarter of 2013	30.95	15.52
Third Fiscal Quarter of 2013	51.38	27.10
Fourth Fiscal Quarter of 2013	56.75	41.28
First Fiscal Quarter of 2014	90.93	50.00
Second Fiscal Quarter of 2014	82.54	51.08
Third Fiscal Quarter of 2014	96.39	67.50
Fourth Fiscal Quarter of 2014	86.00	60.18
Monthly Highs and Lows		
October 2014	84.00	67.10
November 2014	86.00	71.50
December 2014	76.34	60.18
January 2015	73.04	62.49
February 2015	72.36	51.53
March 2015	61.12	50.52
April 2015 (through April 20, 2015)	66.00	54.16

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.

B. Memorandum and Articles of Association

We are a Cayman Islands company and our affairs are governed by our memorandum and articles of association and the Companies Law 2012 (as amended) of the Cayman Islands, referred to as the Companies Law below. The following are summaries of certain provisions of our memorandum and articles of association in effect as of the date of this annual report insofar as they relate to the material terms of our common shares.

Registered Office and Objects

Our registered office in the Cayman Islands is located at Codan Trust Company (Cayman) Limited, Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman, KYI-1111, Cayman Islands. The memorandum of association provides, inter alia, that the liability of the members of our company is limited to the amount, if any, for the time being unpaid on the common shares. The objects for which our company is established are unrestricted (including acting as an investment company), and we shall have and be capable of exercising all the functions of a natural person

of full capacity irrespective of corporate benefit, as provided in Section 27(2) of the Companies Law and in view of the fact that we are an exempted Company, we will not trade in the Cayman Islands with any person, firm or corporation except in furtherance of our business carried on outside the Cayman Islands.

#### Board of Directors

See "Item 6. Directors, Senior Management and Employees—C. Board Practices—Duties of Directors" and "—Terms of Directors and Officers."

#### Common Shares

##### General

Our common shares are divided into Class A common shares and Class B common shares. Holders of Class A common shares and Class B common shares will have the same rights except for voting and conversion rights. The holders of ADSs will not be treated as our shareholders and will be required to surrender their ADSs for cancellation and withdrawal from the depositary facility in which the Class A common shares are held in accordance with the provisions of the deposit agreement in order to exercise shareholders' rights in respect of the Class A common shares. The depositary will agree, so far as it is practical, to vote or cause to be voted the amount of Class A common shares represented by ADSs in accordance with the non-discretionary written instructions of the holders of such ADSs.

All of our outstanding common shares are fully paid and non-assessable. Certificates representing our common shares are issued in the registered form. Our shareholders who are non-residents of the Cayman Islands may freely hold and vote their common shares.

##### Meetings

Shareholders' meetings may be convened by a majority of our board of directors or the chairman. Advance notice in writing of at least ten clear days is required for the convening of our annual general meeting and any other general meeting of our shareholders. A quorum required for a meeting of shareholders consists of at least one or more shareholders present in person or by proxy, or (in the case of a shareholder being a corporation) by its duly authorized representative representing not less than one-third in nominal value of the total issued voting shares in our company present throughout the meeting.



Notwithstanding that a meeting is called by shorter notice than that mentioned above, but, subject to the Companies Law, it will be deemed to have been duly called, if it is so agreed (a) in the case of a meeting called as an annual general meeting by all of our shareholders entitled to attend and vote at the meeting; and (b) in the case of any other meeting, by a majority in number of the shareholders having the right to attend and vote at the meeting, being a majority together holding not less than 95% in nominal value of the issued shares giving that right.

No business other than the appointment of a chairman may be transacted at any general meeting unless a quorum is present at the commencement of business. However, the absence of a quorum will not preclude the appointment of a chairman. If present, the chairman of our board of directors shall be the chairman presiding at any shareholders' meetings.

A corporation being a shareholder shall be deemed for the purpose of our articles of association to be present in person if represented by its duly authorized representative being the person appointed by resolution of the directors or other governing body of such corporation to act as its representative at the relevant general meeting or at any relevant general meeting of any class of our shareholders. Such duly authorized representative shall be entitled to exercise the same powers on behalf of the corporation that he represents as that corporation could exercise if it were our individual shareholder.

The quorum for a separate general meeting of the holders of a separate class of shares is described in "—Modification of Rights" below.

Our articles of association do not allow our shareholders to approve matters to be determined at shareholders' meetings by way of written resolutions without a meeting.

#### Voting Rights

In respect of all matters requiring a shareholders' vote, each Class A common share is entitled to one vote, and each Class B common share is entitled to ten votes, voting together as one class. At any shareholders' meeting, on a show of hands, every shareholder present in person or by proxy (or, in the case of a shareholder being a corporation, by its duly authorized representative) shall have one vote and on a poll, every shareholder present in person or by proxy, or in the case of a shareholder being a corporation, by its duly authorized representative shall have one vote for each fully paid share of which such shareholder is the holder.

No shareholder shall, unless the Board otherwise determines, be entitled to vote or be reckoned in a quorum, in respect of any share, unless such shareholder is duly registered as our shareholder and all calls or installments due by such shareholder to us have been paid.

If a clearing house (or its nominee(s)) or a central depository entity, being a corporation, is a shareholder, it may authorize such person or persons as it thinks fit to act as its representative(s) at any meeting or at any meeting of any class of shareholders, provided that the authorization shall specify the number and class of shares in respect of which each such person is so authorized. A person so authorized is entitled to exercise the same rights and powers on behalf of the clearing house or central depository entity (or its nominee(s)) as if such person was the registered holder of our shares held by the clearing house or central depository entity (or its nominee(s)) including the right to vote individually on a show of hands.

While there is nothing under the laws of the Cayman Islands which specifically prohibits or restricts the creation of cumulative voting rights for the election of directors of our company, it is not a concept that is accepted as a common practice in the Cayman Islands, and our company has made no provisions in our articles of association to allow cumulative voting for such elections.

#### Conversion

Each Class B common share is convertible into one Class A common share at any time by the holder thereof. Class A common shares are not convertible into Class B common shares under any circumstances. Upon any transfer of Class B common shares by a holder to any person or entity which is not an affiliate of such holder and which is not any of our founders or any affiliates of our founders, such Class B common shares shall be automatically and immediately converted into the equivalent number of Class A common shares. In addition, if at any time, Messrs. David Xueling Li, Jun Lei, Tony Bin Zhao and Jin Cao and their affiliates collectively beneficially own less than 5% of the total number of the issued and outstanding Class B common shares, each issued and outstanding Class B common share will be automatically and immediately converted into one Class A common share, and we will not issue any Class B common shares thereafter. Furthermore, if at any time more than 50% of the ultimate beneficial ownership of any holder of Class B common shares (other than our founders or our founders' affiliates) changes, each such Class B common share will be automatically and immediately converted into one Class A common share.



### Calls on Shares and Forfeiture of Shares

Subject to our memorandum and articles of association, our directors may from time to time make such calls upon the members in respect of any amounts unpaid on the shares held by them. The shares that have been called upon and remain unpaid on the specified time are subject to forfeiture.

### Protection of Minority Shareholders

The Cayman Islands courts ordinarily would be expected to follow English case law precedents which permit a minority shareholder to commence a representative action against or derivative actions in the name of the company to challenge (a) an act which is ultra vires the company or illegal, (b) an act which constitutes a fraud against the minority and regarding which the wrongdoers are themselves in control of the company, and (c) an irregularity in the passing of a resolution which requires a qualified (or special) majority.

In the case of a company (not being a bank) having its share capital divided into shares, the Grand Court of the Cayman Islands may, on the application of members holding not less than one fifth of the shares of the company in issue, appoint an inspector to examine the affairs of the company and to report thereon in such manner as the Grand Court of the Cayman Islands shall direct.

Any of our shareholders may petition the Grand Court of the Cayman Islands which may make a winding up order if the Grand Court of the Cayman Islands is of the opinion that it is just and equitable that we should be wound up or, as an alternative to a winding up order, (a) an order regulating the conduct of our affairs in the future, (b) an order requiring us to refrain from doing or continuing an act complained of by the shareholder petitioner or to do an act which the shareholder petitioner has complained we have omitted to do, (c) an order authorizing civil proceedings to be brought in our name and on our behalf by the shareholder petitioner on such terms as the Grand Court of the Cayman Islands may direct, or (d) an order providing for the purchase of the shares of any of our shareholders by other shareholders or us and, in the case of a purchase by us, a reduction of our capital accordingly.

Generally, claims against us must be based on the general laws of contract or tort applicable in the Cayman Islands or individual rights as shareholders as established by our articles of association.

### Pre-Emption Rights

There are no pre-emption rights applicable to the issue of new shares of our company under either Cayman Islands law or our memorandum and articles of association.

### Liquidation Rights

Subject to any class or classes of shares or future shares which are issued with specific rights, privileges or restrictions as to the distribution of available surplus assets on liquidation, (a) if we are wound up and the assets available for distribution among our shareholders are more than sufficient to repay the whole of the capital paid up at the commencement of the winding up, the excess shall be distributed *pari passu* among those shareholders in proportion to the amount paid up at the commencement of the winding up on the shares held by them, respectively, and (b) if we are wound up and the assets available for distribution among the shareholders as such are insufficient to repay the whole of the paid-up capital, those assets shall be distributed so that, as nearly as may be, the losses shall be borne by the shareholders in proportion to the capital paid up at the commencement of the winding up on the shares held by them, respectively.

If we are wound up (whether the liquidation is voluntary or by the court), the liquidator may with the sanction of our special resolution and any other sanction required by the Companies Law, divide among our shareholders in specie or kind the whole or any part of our assets (whether or not they shall consist of property of the same kind) and may, for such purpose, set such value as the liquidator deems fair upon any property to be divided and may determine how such division shall be carried out as between the shareholders or different classes of shareholders. The liquidator may also vest the whole or any part of these assets in trustees upon such trusts for the benefit of the shareholders as the liquidator shall think fit, but so that no shareholder will be compelled to accept any assets, shares or other securities upon which there is a liability.

The consideration received by each holder of a Class A common share and a holder of a Class B common share will be the same in any liquidation event.

#### Variation of Rights

Alterations to our memorandum and articles of association may only be made by special resolution, meaning a majority of not less than two-thirds of votes cast at a shareholders' meeting.

If at any time, our share capital is divided into different classes of shares, all or any of the special rights attached to any class of shares may, subject to the provisions of the Companies Law, be varied with the sanction of a special resolution passed at a general meeting of the holders of the shares of that class. Consequently, the rights of any class of shares cannot be detrimentally altered without a majority of two-thirds of the vote of all of the shares in that class. The provisions of our articles of association relating to general meetings shall apply similarly to every such separate general meeting, but so that the quorum for the purposes of any such separate general meeting or at the adjourned meeting shall be a person or persons together holding (or represented by proxy) on the date of the relevant meeting not less than one-third in nominal value of the issued shares of that class, that every holder of shares of the class shall be entitled on a poll to one vote for every such share held by such holder and that any holder of shares of that class present in person or by proxy may demand a poll.

The rights conferred upon the holders of the shares of any class issued with special rights shall not, unless otherwise expressly provided by the terms of issue of the shares of that class, be deemed to be varied by the creation or issue of further shares ranking *pari passu* with such existing class of shares.

#### Alteration of Capital

We may from time to time by ordinary resolution in accordance with the Companies Law alter the conditions of our memorandum of association to:

- increase our capital by such sum, to be divided into shares of such amounts, as the resolution shall prescribe;
- consolidate and divide all or any of our share capital into shares of larger amounts than our existing shares;

cancel any shares which at the date of the passing of the resolution have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled subject to the provisions of the Companies Law;

sub-divide our shares or any of them into shares of smaller amount than is fixed by our memorandum of association, subject nevertheless to the Companies Law, so that the resolution whereby any share is sub-divided may determine that, as between the holders of the shares resulting from such subdivision, one or more of the shares may have any such preferred or other special rights over, or may have such deferred rights or be subject to any such restrictions as compared with the others, as we have power to attach to unissued or new shares; and

divide shares into several classes and without prejudice to any special rights previously conferred on the holders of existing shares, attach to the shares respectively any preferential, deferred, qualified or special rights, privileges, conditions or such restrictions that in the absence of any such determination in a general meeting may be determined by our directors.

We may, by special resolution, subject to any confirmation or consent required by the Companies Law, reduce our share capital or any capital redemption reserve in any manner authorized by law.

#### Transfer of Shares

Subject to any applicable restrictions set forth in our articles of association, including, for example, the board of directors' discretion to refuse to register a transfer of any share (not being a fully paid up share) to a person of whom it does not approve, or any share issued under share incentive plans for employees upon which a restriction on transfer imposed thereby still subsists, or a transfer of any share to more than four joint holders, any of our shareholders may transfer all or any of his or her shares by an instrument of transfer in the usual or common form or in a form prescribed by the Nasdaq Global Market or in another form that our directors may approve.

Our directors may decline to register any transfer of any share which is not paid up or on which we have a lien. Our directors may also decline to register any transfer of any share unless:

the instrument of transfer is lodged with us and is accompanied by the certificate for the shares to which it relates and such other evidence as our directors may reasonably require to show the right of the transferor to make the transfer;

the instrument of transfer is in respect of only one class of share;

the instrument of transfer is properly stamped (in circumstances where stamping is required); and

fee of such maximum sum as the Nasdaq Global Market may determine to be payable or such lesser sum as our directors may from time to time require is paid to us in respect thereof.

If our directors refuse to register a transfer, they shall, within three months after the date on which the instrument of transfer was lodged, send to each of the transferor and the transferee notice of such refusal.

The registration of transfers may, after compliance with any notice requirement of the Nasdaq Global Market, be suspended and the register closed at such times and for such periods as our directors may from time to time determine; provided, however, that the registration of transfers shall not be suspended nor the register closed for more than 30 days in any year as our directors may determine.

#### Register of Members

In accordance with Section 48 of the Companies Law, the register of members is prima facie evidence of the registered holder or member of shares of a company. Therefore, a person becomes a registered holder or member of shares of the company only upon entry being made in the register of members. Our directors will maintain one register of members, at the office of Codan Trust Company (Cayman) Limited, Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman, KY1-1111, Cayman Islands, which provides us with corporate administrative services. We will perform the procedures necessary to register the shares in the register of members as required in "PART III—Distribution of Capital and Liability of Members of Companies and Associations" of the Companies Law, and will ensure that the entries on the register of members are made without any delay.

The depositary will be included in our register of members as the only holder of the Class A common shares underlying the ADSs. The shares underlying the ADSs are not shares in bearer form, but are in registered form and are

"non-negotiable" or "registered" shares in which case the shares underlying the ADSs can only be transferred on the books of the company in accordance with Section 166 of the Companies Law.

In the event that we fail to update our register of members, the recourse of investors is directly to the depositary under the terms of the deposit agreement, which is governed by New York law. The depositary will have recourse against us under the terms of the deposit agreement, and also will hold a share certificate evidencing the depositary as the registered holder of shares underlying the ADSs. Further, Section 46 of the Companies Law provides for recourse to be available to our investors in case we fail to update our register of members. In the event we fail to update our register of members, the depositary, as the aggrieved party, may apply for an order with the courts of the Cayman Islands for the rectification of the register of members.

### Share Repurchases

We are empowered by the Companies Law and our articles of association to purchase our own shares, subject to certain restrictions. Our directors may only exercise this power on our behalf, subject to the Companies Law, our memorandum and articles of association and to any applicable requirements imposed from time to time by the Nasdaq Global Market, the U.S. Securities and Exchange Commission, or by any other recognized stock exchange on which our securities are listed.

### Dividends

Subject to the Companies Law, our company in a general meeting or our directors may declare dividends in any currency to be paid to our shareholders. Dividends may be declared and paid out of our profits, realized or unrealized, or from any reserve set aside from profits which our directors determine is no longer needed. Our board of directors may also declare and pay dividends out of the share premium account or any other fund or account that can be authorized for this purpose in accordance with the Companies Law.

Except in so far as the rights attaching to, or the terms of issue of, any share otherwise provides, (a) all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls shall be treated for this purpose as paid up on that share and (b) all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid.

Our directors may also pay interim dividends, whenever our financial position, in the opinion of our directors, justifies such payment.

Our directors may deduct from any dividend or bonus payable to any shareholder all sums of money (if any) presently payable by such shareholder to us on account of calls or otherwise.

No dividend or other money payable by us on or in respect of any share shall bear interest against us.

In respect of any dividend proposed to be paid or declared on our share capital, our directors may resolve and direct that (a) such dividend be satisfied wholly or in part in the form of an allotment of shares credited as fully paid up, provided that our shareholders entitled thereto will be entitled to elect to receive such dividend (or part thereof if our directors so determine) in cash in lieu of such allotment or (b) the shareholders entitled to such dividend will be entitled to elect to receive an allotment of shares credited as fully paid up in lieu of the whole or such part of the dividend as our directors may think fit. Our shareholders may, upon the recommendation of our directors, by ordinary resolution resolve in respect of any particular dividend that, notwithstanding the foregoing, a dividend may be satisfied wholly in the form of an allotment of shares credited as fully paid up without offering any right to shareholders to elect to receive such dividend in cash in lieu of such allotment.

Any dividend interest or other sum payable in cash to the holder of shares may be paid by check or warrant sent by mail addressed to the holder at his registered address, or addressed to such person and at such addresses as the holder may direct. Every check or warrant shall, unless the holder or joint holders otherwise direct, be made payable to the order of the holder or, in the case of joint holders, to the order of the holder whose name stands first on the register in respect of such shares, and shall be sent at his or their risk and payment of the check or warrant by the bank on which it is drawn shall constitute a good discharge to us.

All dividends unclaimed for one year after having been declared may be invested or otherwise made use of by our board of directors for the benefit of our company until claimed. Any dividend unclaimed after a period of six years from the date of declaration of such dividend shall be forfeited and reverted to us.

Whenever our directors have resolved that a dividend be paid or declared, our directors may further resolve that such dividend be satisfied wholly or in part by the distribution of specific assets of any kind, and in particular of paid up shares, debentures or warrants to subscribe for our securities or securities of any other company. Where any difficulty arises with regard to such distribution, our directors may settle it as they think expedient. In particular, our directors may issue fractional certificates, ignore fractions altogether or round the same up or down, fix the value for distribution purposes of any such specific assets, determine that cash payments shall be made to any of our shareholders upon the footing of the value so fixed in order to adjust the rights of the parties, vest any such specific assets in trustees as may seem expedient to our directors, and appoint any person to sign any requisite instruments of transfer and other documents on behalf of the persons entitled to the dividend, which appointment shall be effective and binding on our shareholders.

#### Untraceable Shareholders

We are entitled to sell any shares of a shareholder who is untraceable, provided that no such sale shall be made unless:

- all checks or warrants in respect of dividends of such shares, not being less than three in number, for any sums payable in cash to the holder of such shares have remained un-cashed for a period of 12 years prior to the publication of the advertisement and during the three months referred to in the third bullet point below;

- we have not during that time received any indication of the whereabouts or existence of the shareholder or person entitled to such shares by death, bankruptcy or operation of law; and

- we, if so required by the rules of the Nasdaq Global Market, have caused an advertisement to be published in newspapers in accordance with such applicable rules giving notice of our intention to sell these shares, and a period of three months (or such shorter period as permitted under the applicable rules) has elapsed since such advertisement.



The net proceeds of any such sale shall belong to us, and when we receive these net proceeds we shall become indebted to the former shareholder for an amount equal to such net proceeds.

#### Inspection of Books and Records

Holders of our common shares will have no general right under Cayman Islands law to inspect or obtain copies of our list of shareholders or our corporate records. However, we will provide our shareholders with annual audited financial statements.

#### C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described elsewhere in "Item 4. Information on the Company—B. Business Overview," "Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions," or elsewhere in this annual report.

#### D. Exchange Controls

See "Item 4. Information on the Company—B. Business Overview—PRC Regulation—Regulation of Foreign Currency Exchange and Dividend Distribution."

#### E. Taxation

##### Cayman Islands Taxation

See "Item 5. Operating and Financial Review and Prospects—A. Operating Results—Discussion of Selected Statements of Operations Items—Taxation—Cayman Islands."

##### People's Republic of China Taxation

Under the existing tax laws in the PRC, we are qualified as a non-resident enterprise. We are a holding company incorporated in the Cayman Islands; our holding company indirectly holds 100% of the equity interests in our PRC subsidiaries through Duowan BVI, NeoTask and NeoTask Limited. Our business operations are principally conducted through our PRC subsidiaries and our PRC consolidated affiliated entities. The PRC Enterprise Income Tax Law and its implementation rules, both of which became effective on January 1, 2008, provide that China-sourced income of foreign enterprises, such as dividends paid by a PRC subsidiary to its overseas parent that is not a PRC resident enterprise and has no establishment in the PRC, will normally be subject to PRC withholding tax at a rate of 10%.

If the PRC tax authorities determine that YY Inc., our Cayman Islands holding company, is a PRC resident enterprise for enterprise income tax purposes, our world-wide income could be subject to PRC tax at a rate of 25%, which could materially reduce our net income. In addition, we will also be subject to PRC enterprise income tax reporting obligations. Furthermore, although dividends paid by one PRC tax resident to another PRC tax resident should qualify as "tax-exempt income" under the PRC Enterprise Income Tax Law, we cannot assure you that dividends by our PRC subsidiaries to our Cayman holding company will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax on dividends, and the PRC tax 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. In addition, ADS holders may be subject to PRC withholding tax on dividends payable by us and gains realized on the sale or other disposition of ADSs or common shares, if the PRC tax authorities determine that our Cayman Islands holding company is a PRC resident enterprise for enterprise income tax purposes. See "Risk Factors—Risks Related to Doing Business in China—Under the PRC enterprise income tax law, we may be classified as a PRC "resident enterprise," which could result in unfavorable tax consequences to us and our shareholders and have a material adverse effect on our results of operations and the value of your investment."

## United States Federal Income Tax Considerations

The following is a summary of certain United States federal income tax considerations relating to the ownership and disposition of our ADSs or common shares by a U.S. holder (as defined below) that holds our ADSs or common shares as "capital assets" (generally, property held for investment) under the United States Internal Revenue Code of 1986, as amended (the "Code"). This summary is based upon existing United States federal income tax law, which is subject to differing interpretations or change, possibly with retroactive effect. This summary does not discuss all aspects of United States federal income taxation that may be important to particular investors in light of their individual investment circumstances, including investors subject to special tax rules (for example, banks and other financial institutions, insurance companies, broker-dealers, pension plans, cooperatives, real estate investment trusts, regulated investment companies, traders in securities that have elected the mark-to-market method of accounting for their securities, partnerships and their partners, and tax-exempt organizations (including private foundations)), holders who are not U.S. holders, holders who own (directly, indirectly, or constructively) 10% or more of our voting stock, investors that hold their ADSs or common shares as part of a straddle, hedge, conversion, constructive sale, or other integrated transaction for United States federal income tax purposes, persons who acquired ADSs or common shares pursuant to the exercise of any employee share option or otherwise as compensation, or investors that have a functional currency other than the United States dollar, all of whom may be subject to tax rules that differ significantly from those summarized below. In addition, except to the extent described below, this summary does not discuss any state, local or non-United States tax considerations, Medicare tax, the alternative minimum tax or any non-income tax (such as the United States federal estate or gift tax) considerations. Each U.S. holder is urged to consult its tax advisor regarding the United States federal, state, local, and non-United States income and other tax considerations of an investment in our ADSs or common shares.

### General

For purposes of this summary, a "U.S. holder" is a beneficial owner of our ADSs or common shares that is, for United States federal income tax purposes, (i) an individual who is a citizen or resident of the United States, (ii) a corporation (or other entity treated as a corporation for United States federal income tax purposes) created in, or organized under the law of, the United States or any state thereof or the District of Columbia, (iii) an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source, or (iv) a trust (A) the administration of which is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust or (B) that has otherwise elected to be treated as a United States person.

If a partnership (or other entity treated as a partnership for United States federal income tax purposes) is a beneficial owner of our ADSs or common shares, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. Partnerships holding our ADSs or common shares and partners in such partnerships are urged to consult their tax advisors regarding an investment in our ADSs or common shares.

It is generally expected that a holder of ADSs should be treated, for United States federal income tax purposes, as the beneficial owner of the underlying shares represented by the ADSs. The remainder of this discussion assumes that a holder of ADSs will be treated in this manner. Predicated upon such treatment, deposits or withdrawals of common shares for ADSs will not be subject to United States federal income tax.

#### Passive Foreign Investment Company Considerations

A non-United States corporation, such as our company, will be classified as a "passive foreign investment company," or "PFIC", for United States federal income tax purposes, for any taxable year, if either (i) 75% or more of its gross income for such year consists of certain types of "passive" income or (ii) 50% or more of its average quarterly assets (as determined on the basis of fair market value) during such year produce or are held for the production of passive income. For this purpose, cash and assets readily convertible into cash are categorized as passive assets and the company's unbooked intangibles are taken into account for determining the value of its assets. 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, more than 25% (by value) of the stock.

Although the law in this regard is unclear, we treat Guangzhou Huaduo and Beijing Tuda as being owned by us for United States federal income tax purposes, not only because we exercise effective control over the operation of such entities but also because we are entitled to substantially all of their economic benefits, and, as a result, we consolidate their operating results in our consolidated financial statements.

Assuming that we own Guangzhou Huaduo and Beijing Tuda for United States federal income tax purposes, although we do not believe that we were classified as a PFIC, for United States federal income tax purposes, for the taxable year ended December 31, 2014, there is a risk that we will become a PFIC for our current taxable year ending December 31, 2015 and future taxable years because of our significant cash balances and because the value of our assets, for purposes of the PFIC test, will generally be determined by reference to the market price of our ADSs and common shares. Accordingly, fluctuations in the market price of our ADSs and common shares may cause us to become a PFIC for the current taxable year or future taxable years. It is also possible that the Internal Revenue Service may challenge our classification or valuation of our goodwill and other unbooked intangibles, which may result in our company being or, becoming classified as, a PFIC for the current or future taxable years. The determination of whether we will be or become a PFIC will also depend, in part, upon the nature of our income and assets over time, which are subject to change from year to year. There can be no assurance our business plans will not change in a manner that will affect our PFIC status. Because there are uncertainties in the application of the relevant rules and PFIC status is a fact-intensive determination made on an annual basis, no assurance may be given with respect to our PFIC status for any taxable year.

The discussion below under "Dividends" and "Sale or Other Disposition of ADSs or Common Shares" is written on the basis that we will not be classified as a PFIC for United States federal income tax purposes. The United States federal income tax rules that apply if we are classified as a PFIC for the current taxable year or any subsequent taxable year are generally discussed below under "Passive Foreign Investment Company Rules."

## Dividends

Subject to the PFIC rules discussed below, any cash distributions (including the amount of any taxes withheld) paid on our ADSs or common shares out of our current or accumulated earnings and profits, as determined under United States federal income tax principles, will generally be includible in the gross income of a U.S. holder as dividend income on the day actually or constructively received by the U.S. holder, in the case of common shares, or by the Depository, in the case of ADSs. Because we do not intend to determine our earnings and profits on the basis of United States federal income tax principles, any distribution paid will generally be reported as a "dividend" for United States federal income tax purposes. A non-corporate recipient of dividend income will generally be subject to tax on dividend income from a "qualified foreign corporation" at a reduced United States federal tax rate rather than the marginal tax rates generally applicable to ordinary income provided that certain holding period requirements are met.

A non-United States corporation (other than a corporation that is classified as a PFIC for the taxable year in which the dividend is paid or the preceding taxable year) will generally be considered to be a qualified foreign corporation with respect to any dividend it pays on stock (or ADSs in respect of such stock) which is readily tradable on an established securities market in the United States or, in the event that the company is deemed to be a PRC resident under the PRC Enterprise Income Tax Law, the company is eligible for the benefits of the United States-PRC treaty. Although no assurances may be given, our ADSs are expected to be readily tradable on the Nasdaq Global Market, which is an established securities market in the United States. Since we do not expect that our common shares will be listed on established securities markets, it is unclear whether dividends that we pay on our common shares that are not backed

by ADSs currently meet the conditions required for these reduced tax rates. There can be no assurance that our ADSs will be considered readily tradable on an established securities market in the current taxable year or future taxable years.

Dividends received on the ADSs or common shares are not expected to be eligible for the dividends received deduction allowed to corporations. Each U.S. holder is advised to consult its tax advisor regarding the rate of tax that will apply to such holder with respect to dividend distributions, if any, received from us.

Dividends generally will be treated as income from foreign sources for United States foreign tax credit purposes and generally will constitute passive category income. A U.S. holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any foreign withholding taxes imposed on dividends received on ADSs or common shares. A U.S. holder who does not elect to claim a foreign tax credit for foreign tax withheld, may instead claim a deduction, for United States federal income tax purposes, in respect of such withholdings, but only for a year in which such U.S. holder elects to do so for all creditable foreign income taxes. The rules governing the foreign tax credit are complex. Each U.S. holder is advised to consult its tax advisor regarding the availability of the foreign tax credit under their particular circumstances.

## Sale or Other Disposition of ADSs or Common Shares

Subject to the PFIC rules discussed below, a U.S. holder generally will recognize capital gain or loss upon the sale or other disposition of ADSs or common shares in an amount equal to the difference between the amount realized upon the disposition and the U.S. holder's adjusted tax basis in such ADSs or common shares. Any capital gain or loss will be long-term if the ADSs or common shares have been held for more than one year and will generally be United States source gain or loss for United States foreign tax credit purposes. The deductibility of a capital loss may be subject to limitations. Each U.S. holder is advised to consult its tax advisor regarding the tax consequences if a foreign tax is imposed on a disposition of our ADSs or common shares, including the availability of the foreign tax credit under their particular circumstances.

## Passive Foreign Investment Company Rules

If we are classified as a PFIC for any taxable year during which a U.S. holder holds our ADSs or common shares, and unless the U.S. holder makes a mark-to-market election (as described below), the U.S. holder will generally be subject to special tax rules that have a penalizing effect, regardless of whether we remain a PFIC, on (i) any excess distribution that we make to the U.S. holder (which generally means any distribution paid during a taxable year to a U.S. holder that is greater than 125% of the average annual distributions paid in the three preceding taxable years or, if shorter, the U.S. holder's holding period for the ADSs or common shares), and (ii) any gain realized on the sale or other disposition, including, under certain circumstances, a pledge, of ADSs or common shares. Under the PFIC rules:

such excess distribution and/or gain will be allocated ratably over the U.S. holder's holding period for the ADSs or common shares;

such amount allocated to the current taxable year and any taxable years in the U.S. holder's holding period prior to the first taxable year in which we are classified as a PFIC, or pre-PFIC year, will be taxable as ordinary income;

such amount allocated to each prior taxable year, other than a pre-PFIC year, will be subject to tax at the highest tax rate in effect applicable to the U.S. holder for that year; and

an interest charge generally applicable to underpayments of tax will be imposed on the tax attributable to each prior taxable year, other than a pre-PFIC year.

If we are a PFIC for any taxable year during which a U.S. holder holds our ADSs or common shares and any of our non-United States subsidiaries is also a PFIC, such U.S. holder would be treated as owning a proportionate amount (by value) of the shares of the lower-tier PFIC and would be subject to the rules described above on certain

distributions by a lower-tier PFIC and a disposition of shares of a lower-tier PFIC even though such U.S. holder would not receive the proceeds of those distributions or dispositions. Each U.S. holder is advised to consult its tax advisor regarding the application of the PFIC rules to any of our subsidiaries.

As an alternative to the foregoing rules, a U.S. holder of "marketable stock" (as defined below) in a PFIC may make a mark-to-market election for such stock to elect out of the tax treatment discussed above. 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 ("regularly traded") on a qualified exchange or other market, as defined in applicable United States Treasury regulations. Our ADSs are listed on the NASDAQ, which is a qualified exchange or market for these purposes. We anticipate that our ADSs should qualify as being regularly traded, but no assurances may be given in this regard. Because a mark-to-market election cannot be made for equity interests in any lower-tier PFICs that we own, a U.S. holder may continue to be subject to the PFIC rules with respect to its indirect interest in any investments held by us that are treated as an equity interest in a PFIC for United States federal income tax purposes. If a mark-to-market election is made, the U.S. holder will generally (i) include as ordinary income for each taxable year that we are a PFIC the excess, if any, of the fair market value of ADSs held at the end of the taxable year over the adjusted tax basis of such ADSs and (ii) deduct as an ordinary loss the excess, if any, of the adjusted tax basis of the ADSs over the fair market value of such ADSs held at the end of the taxable year, but only to the extent of the net amount previously included in income as a result of the mark-to-market election. The U.S. holder's adjusted tax basis in the ADSs would be adjusted to reflect any income or loss resulting from the mark-to-market election.

If a U.S. holder makes a mark-to-market election in respect of a corporation classified as a PFIC and such corporation ceases to be classified as a PFIC, the U.S. holder will not be required to take into account the mark-to-market gain or loss described above during any period that such corporation is not classified as a PFIC.



We do not intend to provide information necessary for U.S. holders to make qualified electing fund elections, which, if available, would result in tax treatment different from (and generally less adverse than) the general tax treatment for PFICs described above.

If a U.S. holder owns our ADSs or common shares during any taxable year that we are a PFIC, such holder is required to file an annual report containing such information as the United States Treasury Department may require and may be required to file an annual IRS Form 8621. Each U.S. holder is advised to consult its tax advisors regarding the potential tax consequences to such holder if we are or become classified as a PFIC, including the possibility of making a mark-to-market election.

#### Information Reporting

U.S. holders may be subject to information reporting to the Internal Revenue Service with respect to dividends on and proceeds from the sale or other disposition of our ADSs or common shares. Each U.S. holder is advised to consult with its tax advisor regarding the application of the United States information reporting rules to their particular circumstances.

An individual U.S. holder and certain entities may be required to submit to the United States Internal Revenue Service certain information with respect to his or her beneficial ownership of the ADSs or common shares, if such ADSs or common shares are not held on his or her behalf by a U.S. financial institution. This law also imposes penalties if an individual U.S. holder is required to submit such information to the United States Internal Revenue Service and fails to do so in a timely manner. Each U.S. holder is urged to consult its tax advisor as to any such reporting requirements.

#### F. Dividends and Paying Agents

Not applicable.

#### G. Statement by Experts

Not applicable.

## H. Documents on Display

We previously filed with the SEC a registration statement on Form F-1 under the Securities Act with respect to our initial public offering of our Class A common shares represented by ADSs.

We are subject to the periodic reporting and other informational requirements of the Securities Exchange Act of 1934 or the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the SEC. Specifically, we are required to file annually a Form 20-F within four months after the end of each fiscal year which is December 31. The SEC maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. Copies of reports and other information, when filed, may also be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the SEC at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. The public may obtain information regarding the Washington, D.C. Public Reference Room by calling the SEC at 1-800-SEC-0330. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

We will furnish Deutsche Bank Trust Company Americas, the depository of our ADSs, with our annual reports, which will include a review of operations and annual audited consolidated financial statements prepared in conformity with U.S. GAAP, and all notices of shareholders' meetings and other reports and communications that are made generally available to our shareholders. The depository will make such notices, reports and communications available to holders of ADSs and, upon our request, will mail to all record holders of ADSs the information contained in any notice of a shareholders' meeting received by the depository from us.

## I. Subsidiary Information

For a listing of our subsidiaries, see "Item 4. Information on the Company—C. Organizational Structure."

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

The revenues and expenses of our subsidiaries and PRC consolidated affiliated entities are generally denominated in Renminbi and their assets and liabilities are denominated in Renminbi. Our financing activities are denominated in U.S. dollars.

To date, we have not entered into hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. Although our exposure to foreign exchange risks is generally limited, the value of your investment in our ADSs will be affected by the exchange rate between the U.S. dollar and the Renminbi because the value of our business is effectively denominated in Renminbi, while our ADSs will be traded in U.S. dollars.

The Renminbi is not freely convertible into foreign currencies. Remittances of foreign currencies into the PRC and exchange of foreign currencies into Renminbi require approval by foreign exchange administrative authorities and certain supporting documentation. The State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of Renminbi into other currencies.

The value of the Renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of Renminbi into foreign currencies, including U.S. dollars, is based on rates set by the People's Bank of China. The PRC government allowed the Renminbi to appreciate by more than 20% against the U.S. dollar between July 2005 and July 2008. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the Renminbi and the U.S. dollar remained within a narrow band. Since June 2010, the PRC government has allowed the Renminbi to appreciate slowly against the U.S. dollar again, though there have been periods when the U.S. dollar has appreciated against the Renminbi as well. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the Renminbi and the U.S. dollar in the future. To the extent that we need to convert U.S. dollars we receive from our initial public offering into Renminbi for our operations, appreciation of the Renminbi against the U.S. dollar would have an adverse effect on the Renminbi amount we receive from the conversion. Conversely, if we decide to convert the Renminbi into U.S. dollars for the purpose of making payments for dividends on our common shares or ADSs or for other business purposes, appreciation of the U.S. dollar against the Renminbi would have a negative effect on the U.S. dollar amounts available to us.

Interest Rate Risk

Our exposure to interest rate risk primarily relates to the interest income generated by excess cash, which is mostly held in interest-bearing bank deposits. Interest-earning instruments carry a degree of interest rate risk. We have not been exposed to, nor do we anticipate being exposed to, material risks due to changes in market interest rates. However, our future interest income may fall short of expectations due to changes in market interest rates. A hypothetical one percentage point decrease in interest rates would have resulted in a decrease of approximately US\$5.9 million in our interest income for the year ended December 31, 2014.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

Fees and Charges Our ADS holders May Have to Pay

As an ADS holder, you will be required to pay the following service fees to the depositary bank:

<b>Service</b>	<b>Fees</b>
· Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property	Up to \$0.05 per ADS issued
· Cancellation of ADSs, including the case of termination of the deposit agreement	Up to \$0.05 per ADS cancelled
· Distribution of cash dividends or other cash distributions	Up to \$0.05 per ADS held
· Distribution of ADSs pursuant to share dividends, free share distributions or exercise of rights	Up to \$0.05 per ADS held
· Distribution of securities other than ADSs or rights to purchase additional ADSs	A fee equivalent to the fee that would be payable if securities distributed to you had been Class A common shares and the Class A common shares had been deposited for issuance of ADSs
· Depository services	Up to \$0.05 per ADS held on the applicable record date(s) established by the depositary bank
· Transfer of ADSs	\$1.50 per certificate presented for transfer

As an ADS holder, you will also be responsible to pay certain fees and expenses incurred by the depositary bank and certain taxes and governmental charges (in addition to any applicable fees, expenses, taxes and other governmental charges payable on the deposited securities represented by any of your ADSs), such as:

Fees for the transfer and registration of Class A common shares charged by the registrar and transfer agent for the Class A common shares in the Cayman Islands (i.e., upon deposit and withdrawal of Class A common shares).

· Expenses incurred for converting foreign currency into U.S. dollars.

· Expenses for cable, telex and fax transmissions and for delivery of securities.

Taxes and duties upon the transfer of securities, including any applicable stamp duties, any stock transfer charges or withholding taxes (i.e., when Class A common shares are deposited or withdrawn from deposit).

· Fees and expenses incurred in connection with the delivery or servicing of Class A common shares on deposit.

Fees and expenses incurred in connection with complying with exchange control regulations and other regulatory requirements applicable to Class A common shares, deposited securities, ADSs and ADRs.

· Any applicable fees and penalties thereon.

The depositary fees payable upon the issuance and cancellation of ADSs are typically paid to the depositary bank by the brokers (on behalf of their clients) receiving the newly issued ADSs from the depositary bank and by the brokers (on behalf of their clients) delivering the ADSs to the depositary bank for cancellation. The brokers in turn charge these fees to their clients. Depositary fees payable in connection with distributions of cash or securities to ADS holders and the depositary services fee are charged by the depositary bank to the holders of record of ADSs as of the applicable ADS record date.

The depositary fees payable for cash distributions are generally deducted from the cash being distributed or by selling a portion of distributable property to pay the fees. In the case of distributions other than cash (i.e., share dividends, rights), the depositary bank 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 uncertificated in direct registration), the depositary bank sends invoices to the applicable record date ADS holders. In the case of ADSs held in brokerage and custodian accounts (via DTC), the depositary bank generally collects its fees through the 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. The brokers and custodians who hold their clients' ADSs in DTC accounts in turn charge their clients' accounts the amount of the fees paid to the depositary banks.

In the event of refusal to pay the depositary fees, the depositary bank may, under the terms of the deposit agreement, refuse the requested service until payment is received or may set off the amount of the depositary fees from any distribution to be made to the ADS holder.

#### Fees and Other Payments Made by the Depositary to Us

Deutsche Bank Trust Company Americas, as our depositary, has agreed to reimburse us for a portion of certain expenses we incur that are related to establishment and maintenance of the ADS program, including investor relations expenses. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not related to the amounts of fees the depositary collects from investors. Further, the depositary has agreed to reimburse us certain fees payable to the depositary by holders of ADSs. For the year ended December 31, 2014, we have US\$0.5 million payable to us from the depositary as reimbursement for our expenses incurred in connection with the establishment and maintenance of our ADS program.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

See "Item 10. Additional Information" for a description of the rights of securities holders, which remain unchanged.

The following "Use of Proceeds" information relates to the registration statement on Form F-1, as amended (File Number 333-184414) for our initial public offering of 8,970,000 ADSs, representing 179,400,000 Class A common shares, which registration statement was declared effective by the SEC on November 20, 2012. We received net proceeds of US\$82.8 million from our initial public offering.

For the period from the effective date to December 31, 2014, we did not use a substantial portion of the net proceeds received from our initial public offering.

ITEM 15. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Exchange Act, our management, including our chief executive officer, and our chief financial officer, performed an evaluation of the effectiveness of our disclosure controls and procedures, as that term is defined in Rules 13a-15(e) of the Exchange Act, as of the end of the period covered by this annual report. Based on that evaluation, our management has concluded that our disclosure controls and procedures as of December 31, 2014, were effective in ensuring that the information required to be disclosed by us in the reports that we file and furnish under the Exchange Act was recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that the information required to be disclosed by us in the reports that we file or



submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

#### 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 defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles (GAAP) in the United States of America 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 the assets of our company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with GAAP, and that receipts and expenditures of our company are being made only in accordance with authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of the unauthorized acquisition, use or disposition of our company's assets that could have a material effect on the consolidated 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 risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management conducted an evaluation of the effectiveness of our company's internal control over financial reporting as of December 31, 2014 based on the framework in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2014.

PricewaterhouseCoopers Zhong Tian LLP, our independent registered public accounting firm, audited the effectiveness of our company's internal control over financial reporting as of December 31, 2014, as stated in its report, which appears on page F-2 of this Form 20-F.

#### Changes in Internal Control Over Financial Reporting

As required by Rule 13a-15(d), under the Exchange Act, our management, including our chief executive officer and our chief financial officer, also conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the period covered by this report have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, it has been determined that there has been no such change during the period covered by this annual report.

#### ITEM 16. [RESERVED]

#### ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Peter Andrew Schloss is our audit committee financial expert, who is an independent director under the standards set forth in Nasdaq Stock Market Rule 5605(a)(2) and Rule 10A-3 of the Exchange Act. Mr. Schloss is the chairman of our audit committee.

#### ITEM 16B. CODE OF ETHICS

Our board of directors has adopted a code of ethics that applies to our directors, officers, employees and agents, including certain provisions that specifically apply to our chief executive officers, chief financial officer, chief operating officer, vice presidents and any other persons who perform similar functions for us. We filed our code of business conduct and ethics as Exhibit 99.1 to our registration statement on Form F-1, as amended, which was originally filed with the SEC on October 15, 2012 and subsequently amended and filed with this annual report. We have posted a copy of our code of business conduct and ethics on our website at <http://investors.yy.com/governance.cfm>.

#### ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees in connection with certain professional services rendered by PricewaterhouseCoopers Zhong Tian LLP, our independent registered public accounting firm, for the years indicated. We did not pay any other fees to our independent registered public accounting firm during the periods other than those indicated below.

	For the Year Ended December 31, 2013 2014 (in RMB thousands)	
Audit fees <sup>(1)</sup>	9,304	10,634

"Audit fees" means the aggregate fees billed for professional services rendered by our independent registered public accounting firm for the annual audit and the quarterly review of our consolidated financial statement. For (1)2013 and 2014, the audit refers to the audit of our annual consolidated financial statements and our internal controls over financial reporting. The "Audit fees" also includes fees billed for service provided by our independent registered public accounting firm in connection with convertible bonds offering.

The policy of our audit committee is to pre-approve all audit and non-audit services provided by PricewaterhouseCoopers Zhong Tian LLP, including audit services, audit-related services, tax services and other services, other than those for *de minimis* services which are approved by the audit committee prior to the completion of the audit. Our audit committee has approved all of our audit fees for the year ended December 31, 2014.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

On May 4, 2014, our board of directors approved a share repurchase plan, or the Repurchase Plan. Under the terms of the Repurchase Program, we may repurchase up to US\$100 million worth of our outstanding ADSs from time to time, for a period not to exceed twelve (12) months. The repurchases, funded from our existing cash balance, may be made in the open market at prevailing market prices or through privately negotiated transactions, including block trades, depending on market conditions, the trading price of our ADSs and other factors, in compliance with relevant United States securities rules and regulations and our securities trading policy, in a manner that is consistent with the interest of our shareholders.

On March 5, 2015, our board of directors approved another share repurchase plan, or the 2015 Repurchase Plan. Under the terms of the 2015 Repurchase Plan, we may repurchase up to US\$100 million worth of its outstanding ADSs from time to time for a period not to exceed twelve (12) months. The repurchases may be made in the open market at prevailing market prices or through privately negotiated transactions, including block trades. The timing and extent of any repurchases will depend on market conditions, the trading price of our ADSs and other factors. The plan will be implemented in compliance with relevant United States securities rules and regulations and our securities trading policy, in a manner that is consistent with the interests of our shareholders. Our board of directors will review the share repurchase program periodically and may authorize the adjustment of its terms and size accordingly. We expect to fund the repurchases made under this program from our existing cash balance.

Neither we nor our affiliated purchasers made any share repurchases during the year ended December 31, 2014.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

We have followed and intend to continue to follow the applicable corporate governance standards under the Nasdaq Stock Market Rules.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

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PART III

ITEM 17. FINANCIAL STATEMENTS

We have elected to provide financial statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

The consolidated financial statements of YY Inc. are included at the end of this annual report.

ITEM 19. EXHIBITS

<b>Exhibit Number</b>	<b>Description of Document</b>
1.1	Second Amended and Restated Memorandum and Articles of Association of the Registrant (incorporated herein by reference to Exhibit 3.2 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
2.1	Registrant's Specimen American Depositary Receipt (incorporated herein by reference to Exhibit 4.1 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
2.2	Registrant's Specimen Certificate for Common Shares (incorporated herein by reference to Exhibit 4.2 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
2.3	Form of Deposit Agreement, among the Registrant, the depository and holder of the American Depositary Receipts (incorporated herein by reference to Exhibit 4.3 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
2.4	Investors' Rights Agreement dated September 6, 2011 among the Registrant and other parties named therein (incorporated herein by reference to Exhibit 4.4 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)

- 2.6 Share Exchange Agreement dated September 6, 2011, relating to Duowan Entertainment Corp. (incorporated herein by reference to Exhibit 4.6 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
- 4.1 2009 Employee Equity Incentive Scheme of the Registrant, as amended and restated. (incorporated herein by reference to Exhibit 10.1 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
- 4.2 2011 Share Incentive Plan and Amendment No. 1 to the 2011 Share Incentive Plan of the Registrant (incorporated herein by reference to Exhibit 10.2 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
- 4.3 Form of Indemnification Agreement with the Registrant's directors and officers (incorporated herein by reference to Exhibit 10.3 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)

Exhibit Number	Description of Document
4.4	Form of Employment Agreement between the Registrant and an executive officer of the Registrant (incorporated herein by reference to Exhibit 10.4 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.5	English translation of Exclusive Business Cooperation Agreement dated August 12, 2008 between Huanju Shidai (formerly known as Duowan Entertainment Information Technology (Beijing) Co., Ltd.) and Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.5 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.6	English translation of Supplementary Agreement dated November 10, 2011 to Exclusive Business Cooperation Agreement between Huanju Shidai and Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.6 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.7	English translation of Confirmation Letter dated November 10, 2011 to Exclusive Business Cooperation Agreement between Huanju Shidai and Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.7 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.8	English translation of Exclusive Technology Support and Technology Services Agreement dated August 12, 2008 between Huanju Shidai and Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.8 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.9	English translation of Supplementary Agreement dated November 10, 2011 to Exclusive Technology Support and Technology Services Agreement between Huanju Shidai and Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.9 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.10	English translation of Confirmation letter dated November 10, 2011 to Exclusive Technology Support and Technology Services Agreement between Huanju Shidai and Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.10 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.11	English translation of Powers of Attorney dated September 16, 2011 issued to Huanju Shidai by each of the shareholders of Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.11 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.12	English translation of Exclusive Option Agreements dated September 16, 2011 among Huanju Shidai, Guangzhou Huaduo and each of the shareholders of Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.12 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)



4.13 English translation of Equity Interest Pledge Agreements dated September 16, 2011 between Huanju Shidai and each of the shareholders of Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.11 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)

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Exhibit Number	Description of Document
4.14	English translation of Consent Letter dated November 10, 2011 issued by the shareholders of Guangzhou Huaduo (incorporated herein by reference to Exhibit 10.11 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.15	English translation of Exclusive Business Cooperation Agreement dated December 3, 2009 between Huanju Shidai and Beijing Tuda (incorporated herein by reference to Exhibit 10.15 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.16	English translation of Supplementary Agreement dated November 10, 2011 to Exclusive Business Cooperation Agreement between Huanju Shidai and Beijing Tuda (incorporated herein by reference to Exhibit 10.16 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.17	English translation of Confirmation Letter dated November 10, 2011 to Exclusive Business Cooperation Agreement between Huanju Shidai and Beijing Tuda (incorporated herein by reference to Exhibit 10.17 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.18	English translation of Exclusive Technology Support and Technology Services Agreement dated December 3, 2009 between Huanju Shidai and Beijing Tuda (incorporated herein by reference to Exhibit 10.18 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.19	English translation of Supplementary Agreement dated November 10, 2011 to Exclusive Technology Support and Technology Services Agreement between Huanju Shidai and Beijing Tuda (incorporated herein by reference to Exhibit 10.19 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.20	English translation of Confirmation Letter dated November 10, 2011 to Exclusive Technology Support and Technology Services Agreement between Huanju Shidai and Beijing Tuda (incorporated herein by reference to Exhibit 10.20 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.21	English translation of Powers of Attorney dated May 27, 2011 issued to Huanju Shidai by each of the shareholders of Beijing Tuda (incorporated herein by reference to Exhibit 10.21 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.22	English translation of Exclusive Option Agreements dated May 27, 2011 among Huanju Shidai, Beijing Tuda and each of the shareholders of Beijing Tuda (incorporated herein by reference to Exhibit 10.22 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)

4.23 English translation of Equity Interest Pledge Agreements dated July 1, 2011 between Huanju Shidai and each of the shareholders of Beijing Tuda (incorporated herein by reference to Exhibit 10.23 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)

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<b>Exhibit Number</b>	<b>Description of Document</b>
4.24	English translation of Consent Letter dated November 10, 2011 issued by the shareholders of Beijing Tuda (incorporated herein by reference to Exhibit 10.24 to the registration statement on Form F-1, as amended (File No. 333-184414), initially filed with the Securities and Exchange Commission on October 15, 2012)
4.25*	Indenture, dated March 24, 2014, constituting US\$400 million 2.25% Convertible Senior Notes due 2019
4.26*	English summary of Panyu Land Purchase Agreement, dated August 7, 2014, by and among Guangzhou Huanju Shidai Information Technology Co., Ltd. and Guangzhou Panyu Information Technology Investment Development Co., Ltd.
8.1*	List of Subsidiaries and Consolidated Affiliated Entities
11.1	Amended Code of Business Conduct and Ethics of the Registrant (incorporated herein by reference to Exhibit 11.1 to the annual report on Form 20-F (File No. 001-35729) filed with the Securities and Exchange Commission on April 26, 2013)
12.1*	Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2*	Certification by Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1**	Certification by Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2**	Certification by Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1*	Consent of Conyers Dill & Pearman
15.2*	Consent of Fangda Partners
15.3*	Consent of Independent Registered Public Accounting Firm
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed with this annual report on Form 20-F

\*\* Furnished with this annual report on Form 20-F

SIGNATURES

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 21, 2015

**YY INC.**

By:

/s/ David Xueling Li

Name: David Xueling Li

Title: Director and Chief Executive Officer

**YY INC.**

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of YY Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive income, of changes in shareholders' (deficits) equity and of cash flows, present fairly, in all material respects, the financial position of YY Inc. (the "Company") and its subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's report on Internal Control over Financial Report appearing under Item 15 of the accompanying Form 20-F. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

/s/ PricewaterhouseCoopers Zhong Tian LLP

Shanghai, the People's Republic of China

April 21, 2015

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**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2013 AND 2014**

(All amounts in thousands, except share, ADS, per share and per ADS data)

	Notes	As of December 31,		2014 US\$ (Note 2(e))
		2013 RMB	2014 RMB	
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	5	729,598	475,028	76,561
Short-term deposits	6	1,432,863	4,214,576	679,266
Restricted short-term deposits	7	-	100,000	16,117
Accounts receivable, net	8	100,101	257,436	41,491
Inventory		-	1,445	233
Amounts due from related parties	25	73	61,073	9,843
Prepayments and other current assets	9	67,533	204,139	32,901
Deferred tax assets	20	66,921	111,436	17,960
<b>Total current assets</b>		<b>2,397,089</b>	<b>5,425,133</b>	<b>874,372</b>
<b>Non-current assets</b>				
Deferred tax assets	20	625	1,392	224
Investments	10	62,029	186,654	30,083
Property and equipment, net	11	102,636	234,228	37,751
Intangible assets, net	12	29,127	154,034	24,826
Goodwill	13	1,577	300,382	48,413
Other non-current assets	14	4,864	560,971	90,412
<b>Total non-current assets</b>		<b>200,858</b>	<b>1,437,661</b>	<b>231,709</b>
<b>Total assets</b>		<b>2,597,947</b>	<b>6,862,794</b>	<b>1,106,081</b>
<b>Liabilities and shareholders' equity</b>				
<b>Current liabilities</b>				
Accounts payable (including accounts payable of the consolidated variable interest entity without recourse to the Company of RMB55,818 and RMB101,160 as of December 31, 2013 and 2014, respectively)		56,391	101,525	16,363
Deferred revenue (including deferred revenue of the consolidated variable interest entity without recourse to the Company of RMB292,380 and RMB 354,987 as of December 31, 2013 and 2014, respectively)	15	293,866	356,150	57,401
Advances from customers (including advances from customers of the consolidated variable interest entity without recourse to the Company of RMB10,656 and RMB 25,897 as of December 31, 2013 and 2014, respectively)		19,549	34,127	5,500
		78,107	89,161	14,370

Income taxes payable (including income taxes payable of the consolidated variable interest entity without recourse to the Company of RMB47,974 and RMB65,162 as of December 31, 2013 and 2014, respectively)				
Accrued liabilities and other current liabilities (including accrued liabilities and other current liabilities of the consolidated variable interest entity without recourse to the Company of RMB197,851 and RMB357,464 as of December 31, 2013 and 2014, respectively)	16	250,760	478,703	77,153
Amounts due to related parties (including amounts due to related parties of the consolidated variable interest entity without recourse to the Company of RMB2,640 and RMB30,892 as of December 31, 2013 and 2014, respectively)	25	2,640	30,892	4,979
Total current liabilities		701,313	1,090,558	175,766
Non-current liabilities				
Convertible bonds (including convertible bonds of the consolidated variable interest entity without recourse to the Company of nil and nil as of December 31, 2013 and 2014, respectively)	17	-	2,447,980	394,543
Long-term payable (including long-term payable of the consolidated variable interest entity without recourse to the Company of nil and RMB183,000 as of December 31, 2013 and 2014, respectively)	4	-	183,000	29,494
Deferred revenue (including deferred revenue of the consolidated variable interest entity without recourse to the Company of RMB8,457 and RMB24,383 as of December 31, 2013 and 2014, respectively)	15	9,425	24,383	3,930
Deferred tax liabilities (including deferred tax liabilities of the consolidated variable interest entity without recourse to the Company of nil and RMB26,709 as of December 31, 2013 and 2014, respectively)	20	-	26,709	4,305
Total non-current liabilities		9,425	2,682,072	432,272
Total liabilities		710,738	3,772,630	608,038
Commitments and contingencies	27			

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2013 AND 2014 (CONTINUED)**

(All amounts in thousands, except share, ADS, per share and per ADS data)

	Notes	As of December 31,		2014
		2013	2014	US\$
		RMB	RMB	(Note 2(e))
Shareholders' equity				
Class A common shares (US\$0.00001 par value; 10,000,000,000 shares authorized, 622,658,738 shares issued and outstanding as of December 31, 2013 and 706,173,568 shares issued and outstanding as of December 31, 2014)	21	38	43	7
Class B common shares (US\$0.00001 par value; 1,000,000,000 shares authorized, 485,831,386 shares issued and outstanding as of December 31, 2013 and 427,352,696 shares issued and outstanding as of December 31, 2014)	21	34	30	5
Additional paid-in capital		2,765,614	2,900,458	467,469
Statutory reserves	2(dd)	40,657	56,469	9,101
(Accumulated deficits) Retained earnings		(874,697 )	173,963	28,038
Accumulated other comprehensive loss		(44,437 )	(40,799 )	(6,577 )
Total shareholders' equity		1,887,209	3,090,164	498,043
Total liabilities and shareholders' equity		2,597,947	6,862,794	1,106,081

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014**

(All amounts in thousands, except share, ADS, per share and per ADS data)

		For the year ended December 31,			
	Note	2012	2013	2014	2014
		RMB	RMB	RMB	US\$
					(Note2(e))
Net revenues					
Internet value-added service					
—Online music and entertainment		286,446	852,885	2,109,503	339,990
—Online games		332,287	602,111	811,699	130,822
—Others		83,655	205,212	609,823	98,286
Online advertising		117,643	163,260	147,343	23,747
Total net revenues		820,031	1,823,468	3,678,368	592,845
Cost of revenues <sup>(1)</sup>	18	(416,133 )	(881,999 )	(1,849,149 )	(298,029 )
Gross profit		403,898	941,469	1,829,219	294,816
<b>Operating expenses <sup>(1)</sup></b>					
Research and development expenses		(176,725 )	(267,005 )	(431,188 )	(69,495 )
Sales and marketing expenses		(16,954 )	(24,955 )	(102,527 )	(16,524 )
General and administrative expenses		(109,788 )	(200,554 )	(223,019 )	(35,944 )
Total operating expenses		(303,467 )	(492,514 )	(756,734 )	(121,963 )
Other income	19	2,465	27,078	6,319	1,018
Operating income		102,896	476,033	1,078,804	173,871
Gain on disposal of an equity investment		651	-	999	161
Gain on disposal of a cost investment		2,351	-	-	-
Foreign currency exchange (losses) gains, net		(4,153 )	29,555	(10,399 )	(1,676 )
Interest expense	17	-	-	(56,607 )	(9,123 )
Interest income		16,316	60,221	164,969	26,588
Other non-operating income	10	-	-	36,714	5,917
Income before income tax expenses		118,061	565,809	1,214,480	195,738
Income tax expenses	20	(29,041 )	(89,951 )	(154,283 )	(24,866 )
Income before share of income in equity method investments, net of income taxes		89,020	475,858	1,060,197	170,872

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Share of income in equity method investments, net of income taxes		157	1,869	4,275	689
Net income attributable to YY Inc.		89,177	477,727	1,064,472	171,561
Decretion to convertible redeemable preferred shares redemption value	22	1,293,875	-	-	-
Allocation of net income to participating preferred shareholders	22	(478,754 )	-	-	-
Net income attributable to common shareholders		904,298	477,727	1,064,472	171,561
Net income		89,177	477,727	1,064,472	171,561
Other comprehensive (loss) income:					
Foreign currency translation adjustments, net of nil tax		(1,204 )	(31,014 )	3,638	586
Comprehensive income attributable to YY Inc.		87,973	446,713	1,068,110	172,147

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**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014 (CONTINUED)**

(All amounts in thousands, except share, ADS, per share and per ADS data)

	Note	For the year ended December 31,			2014
		2012	2013	2014	2014
		RMB	RMB	RMB	US\$
					(Note2(e))
Net income per ADS*					
—Basic	24	29.91	8.51	18.46	2.98
—Diluted	24	1.80	8.09	17.76	2.86
Weighted average number of ADS used in calculating net income per ADS					
—Basic	24	30,235,191	56,123,784	57,657,035	57,657,035
—Diluted	24	49,623,442	59,056,065	59,927,174	59,927,174
Net income per common share*					
—Basic	24	1.50	0.43	0.92	0.15
—Diluted	24	0.09	0.40	0.89	0.14
Weighted average number of common shares used in calculating net income per common share					
—Basic	24	604,703,810	1,122,475,688	1,153,140,699	1,153,140,699
—Diluted	24	992,468,836	1,181,121,297	1,198,543,473	1,198,543,473

\* Each ADS represents 20 Class A common shares.

(1) Share-based compensation was allocated in cost of revenues and operating expenses as follows:

	Note	For the year ended December 31,			
		2012	2013	2014	2014
		RMB	RMB	RMB	US\$
					(Note2(e))
Cost of revenues		8,407	9,860	18,037	2,907
Research and development expenses		35,441	39,587	54,141	8,726
Sales and marketing expenses		884	1,318	2,807	452
General and administrative expenses		55,619	66,331	59,647	9,613

The accompanying notes are an integral part of these consolidated financial statements.





**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' (DEFICITS) EQUITY FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014**

(All amounts in thousands, except share, ADS, per share and per ADS data)

		Class A common shares		Class B Common shares		Additional paid-in capital		Accumulated other comprehensive loss	Total shareholders' (deficits) equity
	Notes	Number of shares	Amount	Number of shares	Amount	RMB	RMB	RMB	RMB
		Note 21	RMB	Note 21	RMB	RMB	RMB	RMB	RMB
<b>Balance as of December 31, 2011</b>		-	-	543,340,914	37	584,093	(2,433,604)	(12,219)	(1,861,693)
Issuance of common shares	21	179,400,000	11	-	-	515,709	-	-	515,720
Issuance of common shares for vested restricted shares	21	-	-	5,068,000	-	-	-	-	-
Share-based compensation—share options	23	-	-	-	-	(89)	-	-	(89)
Share based compensation—restricted shares	23	-	-	-	-	36,371	-	-	36,371
Share-based compensation—restricted share units	23	-	-	-	-	54,445	-	-	54,445
Share-based compensation—restricted shares to the CEO and Chairman	23	-	-	-	-	9,624	-	-	9,624
Transferred from Series A convertible redeemable preferred shares upon the completion of the initial public offering	22	-	-	136,100,930	9	449,487	-	-	449,496
Transferred from Series B convertible redeemable preferred shares upon the completion of the initial public offering	22	-	-	102,073,860	6	337,110	-	-	337,116
Transferred from Series C convertible	22	-	-	121,249,520	8	400,439	-	-	400,447

redeemable preferred shares upon the completion of the initial public offering									
Decretion of Series A convertible redeemable preferred shares to redemption value	22	-	-	-	-	125,813	359,704	-	485,517
Decretion of Series B convertible redeemable preferred shares to redemption value	22	-	-	-	-	64,102	302,683	-	366,785
Decretion of Series C convertible redeemable preferred shares to redemption value	22	-	-	-	-	71,300	370,273	-	441,573
Components of comprehensive income								-	
Net income		-	-	-	-	-	89,177	-	89,177
Foreign currency translation adjustment, net of nil tax		-	-	-	-	-	-	(1,204 )	(1,204 )
<b>Balance as of December 31, 2012</b>		179,400,000	11	907,833,224	60	2,648,404	(1,311,767)	(13,423)	1,323,285

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' (DEFICITS) EQUITY FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014 (CONTINUED)**

(All amounts in thousands, except share, ADS, per share and per ADS data)

	Notes	Class A common shares Number of shares Note 21	Amount RMB	Class B Common shares Number of shares Note 21	Amount RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated deficits RMB	Accumulated other comprehensive loss RMB	Total shareholders' equity RMB
<b>Balance as of December 31, 2012</b>		179,400,000	11	907,833,224	60	2,648,404	-	(1,311,767)	(13,423)	1,323,285
Issuance of common shares for exercised share options	21	4,648,420	-	-	-	115	-	-	-	115
Issuance of common shares for vested restricted shares and restricted share units	21	16,608,480	1	-	-	(1 )	-	-	-	-
Class B common shares converted to Class A common shares	21	422,001,838	26	(422,001,838)	(26)	-	-	-	-	-
Share based compensation- share options	23	-	-	-	-	14,004	-	-	-	14,004
Share-based compensation- restricted shares	23	-	-	-	-	7,300	-	-	-	7,300
Share based compensation- restricted share units	23	-	-	-	-	95,792	-	-	-	95,792
Appropriations to statutory reserves	2(dd)	-	-	-	-	-	40,657	(40,657 )	-	-
Components of comprehensive										

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income									
Net income	-	-	-	-	-	-	477,727	-	477,727
Foreign									
currency									
translation									
adjustment, net	-	-	-	-	-	-	-	(31,014)	(31,014 )
of nil tax									
<b>Balance as of</b>									
<b>December 31,</b>	622,658,738	38	485,831,386	34	2,765,614	40,657	(874,697 )	(44,437)	1,887,209
<b>2013</b>									

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**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' (DEFICITS) EQUITY FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014 (CONTINUED)**

(All amounts in thousands, except share, ADS, per share and per ADS data)

	Notes	Class A common shares Number of shares Note 21	Class B Common shares Number of shares Amount RMB	Class B Common shares Number of shares Note 21	Class B Common shares Amount RMB	Additional paid-in capital RMB	Statutory reserves RMB	(Accumulated deficits) Retained earnings RMB	Accumulated other comprehensive loss RMB	Total shareholders' equity RMB
<b>Balance as of December 31, 2013</b>		622,658,738	38	485,831,386	34	2,765,614	40,657	(874,697 )	(44,437)	1,887,209
Issuance of common shares for exercised share options	21	5,841,660	-	-	-	213	-	-	-	213
Issuance of common shares for vested restricted shares and restricted share units	21	19,194,480	1	-	-	(1 )	-	-	-	-
Class B common shares converted to Class A common shares	21	58,478,690	4	(58,478,690 )	(4 )	-	-	-	-	-
Share-based compensation- restricted shares	23	-	-	-	-	3,771	-	-	-	3,771
Share based compensation- restricted share units	23	-	-	-	-	130,718	-	-	-	130,718
Share-based compensation - restricted shares to the founder of a subsidiary of a variable interest entity	23	-	-	-	-	143	-	-	-	143

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Appropriation to statutory reserves	2(dd)	-	-	-	-	-	15,812	(15,812 )	-	-
Components of comprehensive income										
Net income		-	-	-	-	-	-	1,064,472	-	1,064,472
Foreign currency translation adjustment, net of nil tax		-	-	-	-	-	-	-	3,638	3,638
<b>Balance as of December 31, 2014</b>		706,173,568	43	427,352,696	30	2,900,458	56,469	173,963	(40,799)	3,090,164

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014**

(All amounts in thousands)

		For the year ended December 31,			
	Note	2012	2013	2014	2014
		RMB	RMB	RMB	US\$
					(Note2(e))
Cash flows from operating activities					
Net income		89,177	477,727	1,064,472	171,561
Adjustments to reconcile net income to net cash provided by operating activities					
Depreciation of property and equipment	11	29,074	44,963	68,035	10,965
Amortization of acquired intangible assets	12	3,369	4,707	12,598	2,030
Allowance for doubtful accounts		6,884	31,987	28,120	4,532
Loss on disposal of property and equipment	7		1	61	10
Impairment of an equity investment		-	899	-	-
Impairment of a cost investment		453	-	4,000	645
Impairment of intangible assets		550	-	5,697	918
Share-based compensation	23	100,351	117,096	134,632	21,698
Share of income in equity method investments		(157)	(1,869)	(4,275)	(689)
Gain on disposal of an equity investment		(651)	-	(999)	(161)
Gain on disposal of a cost investment		(2,351)	-	-	-
Deferred income taxes, net	20	(19,316)	(35,414)	(45,751)	(7,374)
Foreign exchange losses (gains), net		4,153	(29,555)	10,399	1,676
Other non-operating income	10	-	-	(36,714)	(5,917)
Changes in operating assets and liabilities, net					
Accounts receivable		(77,478)	(14,472)	(183,527)	(29,579)
Prepayments and other assets		(11,968)	(46,624)	(90,924)	(14,654)
Amounts due from related parties	25	(73)	-	-	-
Amounts due to related parties	25	1,734	36	28,252	4,553
Accounts payable		7,214	26,342	23,166	3,734
Deferred revenue		125,541	136,945	54,343	8,759
Advances from customers		5,062	12,034	14,578	2,350
Income tax payable		31,129	30,106	11,054	1,782
Accrued liabilities and other current liabilities		64,148	136,264	204,134	32,901
Net cash provided by operating activities		356,852	891,173	1,301,351	209,740
Cash flows from investing activities					
Placements of short-term deposits		(1,040,302)	(1,529,090)	(5,343,934)	(861,286)
Maturities of short-term deposits		615,259	995,996	2,550,059	410,995
Placement of restricted short-term deposits		-	-	(155,000)	(24,981)
Maturities of restricted short-term deposits		-	-	55,000	8,864
Purchase of property and equipment		(60,881)	(55,606)	(178,470)	(28,764)

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Purchase of intangible assets		(1,920 )	(14,631 )	(21,757 )	(3,507 )
Purchase of other non-current assets		-	-	(510,341 )	(82,252 )
Cash paid for equity investments	25	(1,000 )	(11,000 )	(15,000 )	(2,418 )
Cash paid for cost investments		-	(47,110 )	(73,402 )	(11,830 )
Cash received from disposal of a cost investment		1,000	3,000	-	-
Cash received from disposal of an equity investment		2,000	-	1,563	252
Cash paid for business acquisition, net of cash acquired		(11,722 )	-	(170,950 )	(27,552 )
Payment on behalf of a related party	25	-	-	(61,000 )	(9,831 )
Loans to related parties	25	(1,200 )	-	(1,500 )	(242 )
Repayment of loans from related parties	25	2,500	1,000	1,500	242
Loans to employees and third parties		(2,930 )	(3,770 )	(35,512 )	(5,723 )
Repayment of loans from employees and third parties		660	1,560	4,531	730
Proceeds from disposal of property and equipment		32	48	158	25
Net cash used in investing activities		(498,504 )	(659,603 )	(3,954,055 )	(637,278 )
Cash flows from financing activities					
Proceeds from exercise of vested share options		-	115	213	34
Proceeds from initial public offering (net of underwriters' commissions of US\$6,593)	21	550,555	-	-	-
Payments of listing expenses	21	(27,815 )	(5,802 )	-	-
Proceeds from issuance of convertible bonds, net of issuance costs	17	-	-	2,402,549	387,221
Net cash provided by (used in) financing activities		522,740	(5,687 )	2,402,762	387,255
Net increase (decrease) in cash and cash equivalents		381,088	225,883	(249,942 )	(40,283 )
Cash and cash equivalents at the beginning of the year		128,891	504,702	729,598	117,590
Effect of exchange rate changes on cash and cash equivalents		(5,277 )	(987 )	(4,628 )	(746 )
Cash and cash equivalents at the end of the year		504,702	729,598	475,028	76,561



**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014 (CONTINUED)**

(All amounts in thousands)

	For the year ended December 31,			
	Note 2012	2013	2014	2014
	RMB	RMB	RMB	US\$
				(Note2(e))
Supplemental disclosure of cash flows information:				
—Acquisition of property and equipment in form of accounts payable	5,911	7,653	25,514	4,112
—Income taxes paid	(17,228)	(95,259)	(188,979)	(30,458 )

The accompanying notes are an integral part of these consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 1. Organization and principal activities

(a)	Principal activities
-----	----------------------

YY Inc. (the “Company”), through its subsidiaries, its variable interest entities (“VIEs”) and VIE’s subsidiaries (collectively, the “Group”) is principally engaged in operating an online social platform in the People’s Republic of China (the “PRC” or “China”) through its platform, YY Client and through its website *YY.com* and *Duowan.com*.

(b)	Reorganization
-----	----------------

The Company was incorporated in the Cayman Islands on July 22, 2011.

The Group began its operations in the PRC in April 2005 through its PRC domestic company, Guangzhou Huaduo Network Technology Co., Ltd. (“Guangzhou Huaduo”), which was directly owned by Mr. David Xueling Li (the “Founder” or the “CEO”) and Mr. Jun Lei (the “Co-founder” or the “Chairman”). Guangzhou Huaduo holds the necessary licenses and approvals to operate internet-related businesses in the PRC.

For the period between July 2006 and April 2007, the Group undertook a reorganization (the “First Reorganization”) and established Duowan Limited (“Duowan Limited”), an investment holding company under the laws of the British Virgin Islands (the “BVI”), Duowan (Hong Kong) Limited (“Duowan (Hong Kong)”), a Hong Kong incorporated company wholly owned by Duowan Limited, and Guangzhou Duowan Information Technology Co., Ltd. (“Guangzhou Duowan”), a wholly-owned foreign enterprise (“WOFE”) in the PRC owned by Duowan (Hong Kong) (collectively “Duowan Limited Group Structure”). The First Reorganization was necessary to comply with PRC laws and regulations which prohibit or restrict foreign ownership of companies that provide internet content services in the PRC where licenses are required.

By entering into a series of agreements among the Founder, the Co-founder, Guangzhou Huaduo, and Guangzhou Duowan (collectively, “First VIE agreements”), Guangzhou Huaduo became a VIE of Guangzhou Duowan. Guangzhou Duowan became the primary beneficiary of Guangzhou Huaduo.

In November 2007, Duowan Entertainment Corporation (“Duowan BVI”) was incorporated in the BVI. In March 2008, Duowan BVI established Duowan Entertainment Information Technology (Beijing) Co., Ltd. (“Duowan Entertainment”), as a WOFE in the PRC and a wholly-owned subsidiary of Duowan BVI. The Group undertook a second reorganization (the “Second Reorganization”) whereby the First VIE agreements among the Founder, the Co-founder, Guangzhou Huaduo and Guangzhou Duowan were terminated and a new series of VIE agreements (collectively, “Second VIE agreements”) were signed among the Founder, the Co-founder, Guangzhou Huaduo and Duowan Entertainment, through which Duowan Entertainment became the primary beneficiary and exercised effective control over the operations of Guangzhou Huaduo. Duowan BVI became the then holding company of the Group.

In August 2008, Duowan Entertainment purchased all the equity interests in Guangzhou Duowan from Duowan (Hong Kong).

In December 2008, the Group undertook another reorganization (the “Third Reorganization”) and acquired all of the equity interests of NeoTasks Inc. (“NeoTasks”), a Cayman Islands company, together with its wholly-owned subsidiary, NeoTasks Limited, its WOFE, NeoTasks International Media Technology (Beijing) Co., Ltd. (“NeoTasks Beijing”), and its VIE, Beijing Tuda Science and Technology Co., Limited (“Beijing Tuda”).

In July 2009, Guangzhou Duowan was renamed as Zhuhai Duowan Information Technology Co., Ltd. (“Zhuhai Duowan”).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 1. Organization and principal activities (continued)

#### (b) Reorganization (continued)

In December 2009, another series of VIE agreements (collectively, “Third VIE agreements”) were entered into amongst the legal shareholders of Beijing Tuda and Duowan Entertainment and thus completing the Third Reorganization. Through the aforementioned activities, Beijing Tuda became a VIE, whose primary beneficiary is Duowan Entertainment.

In December 2010, Duowan BVI established Zhuhai Duowan Technology Co., Ltd. (“Zhuhai Duowan Technology”), which is directly 100% owned by Duowan BVI.

On September 6, 2011, pursuant to a share swap agreement, all the then existing shareholders of Duowan BVI exchanged their respective shares, including the Series A, Series B, Series C-1 and Series C-2 Preferred Shares, of Duowan BVI for equivalent classes of shares of the Company on a 1 for 1 basis. As a result, Duowan BVI became a wholly-owned subsidiary of the Company and it also became the holding company of the Group (the “Share Swap”).

In May 2012, Duowan Entertainment was renamed as Huanju Shidai Technology (Beijing) Co., Ltd. (“Beijing Huanju Shidai”).

In September 2012, Zhuhai Duowan Technology was renamed as Guangzhou Huanju Shidai Information Technology Co., Ltd. (“Guangzhou Huanju Shidai”).

The First Reorganization, the Second Reorganization, the Third Reorganization and the Share Swap were all reorganization of entities under common control and have been accounted for in a manner akin to a pooling of interest as if the Company, through its wholly owned subsidiaries, had been in existence and been the primary beneficiary of the VIEs throughout the periods presented in the consolidated financial statements. As a result of these arrangements, the Company, through its wholly owned subsidiaries, is considered the primary beneficiary of two VIEs, Guangzhou Huaduo and Beijing Tuda, and accordingly, their results of operation and financial conditions are consolidated in the financial statements of the Group.

(c)

**Initial Public Offering**

The Company completed its initial public offering (“IPO”) on November 21, 2012 on the NASDAQ Global Market and the underwriters subsequently exercised their over-allotment option on December 5, 2012. The Company issued and sold a total of 8,970,000 American Depositary Shares (“ADSs”) in these transactions, representing 179,400,000 Class A common shares. Each ADS represents twenty Class A common shares. The net proceeds received by the Company, after deducting commissions and offering expenses, amounted to approximately US\$82,055. Upon the completion of the IPO, all of the Company’s 359,424,310 outstanding preferred shares and 548,408,914 outstanding common shares were converted into Class B common shares immediately as of the same date.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****1. Organization and principal activities (continued)****(d) Subsidiaries, VIEs and VIE's subsidiaries**

The details of the subsidiaries, VIEs and VIE's subsidiaries as of December 31, 2014 are set out below:

Name	Place of incorporation	Date of incorporation or acquisition	% of direct or indirect economic ownership	Principal activities
<b>Subsidiaries</b>				
Duowan Entertainment Corporation ("Duowan BVI")	BVI	November 6, 2007	100 %	Investment holding
NeoTasks Inc. ("NeoTasks")	Cayman Islands	April 26, 2006	100 %	Investment holding
NeoTasks Limited	Hong Kong	June 16, 2005	100 %	Investment holding
Huanju Shidai Technology (Beijing) Co., Ltd. ("Beijing Huanju PRC Shidai" or "Duowan Entertainment")	PRC	March 19, 2008	100 %	Investment holding
Zhuhai Duowan Information Technology Co., Ltd. ("Zhuhai Duowan" or "Guangzhou Duowan")	PRC	April 9, 2007	100 %	Online advertising and software development
Guangzhou Huanju Shidai Information Technology Co., Ltd. ("Guangzhou Huanju Shidai")	PRC	December 2, 2010	100 %	Software development
Zhuhai Huanju Shidai Information Technology Co., Ltd. ("Zhuhai Huanju Shidai")	PRC	November 14, 2013	100 %	Software development

Variable Interest Entities ("VIEs")

Guangzhou Huaduo Network Technology Co., Ltd. (“Guangzhou Huaduo”)	PRC	April 11, 2005	100	%	Holder of internet content provider licenses and internet value added services
Beijing Tuda Science and Technology Co., Ltd. (“Beijing Tuda”)	PRC	June 2, 2005	100	%	Holder of internet content provider licenses
VIE’s subsidiaries					
Guangzhou Juhui Information Technology Co., Ltd.	PRC	October 24, 2013	100	%	Software development
Guangzhou Huanju Media Co., Ltd. (“Guangzhou Huanju Media”)	PRC	April 1, 2014	100	%	Artists management
Guangzhou Zhuque Information Technology Co., Ltd. (“Zhuque”)	PRC	September 18, 2014	100	%	Online games development
Zhengrenqiang and His Partners Education Technology (Beijing) Co., Ltd. (“Zhengrenqiang”)	PRC	December 2, 2014	100	%	Online education
Beijing DuBooker Culture Communication Co., Ltd. (“DuBooker”)	PRC	December 2, 2014	100	%	Publishing of teaching materials
Beijing Huanqiu Xingxue Technology Development Co., Ltd. (“Xingxue”)	PRC	December 23, 2014	100	%	Online education
Beijing Huanqiu Chuangzhi Software Co., Ltd. (“Chuangzhi”)	PRC	December 23, 2014	100	%	Software development

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 1. Organization and principal activities (continued)

#### (e) Variable Interest Entities

To comply with PRC laws and regulations that prohibit or restrict foreign ownership of companies that provide internet-content, the Group conducts substantially all its operations through Guangzhou Huaduo and Beijing Tuda, which holds the internet value-added service license and approvals to provide such internet services in the PRC. Beijing Huanju Shidai entered into a series of contractual agreements among Beijing Huanju Shidai, Guangzhou Huaduo and their legal shareholders. Beijing Huanju Shidai also entered into a series of contractual agreements among Beijing Huanju Shidai, Beijing Tuda, and Beijing Tuda's legal shareholders.

#### Guangzhou Huaduo

The Company's relationships with Guangzhou Huaduo and its shareholders are governed by the following contractual arrangements:

- Exclusive Technology Support and Technology Services Agreement

Under the exclusive technology support and technology services agreement between Beijing Huanju Shidai and Guangzhou Huaduo, Beijing Huanju Shidai has the exclusive right to provide to Guangzhou Huaduo technology support and technology services related to all technologies needed for its business. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Guangzhou Huaduo to Beijing Huanju Shidai is determined by various factors, including the expenses Beijing Huanju Shidai incurs for providing such services and Guangzhou Huaduo's revenues. The term of this agreement will expire in 2028 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai is entitled to terminate the agreement at any time by providing 30 days' prior written notice to Guangzhou Huaduo.

- Exclusive Business Cooperation Agreement



Under the exclusive business cooperation agreement between Beijing Huanju Shidai and Guangzhou Huaduo, Beijing Huanju Shidai has the exclusive right to provide to Guangzhou Huaduo technology support, business support and consulting services related to the services provided by Guangzhou Huaduo, the scope of which is to be determined by Beijing Huanju Shidai from time to time. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Guangzhou Huaduo to Beijing Huanju Shidai is a certain percentage of its earnings. The term of this agreement will expire in 2039 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai is entitled to terminate the agreement at any time by providing 30 days' prior written notice to Guangzhou Huaduo.

- Exclusive Option Agreement

The parties to the exclusive option agreement are Beijing Huanju Shidai, Guangzhou Huaduo and each of the shareholders of Guangzhou Huaduo. Under the exclusive option agreement, each of the shareholders of Guangzhou Huaduo irrevocably granted Beijing Huanju Shidai or its designated representative(s) an exclusive option to purchase, to the extent permitted under PRC law, all or part of his or its equity interests in Guangzhou Huaduo. Beijing Huanju Shidai or its designated representative(s) have sole discretion as to when to exercise such options, either in part or in full. Without Beijing Huanju Shidai's prior written consent, Guangzhou Huaduo's shareholders shall not sell, transfer, mortgage or otherwise dispose their equity interests in Guangzhou Huaduo. The term of this agreement is ten years and may be extended at Beijing Huanju Shidai's sole discretion.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 1. Organization and principal activities (continued)

#### (e) Variable Interest Entities (continued)

- Powers of Attorney

Pursuant to the irrevocable power of attorney executed by each shareholder of Guangzhou Huaduo, each such shareholder appointed Beijing Huanju Shidai as its attorney-in-fact to exercise such shareholders' rights in Guangzhou Huaduo, including, without limitation, the power to vote on its behalf on all matters of Guangzhou Huaduo requiring shareholder approval under PRC laws and regulations and the articles of association of Guangzhou Huaduo. Each power of attorney will remain in force until the shareholder ceases to hold any equity interest in Guangzhou Huaduo.

- Share Pledge Agreement

Pursuant to the share pledge agreement between Beijing Huanju Shidai and the shareholders of Guangzhou Huaduo, the shareholders of Guangzhou Huaduo have pledged all of their equity interests in Guangzhou Huaduo to Beijing Huanju Shidai to guarantee the performance by Guangzhou Huaduo and its shareholders' performance of their respective obligations under the exclusive business cooperation agreement, exclusive option agreement, exclusive technology support and technology services agreement and powers of attorney. If Guangzhou Huaduo and/or its shareholders breach their contractual obligations under those agreements, Beijing Huanju Shidai, as pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests.

#### Beijing Tuda

The Company's relationships with Beijing Tuda and its shareholders are governed by the following contractual arrangements:

- Exclusive Technology Support and Technology Services Agreement

Pursuant to the exclusive technology support and technology services agreement between Beijing Huanju Shidai and Beijing Tuda, Beijing Huanju Shidai has the exclusive right to provide to Beijing Tuda technology support and technology services related to all technologies needed for its business. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Beijing Tuda to Beijing Huanju Shidai is determined by various factors, including the expenses Beijing Huanju Shidai incurs for providing such services and Beijing Tuda's revenues. The term of this agreement will expire in 2029 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai is entitled to terminate the agreement at any time by providing 30 days' prior written notice to Beijing Tuda.

- Exclusive Business Cooperation Agreement

Pursuant to the exclusive business cooperation agreement between Beijing Huanju Shidai and Beijing Tuda, Beijing Huanju Shidai has the exclusive right to provide to Beijing Tuda technology support, business support and consulting services related to the services provided by Beijing Tuda, the scope of which is to be determined by Beijing Huanju Shidai from time to time. Beijing Huanju Shidai owns the exclusive intellectual property rights created as a result of the performance of this agreement. The service fee payable by Beijing Tuda to Beijing Huanju Shidai is a certain percentage of its earnings. The term of this agreement will expire in 2039 and may be extended with Beijing Huanju Shidai's written confirmation prior to the expiration date. Beijing Huanju Shidai is entitled to terminate the agreement at any time by providing 30 days' prior written notice to Beijing Tuda.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 1. Organization and principal activities (continued)

#### (e) Variable Interest Entities (continued)

##### •Exclusive Option Agreement

The parties to the exclusive option agreement are Beijing Huanju Shidai, Beijing Tuda and each of the shareholders of Beijing Tuda. Under the exclusive option agreement, each of the shareholders of Beijing Tuda irrevocably granted Beijing Huanju Shidai or its designated representative(s) an exclusive option to purchase, to the extent permitted under PRC law, all or part of his or its equity interests in Beijing Tuda. Beijing Huanju Shidai or its designated representative(s) have sole discretion as to when to exercise such options, either in part or in full. Without Beijing Huanju Shidai's prior written consent, Beijing Tuda's shareholders shall not sell, transfer, mortgage or otherwise dispose their equity interests in Beijing Tuda. The term of this agreement is ten years and may be extended at Beijing Huanju Shidai's sole discretion.

##### •Powers of Attorney

Pursuant to the irrevocable power of attorney executed by each shareholder of Beijing Tuda, each such shareholder appointed Beijing Huanju Shidai as its attorney-in-fact to exercise such shareholders' rights in Beijing Tuda, including, without limitation, the power to vote on its behalf on all matters of Beijing Tuda requiring shareholder approval under PRC laws and regulations and the articles of association of Beijing Tuda. Each power of attorney will remain in force until the shareholder ceases to hold any equity interest in Beijing Tuda.

##### •Share Pledge Agreement

Under the share pledge agreement between Beijing Huanju Shidai and the shareholders of Beijing Tuda, the shareholders of Beijing Tuda have pledged all of their equity interests in Beijing Tuda to Beijing Huanju Shidai to guarantee the performance by Beijing Tuda and its shareholders' performance of their respective obligations under the exclusive business cooperation agreement, exclusive option agreement, exclusive technology support and technology services agreement and powers of attorney. If Beijing Tuda or its shareholders breach their contractual obligations under those agreements, Beijing Huanju Shidai, as pledgee, will be entitled to certain rights, including the right to sell

the pledged equity interests.

Through the aforementioned contractual agreements, Guangzhou Huaduo and Beijing Tuda are considered VIEs in accordance with Generally Accepted Accounting Principles in the United States (“US GAAP”) because the Company, through Beijing Huanju Shidai has the ability to:

- exercise effective control over Guangzhou Huaduo or Beijing Tuda;
- receive substantially all of the economic benefits and residual returns, and absorb substantially all the risks and expected losses from VIEs as if it were their sole shareholder; and
- have an exclusive option to purchase all of the equity interests in the VIEs.

Management evaluated the relationships among the Company, Beijing Huanju Shidai, the VIEs and concluded that Beijing Huanju Shidai is the primary beneficiary of the VIEs. As a result, the VIEs’ results of operations, assets and liabilities have been included in the Company’s consolidated financial statements.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 1. Organization and principal activities (continued)

#### (e) Variable Interest Entities (continued)

As of December 31, 2014, the total assets of the consolidated VIEs and VIE's subsidiaries were RMB2,651,352, mainly comprising cash and cash equivalents, short-term deposits, restricted short-term deposits, accounts receivable, prepayments and other current assets, investments, property and equipment, intangible assets, goodwill and deferred tax assets. As of December 31, 2014, the total liabilities of the consolidated VIEs and VIE's subsidiaries were RMB1,169,654, mainly comprising accounts payable, deferred revenue, accrued liabilities and other current liabilities, income taxes payable and long-term payable.

In accordance with the aforementioned agreements, the Company has power to direct activities of the VIEs, and can have assets transferred out of the VIEs. Therefore the Company considers that there is no asset in the consolidated VIEs and VIE's subsidiaries that can be used only to settle obligations of the consolidated VIEs and VIE's subsidiaries, except for registered capital and PRC statutory reserves of the VIEs and VIE's subsidiaries amounting to RMB292,827 as of December 31, 2014. As the consolidated VIEs and VIE's subsidiaries were incorporated as limited liability companies under the PRC Company Law, the creditors do not have recourse to the general credit of the Company for all the liabilities of the consolidated VIEs and VIE's subsidiaries.

Currently there is no contractual arrangement that could require the Company to provide additional financial support to the VIEs. As the Company is conducting its PRC internet value-added services business through the VIEs, the Company will, if needed, provide such support on a discretionary basis in the future, which could expose the Company to a loss.

There is no VIE where the Company has variable interest but is not the primary beneficiary.

### 2. Principal accounting policies

#### (a) Basis of presentation

The consolidated financial statements have been prepared in accordance with the US GAAP to reflect the financial position and results of operations of the Group.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (b) Consolidation

The Group's consolidated financial statements include the financial statements of the Company, its subsidiaries, and its VIEs and VIE's subsidiaries for which the Company or its subsidiary is the primary beneficiary. All transactions and balances among the Company, its subsidiaries, its VIEs and VIE's subsidiaries have been eliminated upon consolidation.

A subsidiary is an entity in which the Company, directly or indirectly, controls more than one half of the voting powers; or has the power to appoint or remove the majority of the members of the board of directors; or to cast a majority of votes at the meeting of directors; or has the power to govern the financial and operating policies of the investee under a statute or agreement among the shareholders or equity holders.

A VIE is an entity in which the Company, or its subsidiary, through contractual agreements, bears the risks of, and enjoys the rewards normally associated with ownership of the entity, and therefore the Company or its subsidiary is the primary beneficiary of the entity. In determining whether the Company or its subsidiaries are the primary beneficiary, the Company considered whether it has the power to direct activities that are significant to the VIEs economic performance, and also the Company's obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Beijing Huanju Shidai and ultimately the Company hold all the variable interests of the VIEs and VIE's subsidiaries and has been determined to be the primary beneficiary of the VIEs and VIE's subsidiaries.

#### (c) Use of estimates

The preparation of the Company's consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from such estimates. The Company believes that lives of the game and lives of the user relationship related to online games revenue, assessment of whether the Group acts as a principal or an agent in different revenue streams, classification of perpetual items versus consumable items under item-based model, the determination of estimated selling prices of multiple element revenue contracts, sales rebate to advertising agencies, income taxes, allowances for doubtful accounts, determination



of share-based compensation expenses, impairment assessment of goodwill, long-lived assets and intangible assets, tax considerations for earnings retained in the Group's VIEs, fair value determination related to the accounting for business combinations, represent critical accounting policies that reflect more significant judgments and estimates used in the preparation of its consolidated financial statements.

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 differ from these estimates.

**(d) Foreign currency translation**

The Group uses Renminbi ("RMB") as its reporting currency. The functional currency of the Company and its subsidiaries incorporated in the Cayman Islands, British Virgin Islands, and Hong Kong is United States dollar ("US\$"), while the functional currency of the other entities, VIEs and VIE's subsidiaries in the Group is RMB, which is their respective local currency. In the consolidated financial statements, the financial information of the Company and its subsidiaries, which use US\$ as their functional currency, have been translated into RMB. Assets and liabilities are translated at the exchange rates on the balance sheet date, equity amounts are translated at historical exchange rates, and revenues, expenses, gains, and losses are translated using the average exchange rate for the period. Translation adjustments arising from these are reported as foreign currency translation adjustments and are shown as a component of other comprehensive income or loss in the statement of operations and comprehensive income.

Foreign currency transactions denominated in currencies other than functional currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are remeasured at the applicable rates of exchange in effect at that date. Foreign exchange gains and losses resulting from the settlement of such transactions and from remeasurement at year-end are recognized in foreign currency exchange gains (losses), net in the consolidated statement of operations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (e) Convenience translation

Translations of amounts from RMB into US\$ for the convenience of the reader were calculated at the noon buying rate of US\$1.00 = RMB6.2046 on December 31, 2014 as set forth in the H.10 statistical release of the U.S. Federal Reserve Board. No representation is made that the RMB amounts could have been, or could be, converted into US\$ at such rate.

#### (f) Fair value of financial instruments

US GAAP establishes a three-tier hierarchy to prioritize the inputs used in the valuation methodologies in measuring the fair value of financial instruments. This hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three-tier fair value hierarchy is:

Level 1—observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2—other inputs that are directly or indirectly observable in the marketplace.

Level 3—unobservable inputs which are supported by little or no market activity.

The carrying values of cash and cash equivalents, short-term deposits, restricted short-term deposits, accounts receivable, other receivables, amounts due from (to) related parties, accounts payable, and other payables approximate their fair values because of their generally short maturities, and the carrying value of convertible bonds also approximates their fair value, as they bear interest at rates determined based on prevailing interest rates in the market.

The fair value of the contingent consideration recognized on the acquisition date was measured using unobservable input (level 3). Trinomial tree model was applied in determining the fair value of the contingent consideration. Under this model, the Group performs a scenario analysis and calculates the fair value of the contingent consideration based on the net present value of the total contingent payments under each scenario and the expected probability of each scenario. Contingent consideration is remeasured at fair value at each reporting date since initial recognition.

**(g) Cash and cash equivalents**

Cash includes currency on hand and deposits held by financial institutions that can be added to or withdrawn without limitation. Cash equivalents represent short-term and highly liquid investments placed with banks, which have both of the following characteristics:

- i) Readily convertible to known amounts of cash throughout the maturity period;
- ii) So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

**(h) Short-term deposits**

Short-term deposits represent time deposits placed with banks with original maturities of less than one year. Interest earned is recorded as interest income in the consolidated statements of operations during the periods presented.

**(i) Accounts receivable, net**

Accounts receivable are presented net of allowance for doubtful accounts. The Group uses specific identification in providing for bad debts when facts and circumstances indicate that collection is doubtful and a loss is probable and estimable. If the financial conditions of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowance may be required.

The Company maintains an allowance for doubtful accounts which reflects its best estimate of amounts that potentially will not be collected. The Company determines the allowance for doubtful accounts on an individual basis taking into consideration various factors including but not limited to historical collection experience and credit-worthiness of the debtors as well as the age of the individual receivables balance. Additionally, the Company makes specific bad debt provisions based on any specific knowledge the Company has acquired that might indicate that an account is uncollectible. The facts and circumstances of each account may require the Company to use substantial judgment in assessing its collectability.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (j) Equity investment

The equity investment is comprised of investments in privately-held companies. The Group accounts for its equity investment over which it has significant influence but does not own a majority equity interest or otherwise control using the equity method. The Group adjusts the carrying amount of the investment and recognizes investment income or loss for share of the earnings or loss of the investee after the date of investment. The Group assesses its equity investment for other-than-temporary impairment by considering factors including, but not limited to, current economic and market conditions, operating performance of the companies, including current earnings trends and undiscounted cash flows, and other company-specific information. The fair value determination, particularly for investment in privately-held companies, requires judgment to determine appropriate estimates and assumptions. Changes in these estimates and assumptions could affect the calculation of the fair value of the investment and determination of whether any identified impairment is other-than-temporary.

#### (k) Cost investment

The cost investment is comprised of investments in privately-held companies. The Group accounts for cost investment which has no readily determinable fair value using the cost method. Under the cost method, the investment is measured initially at cost. The investment carried at cost should recognize income when dividends are received from the distribution of the investee's earnings. The Group periodically evaluates the carrying value of investments accounted for under the cost method of accounting and any impairment is included in the consolidated statements of operations.

#### (l) Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment loss, if any. Depreciation is calculated using the straight-line method over their estimated useful lives. Residual rate is determined based on the economic value of the equipment at the end of the estimated useful lives as a percentage of the original cost.

Estimated useful lives

		Residual rate
Servers, computers and equipment	3 years	0%-5%
Furniture, fixture and office equipment	5 years	0%-5%
Motor vehicles	4 years	5%
Leasehold improvement	Shorter of lease term or 5 years	-

Expenditures for maintenance and repairs are expensed as incurred. The gain or loss on the disposal of property and equipment is the difference between the net sales proceeds and the carrying amount of the relevant assets and is recognized in the consolidated statements of operations.

All direct and indirect costs that are related to the construction of property and equipment and incurred before the assets are ready for their intended use are capitalized as construction in progress. Construction in progress is transferred to specific property and equipment items and depreciation of these assets commences when they are ready for their intended use.

#### **(m) Business combinations**

Business combinations are recorded using the purchase method of accounting, and the cost of an acquisition is measured as the aggregate of the fair values at the date of exchange of the assets given, liabilities incurred, and equity instruments issued as well as the contingent considerations and all contractual contingencies as of the acquisition date. The costs directly attributable to the acquisition are expensed as incurred. Identifiable assets, liabilities and contingent liabilities acquired or assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any non-controlling interests. The excess of the (i) the total of consideration of acquisition, fair value of the non-controlling interests and acquisition date fair value of any previously held equity interest in the subsidiary acquired over (ii) the fair value of the identifiable net assets of the subsidiary acquired is recorded as goodwill. If the consideration of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statements of operations and comprehensive income.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****2. Principal accounting policies (continued)****(n) Intangible assets, net**

Intangible assets mainly consist of brand names, domain names and software. Identifiable intangible assets are carried at acquisition cost less accumulated amortization and impairment loss, if any. Finite-lived intangible assets are tested for impairment if impairment indicators arise. Amortization of finite-lived intangible assets is computed using the straight-line method over the following estimated useful lives, which are as follows:

	<b>Estimated useful lives</b>
Software	3 -5 years
Technology	5 years
Domain names	15 years
Operating rights for licensed games	Shorter of the economic life or license period of relevant online game
Brand names	1-15 years

**(o) Impairment of long-lived assets**

For other long-lived assets including amortizable intangible assets and property and equipment, the Group evaluates for impairment whenever events or changes (triggering events) indicate that the carrying amount of an asset may no longer be recoverable. The Group assesses the recoverability of the long-lived assets by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to receive from use of the assets and their eventual disposition. Such assets are considered to be impaired if the sum of the expected undiscounted cash flows is less than the carrying amount of the assets. The impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

**(p) Goodwill**

Goodwill represents the excess of the purchase price over the amounts assigned to the fair value of the assets acquired and the liabilities assumed of an acquired business.

**(q) Annual test for impairment of goodwill**

Goodwill assessment for impairment is performed on at least an annual basis on October 1 or whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. The Group performs a two-step goodwill impairment test. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of the affected reporting unit's goodwill to the carrying value of that goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. The judgment in estimating the fair value of reporting units includes estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of the fair value of each reporting unit.

No goodwill impairment losses were recognized for the years ended December 31, 2012, 2013 and 2014.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (r) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating lease are charged to the consolidated statements of operations on a straight-line basis over the period of the lease.

#### (s) Convertible bonds

The Group determines the appropriate accounting treatment of its convertible bonds in accordance with the terms in relation to the conversion feature, call and put options, and beneficial conversion feature. After considering the impact of such features, the Group may account for such instrument as a liability in its entirety, or separate the instrument into debt and equity components following the respective guidance described under ASC 815 Derivatives and Hedging and ASC 470 Debt. The debt discount, if any, together with related issuance cost are subsequently amortized as interest expense, using the effective interest method, from the issuance date to the earliest conversion date.

#### (t) Revenue recognition

The Group generates revenues from internet value-added services (“IVAS”) and online advertising. Revenues from IVAS are generated from online music and entertainment, online games, online dating, live game broadcasting, membership subscription fees and other IVAS. Online advertising revenues are primarily generated from sales of different forms of advertising on the Group’s platform. Revenue is recognized when persuasive evidence of an arrangement exists, service has been rendered, the price is fixed or determinable and collection is reasonably assured. Revenue is deferred until these criteria are met as described below.

#### (i) Internet value-added services

The Group operates a virtual currency system, under which, the users can directly purchase virtual currency, virtual items on YY Client’s online community channels or pay membership subscription fees via online payment systems provided by third parties including payments using mobile phone, internet debit/credit card payment and other third party payment systems. The virtual currency can be converted into game tokens that can be used to purchase virtual



items in online games (both developed by third parties and self-developed), or used directly to purchase virtual items on YY Client's online community channels or used to pay membership subscription fees. Virtual currency sold but not yet consumed by the purchasers is recorded as "Advances from customers" and upon conversion or being used, is recognized as revenue according to the respective prescribed revenue recognition policies addressed below:

**(1) Online music and entertainment revenue**

The Group creates and offers virtual items to be used by users on online music and entertainment channels, which the Group operates and maintains. The virtual items are offered free of charge or sold to users at different specified prices as pre-determined by the Company. Online music and entertainment revenue consists of sales of virtual items. Users purchase consumable virtual items from the Group and present them to performers to show support for their favorite performers or time-based virtual items, which provide users with recognized status, such as priority speaking rights or special symbols on the music channels for a specific period of time. In order to attract user traffic, the Group shares with certain popular performers and channel owners, who have entered into revenue sharing arrangements with the Group, a portion of the revenues the Group derives from such in-channel virtual item sales on online music and entertainment channels, which the Group accounts for as cost of revenues. Performers and channel owners, who do not have revenue sharing arrangements with the Group, are not entitled to share any revenue derived from the virtual items sold. The Group does not recognize any revenue from offering free virtual items nor share any revenue with performers or channel owners when free virtual items are presented to performers by the users. Accordingly, online music and entertainment revenue is recognized for the sale of virtual items sold in online music and entertainment channels immediately if the virtual item is a consumable or, in the case of time-based virtual items, recognized ratably over the period each virtual item is made available to the user, which does not exceed one year. The Group does not have further obligations to the user after the virtual items are consumed. Virtual items may be sold individually or bundled into one arrangement. When the Group's users purchase multiple virtual items bundled within the same arrangement, the Group evaluates such arrangements under ASC 605-25 Multiple-Element Arrangements. The Group identifies individual elements under the arrangement and determines if such elements meet the criteria to be accounted for as separate units of accounting. The Group allocates the arrangement consideration to the separate units of accounting based on their relative selling price.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (t) Revenue recognition (continued)

##### (i) Internet value-added services (continued)

###### (1) Online music and entertainment revenue (continued)

The following hierarchy has been followed when determining the relative selling price for each element: (1) vendor specific objective evidence (“VSOE”), (2) third party evidence (“TPE”), and (3) best estimate of selling price (“BESP”). Given that the VSOE of the selling price cannot be determined, the Group has adopted a policy to allocate the consideration of the whole arrangement to different virtual item elements based on the TPE of selling price or the BESP for each virtual item element. The Group determines the fair values of virtual items sold in a bundle based on similar products sold separately on the YY platform based on the TPE of the selling price and determines the fair values of virtual items without similar products sold separately on the YY platform based on the BESP. The BESP is generally based on the selling prices of the various elements of a similar nature when they are sold to users on a stand-alone basis. The BESP may also be based on an estimated stand-alone pricing when the element has not previously been sold on a stand-alone basis.

These estimates are generally determined based on pricing strategies, market factors and strategic objectives. The Group recognizes revenue for each virtual item element in accordance with the applicable revenue recognition method.

###### (2) Online games revenue

The Group generates revenues from offering virtual items in online games developed by third parties or the Group itself to gaming players. Historically, the majority of online games revenues for the three years ended December 31, 2012, 2013 and 2014 were derived from third parties developed games.

Users play games through the Group's platform free of charge and are charged for purchases of virtual items including consumable and perpetual items, which can be utilized in the online games to enhance their game-playing experience. Consumable items represent virtual items that can be consumed by a specific user within a specified period of time. Perpetual items represent virtual items that are accessible to the users' account over the life of the online games.

The Group recognizes revenue when recognition criteria defined under US GAAP are satisfied. For purposes of determining when the service has been provided to the paying player, the Group has determined that an implied obligation exists to the paying player to continue providing access to the games such that the users can utilize the virtual items purchased by game tokens. Game players need to log on and access the games through the Group's platform because their game tokens, virtual items, and game history are specific to the Group's game accounts and non-transferable to other platforms. To purchase in-game virtual items, players can either charge their game accounts by purchasing game tokens or virtual currency from the Group's platform, which are convertible into game tokens based on a predetermined exchange rate agreed among the Group and the relevant game developers.

The proceeds from the purchase of the Group's virtual currency is recorded as "advances from customers", representing prepayments received from users in the form of the Group's virtual currency not yet converted into game specific tokens. Upon the conversion into a game token from the Group's virtual currency or upon the direct purchase of a game token, whichever is applicable, the proceeds will be shared between the Group and the relevant game developer based on a predetermined contractual ratio. Game tokens are non-refundable and non-exchangeable among different games. The Group's portion, net of the game developer's entitled consideration, is recorded as deferred revenue and amortized according to the prescribed revenue recognition policies described below. Users typically do not convert the virtual currency into game tokens or purchase the game tokens unless they plan to purchase in-game virtual items soon.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**(All amount in thousands, except share and per share data, unless otherwise stated)**

**2. Principal accounting policies (continued)**

**(t) Revenue recognition (continued)**

**(i) Internet value-added services (continued)**

**(2) Online games revenue (continued)**

There are two types of third party developed online games:

-	Non-exclusive third party developed games
-	Exclusive third party developed games

Under the non-exclusive arrangement, game developers license the games to various platforms and the Group is only one of the platforms. Game developers will receive only revenue shared from the Group pursuant to the mutually agreed sharing percentage.

Under the exclusive arrangement, game developers only license the game to the Group as the exclusive licensee. The Group, as the exclusive licensee, can sub-license the games to other platforms. In addition to the revenue shared to the game developers, the Group should also pay an exclusive license fee to the game developers.

-	<i>Non-exclusive third party developed games</i>
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Pursuant to contracts signed between the Group and the respective game developers, revenues from the sale or conversion of game tokens to be used for the purchase of in-game virtual items from online games developed by third parties are shared between the Group and the game developers based on a pre-agreed ratio for each game. These revenue-sharing contracts typically last one to two years.

The third party developed games under non-exclusive licensing contracts are maintained and updated by the game developers. The Group views the game developers to be the Group's customers and considers the Group's responsibilities under the Group's agreements with the game developers to offer certain standard promotions that include providing access to the platform, announcing the new games to users on the platform, and occasional advertising on the YY platform. The determination of whether to record these revenues using gross or net method is based on an assessment of various factors. The primary factors are whether the Group is acting as the principal in offering services to the game players or as agent in the transaction, and the specific requirement of each contract. The Group determined that for third party developed games, the third party game developers are the principal given the game developers design and develop the web-game services offered, have reasonable latitude to establish prices of game tokens, and are responsible for maintaining and upgrading the game contents and virtual items. Accordingly, the Group records online games revenue, net of the pre-agreed portion of sharing of the revenues with the game developers.

Given that third party developed games under non-exclusive licensing contracts are managed and administered by the third party game developers, the Group does not have access to the data on the consumption details such as when the game token is spent on the virtual items or the types of virtual items (consumable or perpetual items) purchased by each individual game player. However, the Group maintains historical data on timing of the conversion of its virtual currency into game specific tokens and the amount of purchases of game tokens. The Group believes that its performance for, and obligation to, the game developers correspond to the game developers' services to the users. The Group has adopted a policy to recognize revenues relating to game tokens for third party developed games over the estimated user relationship with the Group on a game-by-game basis, which is approximately one to six months for the periods presented. Future usage patterns may differ from historical usage patterns and therefore the estimated user relationship with the Group may change in the future.

When the Group launches a new game, it estimates the user relationship based on other similar types of games in the market until the new game establishes its own history. The Group considers the game's profile, attributes, target audience, and its appeal to players of different demographics groups in estimating the user relationship period.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (t) Revenue recognition (continued)

#### (i) Internet value-added services (continued)

#### (2) Online games revenue (continued)

- *Non-exclusive third party developed games (continued)*

The estimated user relationship period is based on data collected from those users who have acquired game tokens. To estimate the user relationship period, the Group maintains a software system that captures the following information for each user: (a) the frequency that users log into each game via the Group's platform, and (b) the amount and the timing of when the users convert or charge his or her game tokens. The Group estimates the user relationship period for a particular game to be the date a player purchases or converts from virtual currency to a game token through the date the Group estimates the user plays the game for the last time. This computation is completed on a user by user basis. Then, the results for all analyzed users are averaged to determine an estimated end user relationship period for each game. Revenues from in-game payments of each month are recognized over the user relationship period estimated for that game.

The consideration of user relationship with each online game is based on the Group's best estimate that takes into account all known and relevant information at the time of assessment. The Group assesses the estimated user relationships on a quarterly basis. Any adjustments arising from changes in the user relationship as a result of new information will be accounted as a change in accounting estimate in accordance with ASC 250 Accounting Changes and Error Corrections.

- *Exclusive third party developed games*

Under certain exclusive arrangements, the Group pays additional license fees to the game developers as the Group is entitled to an exclusive right to operate third party developed games in specified geographic areas. Based on ASC 350-30-35-6, the Group has adopted an accounting policy to recognize the exclusive license fee as an intangible asset

upon the commercial launch of the related online games. This intangible asset is amortized on a straight-line basis over the shorter of the economic life or license period of the relevant online game.

Pursuant to the exclusive licensing contracts signed between the Group and the third party game developers, the Group's responsibilities in operating the licensed games vary game-by-game. The determination of whether to record these revenues using gross or net method is based on an assessment of various factors, including but not limited to whether the Group (i) is the primary obligor in the arrangement; (ii) has latitude in establishing the selling price; (iii) changes the product or performs part of the service, (iv) has involvement in the determination of product and service specifications.

For the game license arrangements under which the Group takes primary responsibilities of game operation, including determining distribution and payment channels, providing customer services, hosting game servers, if needed, and controlling game and services specifications and pricing, the Group considered itself to be the principal in these arrangements. Accordingly, the Group records online games revenues from these third party licensed games on a gross basis. Commission fees paid to distribution channels and payment channels and content fees paid to third party game developers are recorded as cost of revenues.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (t) Revenue recognition (continued)

##### (i) Internet value-added services (continued)

##### (2) Online games revenue (continued)

- *Exclusive third party developed games (continued)*

For the game license arrangements under which the Group's responsibilities are limited to publishing, providing payment solutions and game operating advice, the Group views the game developers to be its customers and considers itself to be the agent in the arrangements. Accordingly, the Group records online games revenues from these third party licensed games, net of fees paid to third parties upon the provision of service.

Pursuant to the terms and conditions of certain online game exclusive license agreement entered into between game developers and the Group, the Group, as the exclusive licensee, could sublicense a non-exclusive, non-transferable and limited license to any third party without the prior formal consent of game developers. Under the non-exclusive and non-transferable limited license, the sub-licensee cannot further license the game to other platforms. The Group received monthly revenue-based royalty payments from all sub-licensees. The Group views the third-party licensee operators as its customers and recognizes revenues on a net basis, as the Group does not have the primary responsibility for fulfillment and acceptability of the game services.

Similar to other online games, the exclusive third party developed games are free to play and players can pay for virtual items for better in-game experience. For exclusive third party games, the consumption details can be provided by third party developers or the Group has access to such data. Therefore, the Group recognizes revenues based on item-based model: (1) for consumable items, the revenue is recognized immediately upon consumption; (2) for perpetual items, the revenue is recognized ratably over the user relationship period of a specific game as described. The determination of user relationship period is the same as what is described in "*Non-exclusive third party developed games*" above.



*- Self-developed games*

Revenues derived from self-developed games are recorded on a gross basis as the Group acts as a principal to fulfill all obligations. Considering that revenues derived from self-developed games were immaterial to the Group for the years presented, the Group does not maintain information on consumption details of in-game virtual items, and only maintains limited information related to the frequency of log-ons for its self-developed games. Given that certain historical data is not available, the Group uses the user relationship of third party games with similar popularity, gaming experience and sales to determine the estimated period of user relationship for its self-developed games.

**(3) Other IVAS revenue**

Other IVAS revenue mainly represents membership subscription revenue, revenue from sales of virtual items in various channels in YY platform, such as online dating and live game broadcasting channels etc. and other miscellaneous sales in YY platform.

The Group operates a membership subscription program where subscription members can have enhanced user privileges when using YY Client. The membership fee is collected up-front from subscribers. The receipt of the revenue is initially recorded as deferred revenue and revenue is recognized ratably over the period of the subscription as services are rendered. Unrecognized portion beyond 12 months from balance sheet date is classified as long-term deferred revenue. Revenue from sales of virtual items in various channels, including online dating and live game broadcasting, is recognized on item basis, which is consistent with the revenue recognition policies for online music and entertainment revenue stream.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (t) Revenue recognition (continued)

##### (ii) Advertising revenues

Advertising revenues are derived principally from advertising arrangements where the advertisers pay to place their advertisements on the Group's platform in different formats over a particular period of time. Such formats generally include but are not limited to banners, text-links, videos, logos, and buttons. Advertisements on the Group's platform are generally charged on the basis of duration, and advertising contracts are signed to establish the fixed price and the advertising services to be provided. Where collectability is reasonably assured, advertising revenues from advertising contracts are recognized ratably over the contract period of display.

The Group enters into advertising contracts directly with advertisers or third party advertising agencies that represent advertisers. Contract terms generally range from 1 to 3 months. Both third party advertising agencies and direct advertisers are generally billed at the end of the display period and payments are due usually within 6 months.

Where customers purchase multiple advertising spaces with different display periods in the same contract, the Group allocates the total consideration to the various advertising elements based on the relative selling price method and recognizes revenue for the different elements over their respective display periods. The following hierarchy should be followed when determining the appropriate selling price for each element: (1) vendor specific objective evidence ("VSOE"), (2) third party evidence ("TPE"), and (3) best estimate of selling price ("BESP"). Given that the VSOE or TPE of the selling price cannot be determined, the Group has adopted a policy to allocate the fair values of different advertising elements based on the best estimate selling prices of each advertisement within the contract taking into consideration the standard price list and historical discounts granted. The Group recognizes revenue on the elements delivered and defers the recognition of revenue for the fair value of the undelivered elements until the remaining obligations have been satisfied. Where all of the elements within an arrangement are delivered uniformly over the agreement period, the revenues are recognized on a straight line basis over the contract period.

*Transactions with third party advertising agencies*

For contracts entered into with third party advertising agencies, the third party advertising agencies will in turn sell the advertising services to advertisers. Revenue is recognized ratably over the contract period of display based on the following criteria:

• There is persuasive evidence that an arrangement exists—the Group will enter into framework and execution agreements with the advertising agencies, specifying price, advertising content, format and timing.

• Price is fixed or determinable—price charged to the advertising agencies are specified in the agreements, including relevant discount and rebate rates.

• Services are rendered—the Group recognizes revenue ratably as the element are delivered over the contract period of display.

• Collectability is reasonably assured—the Group assesses credit history of each advertising agency before entering into any framework and execution agreements. If the collectability from the agencies is assessed as not reasonably assured, the Group recognizes revenue only when the cash is received and all the other revenue criteria are met.

The Group provides sales incentives in the forms of discounts and rebates to third party advertising agencies based on purchase volume. As the advertising agencies are viewed as the customers in these transactions, revenue is recognized based on the price charged to the agencies, net of sales incentives provided to the agencies. Sales incentives are estimated and recorded at the time of revenue recognition based on the contracted rebate rates and estimated sales volume based on historical experience.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (t) Revenue recognition (continued)

#### (ii) Advertising revenues (continued)

##### *Transactions with advertisers*

The Group also enters into advertisement contracts directly with advertisers. Similar to transactions with third party advertising agencies, the Group recognizes revenue ratably as the elements are delivered over the contract period of display. The terms and conditions, including price, are fixed according to the contract between the Group and the advertisers. The Group also performs a credit assessment of all advertisers prior to entering into contracts. Revenue is recognized based on the amount charged to the advertisers, net of discounts.

#### (u) Advances from customers and deferred revenue

Advances from customers primarily consist of (i) prepayments from users in the form of the Group's virtual currency that are not yet consumed or converted into game tokens, and upon the consumption or conversion, are recognized as revenue according to the prescribed revenue recognition policies described above, (ii) prepayments from sub-licensees for obtaining operation rights of certain online games over a period of time, and (iii) prepayments from advertising agencies and advertisers.

Deferred revenue primarily consists of the unamortized game tokens, prepaid subscriptions under the membership program and unamortized revenue from virtual items in various channels in YY platform, where there is still an implied obligation to be provided by the Group, which will be recognized as revenue when all of the revenue recognition criteria are met.

#### (v) Cost of revenues

Amounts recorded as cost of revenue relate to direct expenses incurred in order to generate IVAS and advertising revenue. Such costs are recorded as incurred. Cost of revenues consists primarily of (i) revenue sharing fees and content costs, including payments to various channel owners and performers, and content providers, (ii) bandwidth costs, (iii) salary and welfare, (iv) depreciation and amortization expense for servers, other equipment and intangibles directly related to operating the platform, (v) payment handling cost, (vi) business taxes and related surcharges, cultural development fee, (vii) share-based compensation, and (viii) other costs.

In the PRC, business taxes are imposed by the government on revenues reported by any selling entity for the provision of taxable services in the PRC. The business tax rate varies depending on the nature of the revenues. The Group is also subject to cultural development fee at a tax rate of 3% on service income from provision of advertising services in the PRC.

On January 1, 2012, a pilot program (the “Pilot Program”) was launched in Shanghai for a transition of imposing value-added tax (“VAT”) on revenues derived from certain pilot industries (the “Pilot Industries”) other than business taxes. Starting from September 1, 2012, the Pilot Program was expanded from Shanghai to eight other cities and provinces in the PRC, including Beijing and Guangdong province, where the Group’s subsidiaries and VIEs are incorporated and have operations therein. The Group’s advertising revenue, online games revenue and other IVAS revenue are within the scope of Pilot Industries and they became subject to VAT effective from November 1, 2012, December 1, 2012 and June 1, 2014, at a rate of 6% respectively. The Group hence recognizes advertising revenue and IVAS revenue net of VAT thereafter. Prior to the Pilot Program’s being applied to Group’s revenue, the Group’s advertising revenues earned from external customers were subject to business taxes at 5% for the ten months ended December 31, 2012, and the Group’ IVAS revenue earned from external customers were subject to business taxes of 3% for the years ended December 31, 2012, 2013 and for the first five months of 2014, except that the Group’s online games revenue began to be subject to VAT of 6% commencing December 2012.

The Group is subject to surcharges of business taxes and VAT, which are calculated based on 12% of the business taxes and VAT payable for the years ended December 31, 2012, 2013 and 2014.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (v) Cost of revenues (continued)

The Group reported business taxes and surcharges, and cultural development fees in cost of revenues.

Based on the Group's corporate structure and the contractual arrangements among the Group's PRC subsidiaries, the Group's VIEs and their shareholders, the Group is effectively subject to 6% or 17% VAT and related surcharges on revenues generated by the Group's subsidiaries based on the Group's contractual arrangements entered into with the Group's VIEs.

#### (w) Research and development expenses

Research and development expenses consist primarily of (i) salary and welfare for research and development personnel, (ii) share-based compensation for research and development personnel, (iii) rental expenses and (iv) depreciation of office premise and servers utilized by research and development personnel. Costs incurred during the research stage are expensed as incurred. Costs incurred in the development stage, prior to the establishment of technological feasibility, which is when a working model is available, are expensed when incurred.

The Company recognizes internal use software development costs in accordance with guidance on intangible assets and internal use software. This requires capitalization of qualifying costs incurred during the software's application development stage and to expense costs as they are incurred during the preliminary project and post implementation/operation stages. The Company has not capitalized any costs related to internal use software during the years ended December 31, 2012, 2013 and 2014, respectively.

#### (x) Sales and marketing expenses

Sales and marketing expenses consist primarily of (i) advertising and market promotion expenses, (ii) salary and welfare for sales and marketing personnel, and (iii) share-based compensation for sales and marketing personnel. The advertising and market promotion expenses amounted to approximately RMB5,534, RMB8,054 and RMB76,192

during the years ended December 31, 2012, 2013 and 2014, respectively.

**(y) General and administrative expenses**

General and administrative expenses consist primarily of (i) salary and welfare for general and administrative personnel, (ii) share-based compensation for management and administrative personnel, (iii) allowance for doubtful receivables, and (iv) professional service fees.

**(z) Employee social security and welfare benefits**

Employees of the Group in the PRC are entitled to staff welfare benefits including pension, work-related injury benefits, maternity insurance, medical insurance, unemployment benefit and housing fund plans through a PRC government-mandated multi-employer defined contribution plan. The Group is required to accrue for these benefits based on certain percentages of the employees' salaries, up to a maximum amount specified by the local government. The Group is required to make contributions to the plans out of the amounts accrued. The PRC government is responsible for the medical benefits and the pension liability to be paid to these employees and the Group's obligations are limited to the amounts contributed and no legal obligation beyond the contributions made. Employee social security and welfare benefits included as expenses in the accompanying statements of operations amounted to RMB39,660, RMB68,334 and RMB115,012 for the years ended December 31, 2012, 2013 and 2014, respectively.

**(aa) Share-based compensation**

The Company grants stock-based award, such as, but not limited to, share options, restricted shares, restricted share units and warrants to eligible employees, officers, directors, and non-employee consultants.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (aa) Share-based compensation (continued)

Awards granted to employees, officers, and directors are initially accounted for as equity-classified awards. The related share-based compensation expenses are measured at the grant date fair value of the award and are recognized using the graded vesting method, net of estimated forfeiture rates, over the requisite service period, which is generally the vesting period. Forfeitures are estimated at the time of grant based on historical forfeiture rates and will be revised in the subsequent periods if actual forfeitures differ from those estimates. Duowan BVI also granted share options, restricted shares and restricted share units to non-employees, which are also initially accounted for as equity-classified awards. Awards granted to non-employees are initially measured at fair value on the grant date and periodically re-measured thereafter until the earlier of the performance commitment date or the date the service is completed and recognized over the period the service is provided. Awards are re-measured at each reporting date using the fair value as at each period end until the measurement date, generally when the services are completed and share-based awards are vested. Changes in fair value between the interim reporting dates are recorded in consistent with the method used in recognizing the original compensation costs.

Following the listing of the Company, the grant date fair value of share-based awards is based on stock price of the Company in the NASDAQ Global Market.

#### (bb) Other income

Other income primarily consists of government grants which represent cash subsidies received from the PRC government by the operating subsidiaries or VIEs of the Company. Government grants are originally recorded as deferred revenue when received upfront. After all of the conditions specified in the grants have been met, the grants are recognized as operating or non-operating income based on the nature of the government grants.

#### (cc) Income taxes

Current income taxes are provided on the basis of net income for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes, in accordance with the regulations of the relevant tax jurisdictions. Deferred income taxes are accounted for using an asset and liability method. Under this method, deferred income taxes are recognized for the tax consequences of temporary differences by applying



enacted statutory rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purpose. The effect on deferred taxes of a change in tax rates is recognized in statement of operations and comprehensive income in the period of change. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of the deferred tax assets will not be realized.

*Uncertain tax positions*

The guidance on accounting for uncertainties in income taxes prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Guidance was also provided on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. Significant judgment is required in evaluating the Group's uncertain tax positions and determining its provision for income taxes. The Group recognizes interests and penalties, if any, under accrued expenses and other current liabilities on its balance sheet and under other expenses in its statements of operations. The Group did not recognize any significant interest and penalties associated with uncertain tax positions for the years ended December 31, 2012, 2013 and 2014. As of December 31, 2013 and 2014, the Group did not have any significant unrecognized uncertain tax positions.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (dd) Statutory reserves

The Group's subsidiaries, VIEs and VIE's subsidiaries established in the PRC are required to make appropriations to certain non-distributable reserve funds.

In accordance with the laws applicable to China's Foreign Investment Enterprises, the Group's subsidiaries registered as wholly-owned foreign enterprises have to make appropriations from its after-tax profit (as determined under the Accounting Standards for Business Enterprises as promulgated by the Ministry of Finance of the People's Republic of China ("PRC GAAP")) to reserve funds including general reserve fund, and staff bonus and welfare fund. The appropriation to the general reserve fund must be at least 10% of the after-tax profits calculated in accordance with PRC GAAP. Appropriation is not required if the reserve fund has reached 50% of the registered capital of the company. Appropriation to the staff bonus and welfare fund is at the company's discretion.

In addition, in accordance with the Company Laws of the PRC, the VIEs and VIE's subsidiaries of the Company registered as PRC domestic companies must make appropriations from its after-tax profit as determined under the PRC GAAP to non-distributable reserve funds including a statutory surplus fund and a discretionary surplus fund. The appropriation to the statutory surplus fund must be at least 10% of the after-tax profits as determined under the PRC GAAP. Appropriation is not required if the surplus fund has reached 50% of the registered capital of the company. Appropriation to the discretionary surplus fund is made at the discretion of the company.

The use of the general reserve fund, statutory surplus fund and discretionary surplus fund are restricted to the off-setting of losses or increasing capital of the respective company. The staff bonus and welfare fund is a liability in nature and is restricted to fund payments of special bonus to staff and for the collective welfare of employees. All these reserves are not allowed to be transferred to the company in terms of cash dividends, loans or advances, nor can they be distributed except under liquidation.

During the year ended December 31, 2013 and 2014, appropriations to statutory reserves amounted to RMB40,657 and RMB15,812, respectively. No appropriations have been made in 2012 since the companies were in accumulated loss positions.

**(ee) Related parties**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or significant influence, such as a family member or relative, shareholder, or a related corporation.

**(ff) Dividends**

Dividends are recognized when declared. No dividends were declared for the years ended December 31, 2012, 2013 and 2014, respectively. The Group does not have any present plan to pay any dividends on common shares in the foreseeable future. The Group currently intends to retain the available funds and any future earnings to operate and expand its business.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (gg) Income per share

Basic income per share is computed by dividing net income attributable to common shareholders, considering the accretion or decrction of redemption feature, deemed dividend to preferred shareholders and amortization of beneficial conversion feature related to its convertible redeemable preferred shares (Note 24), by the weighted average number of common shares outstanding during the period using the two-class method. Under the two-class method, net income is allocated between common shares and other participating securities based on their participating rights. Net losses are not allocated to other participating securities if based on their contractual terms they are not obligated to share the losses.

Diluted income per share is calculated by dividing net income attributable to common shareholders, as adjusted for the effect of dilutive common equivalent shares, if any, by the weighted average number of common and dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of common shares issuable upon the conversion of the preferred shares and convertible bonds, using the if-converted method, and shares issuable upon the exercise of share options using the treasury stock method. Common equivalent shares are not included in the denominator of the diluted loss per share calculation when inclusion of such share would be anti-dilutive.

#### (hh) Comprehensive income

Comprehensive income is defined as the change in equity of the Company during a period arising from transactions and other events and circumstances excluding transactions resulting from investments by shareholders and distributions to shareholders. Comprehensive income is reported in the consolidated statements of operations and comprehensive income. Accumulated other comprehensive loss of the Group includes the foreign currency translation adjustments.

#### (ii) Segment reporting

Operating segments are defined as components of an enterprise engaging in businesses activities for which separate financial information is available that is regularly evaluated by the Group's chief operating decision makers in deciding how to allocate resources and assess performance. The Group's chief operating decision maker has been identified as

the Chief Executive Officer, who reviews consolidated results when making decisions about allocating resources and assessing performance of the Group. The Group has internal reporting of cost and expenses that does not distinguish between segments, and reports costs and expenses by nature as a whole. The Group does not distinguish between markets or segments for the purpose of internal reporting. Hence, the Group has only one operating segment. As the Group's long-lived assets and revenue are substantially located in and derived from the PRC, no geographical segments are presented.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (jj) Recently issued accounting pronouncements

In April 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” (“ASU 2014-08”). The new guidance changes the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization’s operations and financial results. Additionally, ASU 2014-08 requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. ASU 2014-08 is effective for the Company in the first quarter of fiscal 2015. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. The Company is in the process of evaluating the impact of the standard on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 will eliminate transaction-specific and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principle-based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. The ASU also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. Entities can transition to the standard either retrospectively or as a cumulative effect adjustment as of the date of adoption. The Company is in the process of evaluating the impact of the standard on its consolidated financial statements.

In June 2014, under ASC 718, Compensation — Stock Compensation, the FASB issued Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. These amendments apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target could be achieved and still be eligible to vest in the award

if and when the performance target is achieved. For all entities, the amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company is in the process of evaluating the impact of the standard on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU 2014-15”). Pursuant to ASU 2014-15, in connection with preparing financial statements for each annual and interim reporting period, an entity’s management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is in the process of evaluating the impact of the standard on its consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 2. Principal accounting policies (continued)

#### (jj) Recently issued accounting pronouncements (continued)

In February 2015, the FASB issued ASU No. 2015-02, “Consolidation (Topic 810): Amendments to the Consolidation Analysis” (“ASU 2015-02”). ASU 2015-02 focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The ASU simplifies consolidation accounting by reducing the number of consolidation models from four to two. In addition, the new standard simplifies the FASB Accounting Standards Codification and improves current guidance by: (i) placing more emphasis on risk of loss when determining a controlling financial interest; (ii) reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a VIE; and (iii) changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The ASU will be effective for periods beginning after December 15, 2015, for public companies. For private companies and not-for-profit organizations, the ASU will be effective for annual periods beginning after December 15, 2016; and for interim periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The Company is in the process of evaluating the impact of the standard on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest - Imputation of Interest (Subtopic 835-30)” (“ASU 2015-03”). To simplify presentation of debt issuance costs, ASU 2015-03 requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs would not be affected by the amendments in ASU 2015-03. For public business entities, ASU 2015-03 will be effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company is in the process of evaluating the impact of the standard on its consolidated financial statements.

### 3. Certain risks and concentration

#### (a) PRC regulations

Foreign ownership of internet-based businesses is subject to significant restrictions under the current PRC laws and regulations. The PRC government regulates internet access, the distribution of online information and the conduct of online commerce through strict business licensing requirements and other government regulations. These laws and regulations also limit foreign ownership in PRC companies that provide internet information distribution services. Specifically, foreign ownership in an internet information provider or other value-added telecommunication service



providers may not exceed 50%. Foreigners or foreign invested enterprises are currently not able to apply for the required licenses for operating online games in the PRC. The Company is incorporated in the Cayman Islands and accordingly, the Company is considered as a foreign invested enterprise under PRC law.

In order to comply with the PRC laws restricting foreign ownership in the online business in China, the Group operates the online business in China through contractual arrangements with Guangzhou Huaduo and Beijing Tuda, the Group's two VIEs. As of December 31, 2014, Mr. David Xueling Li, CEO, Mr. Jun Lei, Chairman of the Company, Mr. Tony Bin Zhao, Director and Chairman of Technology Committee, Mr. Jin Cao, Executive Vice President, and Beijing Tuda own approximately 0.5%, 0.44%, 0.04%, 0.02% and 99% of Guangzhou Huaduo's equity interests, respectively. As of December 31, 2014, Mr. David Xueling Li, Mr. Tony Bin Zhao, and Mr. Jin Cao, own 97.7%, 1.5% and 0.8% of Beijing Tuda's equity interests, respectively.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****3. Certain risks and concentration (continued)****(a) PRC regulations (continued)**

The VIEs hold the licenses and permits necessary to conduct its internet value-added services and online advertising in the PRC. If the Company had direct ownership of the VIEs, it would be able to exercise its rights as a shareholder to effect changes in the board of directors, which in turn could affect changes at the management level, subject to any applicable fiduciary obligations. However, under the current contractual arrangements, it relies on the VIEs and its' shareholders' performance of their contractual obligations to exercise effective control. In addition, the Group's contractual agreements have terms range from 10 to 30 years, which are subject to Beijing Huanju Shidai's unilateral termination right. Under the respective service agreements, Beijing Huanju Shidai will provide services including technology support, technology services, business support and consulting services to Beijing Tuda and Guangzhou Huaduo in exchange for service fees. The amount of service fees payable is determined by various factors, including (a) a percentage of Beijing Tuda and Guangzhou Huaduo's revenues or earnings, and (b) the expenses that Beijing Huanju Shidai incurs for providing such services. Beijing Huanju Shidai may charge up to 100% of the income in Beijing Tuda and Guangzhou Huaduo and a multiple of the expenses incurred for providing such services, as determined by Beijing Huanju Shidai from time to time. The service fees payable by Beijing Tuda and Guangzhou Huaduo to Beijing Huanju Shidai are determined to be up to 100% of the profits of Beijing Tuda and Guangzhou Huaduo, with the timing of such payment to be determined at the sole discretion of Beijing Huanju Shidai. If fees were incurred, it would be significant to the Company and the operating companies' economic performance because it will be incurred and paid at up to 100% of the earnings of the VIEs. Fees incurred would be remitted, subject to further PRC restrictions. None of the VIEs or their shareholders are entitled to terminate the contracts prior to the expiration date, unless under remote circumstances such as a material breach of agreement or bankruptcy as it pertains to the service and business operation agreements and their amendment. For the years ended December 31, 2012, no service fees were charged by WOFEs to VIEs as both VIEs had accumulated losses since inception. For the year ended December 31, 2013 and 2014, Guangzhou Huanju Shidai and Beijing Huanju Shidai determined that service fees of RMB31,153 and RMB363,117 were charged to Guangzhou Huaduo. The service fees are typically determined based on the costs and expenses that WOFEs incurs for providing relevant technology support to Guangzhou Huaduo, as well as the consideration of Guangzhou Huaduo's future business development plan and its increasingly growing and diverse operational needs.

Further, the Group believes that the contractual arrangements among Beijing Huanju Shidai, the VIEs, and their shareholders are in compliance with PRC law and are legally enforceable. However, the PRC government may issue from time to time new laws or new interpretations on existing laws to regulate this industry. Regulatory risk also encompasses the interpretation by the tax authorities of current tax laws, and the Group's legal structure and scope of operations in the PRC, which could be subject to further restrictions resulting in limitations on the Company's ability to conduct business in the PRC. The PRC government may also require the Group to restructure the Group's operations entirely if it finds that its contractual arrangements do not comply with applicable laws and regulations. Furthermore,

it could revoke the Group's business and operating licenses, require it to discontinue or restrict its operations, restrict its right to collect revenues, block its website, require it to restructure its operations, impose additional conditions or requirements with which the Group may not be able to comply, or take other regulatory or enforcement actions against the Group that could be harmful to its business. The imposition of any of these penalties may result in a material and adverse effect on the Group's ability to conduct the Group's business. In addition, if the imposition of any of these penalties causes the Group to lose the rights to direct the activities of the VIEs or the right to receive their economic benefits, the Group would no longer be able to consolidate the VIEs and VIE's subsidiaries. The Group does not believe that any penalties imposed or actions taken by the PRC government would result in the liquidation of the Company, Beijing Huanju Shidai, and the VIEs.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****3. Certain risks and concentration (continued)****(a) PRC regulations (continued)**

On January 19, 2015, the Ministry of Commerce of the PRC, or (the “MOFCOM”) released on its Website for public comment a proposed PRC law (the “Draft FIE Law”) that appears to include VIEs within the scope of entities that could be considered to be foreign invested enterprises (or “FIEs”) that would be subject to restrictions under existing PRC law on foreign investment in certain categories of industry. Specifically, the Draft FIE Law introduces the concept of “actual control” for determining whether an entity is considered to be an FIE. In addition to control through direct or indirect ownership or equity, the Draft FIE Law includes control through contractual arrangements within the definition of “actual control.” If the Draft FIE Law is passed by the People’s Congress of the PRC and goes into effect in its current form, these provisions regarding control through contractual arrangements could be construed to reach the Group’s VIE arrangements, and as a result the Group’s VIEs could become explicitly subject to the current restrictions on foreign investment in certain categories of industry. The Draft FIE Law includes provisions that would exempt from the definition of foreign invested enterprises entities where the ultimate controlling shareholders are either entities organized under PRC law or individuals who are PRC citizens. The Draft FIE Law does not make clear how “control” would be determined for such purpose, and is silent as to what type of enforcement action might be taken against existing VIEs that operate in restricted industries and are not controlled by entities organized under PRC law or individuals who are PRC citizens. If a finding were made by PRC authorities under the Draft FIE Law if it becomes effective, that the Group’s operation of certain of its operations and businesses through VIEs violates the Draft FIE Law, regulatory authorities with jurisdiction over the licensing and operation of such operations and businesses may require the Group to take various actions as discussed in the paragraph above. The Group’s management considers the possibility of such a finding by PRC regulatory authorities under the Draft VIE law, if it becomes effective, to be remote.

The following consolidated financial information of the Group’s VIEs and VIE’s subsidiaries excluding the intercompany items with the Group’s subsidiaries was included in the accompanying consolidated financial statements as of and for the years ended:

	December 31,	
	2013	2014
	RMB	RMB
Assets		
Current assets		
Cash and cash equivalents	575,262	305,405

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Short-term deposits	594,000	1,002,020
Restricted short-term deposits	-	100,000
Accounts receivable, net	48,329	243,529
Inventory	-	1,445
Amount due from related parties	73	43,816
Prepayments and other current assets	29,753	113,939
Deferred tax assets	51,631	85,004
Total current assets	1,299,048	1,895,158
Non-current assets		
Deferred tax assets	383	1,392
Investments	33,920	63,220
Property and equipment, net	100,059	227,372
Intangible assets, net	9,717	133,888
Goodwill	-	298,802
Other non-current assets	-	31,520
Total non-current assets	144,079	756,194
Total assets	1,443,127	2,651,352

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

## 3. Certain risks and concentration (continued)

## (a) PRC regulations (continued)

	December 31,	
	2013	2014
	RMB	RMB
Liabilities		
Current liabilities		
Accounts payable	55,818	101,160
Deferred revenue	292,380	354,987
Advances from customers	10,656	25,897
Income taxes payable	47,974	65,162
Accrued liabilities and other current liabilities	197,851	357,464
Amounts due to related parties	2,640	30,892
Total current liabilities	607,319	935,562
Non-current liabilities		
Long-term payable	-	183,000
Deferred revenue	8,457	24,383
Deferred tax liabilities	-	26,709
Total non-current liabilities	8,457	234,092
Total liabilities	615,776	1,169,654

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Net revenues	702,929	1,669,852	3,543,994
Net income	80,071	486,095	1,136,570

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB

Net cash provided by operating activities	322,378	845,198	1,313,521
Net cash used in investing activities	(152,197)	(592,390)	(994,574 )
	170,181	252,808	318,947

**(b) Foreign exchange risk**

The revenues and expenses of the Group's subsidiaries, VIEs and VIE's subsidiaries in the PRC are generally denominated in RMB and their assets and liabilities are denominated in RMB. The Group's financing activities are denominated in U.S. dollars. The RMB is not freely convertible into foreign currencies. Remittances of foreign currencies into the PRC and exchange of foreign currencies into RMB require approval by foreign exchange administrative authorities and certain supporting documentation. The State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of RMB into other currencies.

**(c) Concentration risk****(i) Concentration of revenue**

No individual customer accounted for more than 10% of net revenues for the years ended December 31, 2012, 2013 and 2014.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****3. Certain risks and concentration (continued)****(c) Concentration risk (continued)****(ii) Concentration of accounts receivable**

The Group collects accounts receivable for IVAS revenue from collection agencies, online games revenue sharing from sub-licensed platforms, and online advertising revenue from customers. The Group depends on payments from a limited number of collection agencies and advertising customers. The top 10 accounts receivable accounted for 87% and 83% of the total accounts receivable as of December 31, 2013 and 2014, respectively. The following table summarizes the percentage of accounts receivable from collection agencies and advertising customers with over 10% of total accounts receivable:

	December 31,	
	2013	2014
	RMB	RMB
Collection agencies and advertising customers		
B1	*	57 %
B2	11 %	*
B3	25 %	*
B4	12 %	*

\*Less than 10%

**(d) Credit risk**

As of December 31, 2013 and 2014, substantially all of the Group's cash and cash equivalents and short-term deposits were placed with the PRC and international financial institutions. Management chooses these institutions because of their reputations and track records for stability, and their known large cash reserves, and management periodically reviews these institutions' reputations, track records, and reported reserves. Management expects that any additional institutions that the Group uses for its cash and bank deposits will be chosen with similar criteria for soundness. The balances in the PRC are not insured since it is not a market practice in the PRC. Nevertheless under the PRC law, it is required that a commercial bank in the PRC that holds third party cash deposits should maintain a certain percentage of total customer deposits taken in a statutory reserve fund for protecting the depositors' rights over their interests in



deposited money. PRC banks are subject to a series of risk control regulatory standards; PRC bank regulatory authorities are empowered to take over the operation and management of any PRC bank that faces a material credit crisis. The Group believes that it is not exposed to unusual risks as these financial institutions are either PRC banks or international banks with high credit quality. The Group had not experienced any losses on its deposits of cash and cash equivalents and term deposits during the years ended December 31, 2012, 2013 and 2014 and believes that its credit risk to be minimal.

#### 4. Business combination

##### *Acquisition of a majority of the assets of an internet service company*

On March 12, 2012, the Group acquired a majority of the assets of an internet service company, which is in the business of operating an internet platform, for cash consideration of RMB11,722. As a result of the acquisition, the Group obtained the key intellectual property to develop and expand the platform of YY Client. The acquisition was recorded using the acquisition method of accounting and the allocation of the purchase price at the date of acquisition is as follows:

	RMB
Property and equipment	128
Intangible assets	
- Technology	10,035
- Software	660
Goodwill	899
Total	11,722

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 4. Business combination (continued)

#### *Acquisition of a majority of the assets of an internet service company (continued)*

The business combination was completed on March 12, 2012 and there was no further adjustment to the purchase price allocation. The excess of purchase price over tangible assets and identifiable intangible assets acquired and liabilities assumed was recorded as goodwill. The acquired goodwill is not deductible for tax purposes. Acquisition related costs were immaterial and were included in general and administrative expenses for the year ended December 31, 2012.

Pro forma results of operations related to the acquisition have not been presented because they are not material to the Group's consolidated statements of operations and comprehensive income.

Since the acquired business has been fully integrated into the Company's current business after the acquisition, it is impracticable to disclose separately its standalone revenue and earnings after the acquisition.

#### *Acquisition of Zhengrenqiang and DuBooker*

On December 2, 2014, the Group acquired 100% of the equity interests of Zhengrenqiang and DuBooker for a fixed cash consideration of RMB60 million, plus additional variable cash consideration that is contingent upon the achievement of pre-established performance metrics. Zhengrenqiang is primarily engaged in providing a variety of online English courses specialising in the preparation of International English Language Testing System ("IELTS") to registered students through online education platforms, and DuBooker is primarily engaged in the publishing of a variety of teaching materials relevant to language education. The purpose of the acquisition was to strengthen the Group's competitive advantages in China's online education business. On the acquisition date, the allocation of the consideration of the assets acquired and liabilities assumed based on their fair value was as follows:

RMB

Cash consideration	60,000
Contingent consideration	183,000
Total consideration	243,000
Net assets acquired	1,882
Identifiable intangible assets acquired	
- Brand names	42,000
- Others	18,300
Goodwill	195,893
Deferred tax liabilities	(15,075 )
Total	243,000

The agreements for the acquisition of Zhengrenqiang included a contingent consideration arrangement that required additional consideration to be paid by the Group based on the actual net profit of Zhengrenqiang for years 2015 through 2017 as compared to the pre-established performance metrics as stipulated in the agreements. The undiscounted amounts the Company shall pay when the net profit of Zhengrenqiang from 2015 through 2017 equals to 100% of the performance metrics is RMB240 million. The actual contingent payments would be adjusted based on the degree of how the actual net profit is higher or lower than the performance metrics from 2015 through 2017. The fair value of the contingent consideration recognized on the acquisition date of RMB183.0 million was determined by the Company using the trinomial model. Under this model, the Company performs a scenario analysis by assuming different scenarios under which Zhengrenqiang achieves different actual net profit for years 2015 through 2017. Under different scenarios, the amount of contingent consideration differs according to the stipulation in the agreements. The Company then calculated the fair value of the contingent consideration based on the net present value of the total contingent consideration under different scenarios and the expected probability of each scenario. Please refer to note 26 for the key parameters adopted in the valuation.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 4. Business combination (continued)

#### *Acquisition of Zhengrenqiang and DuBooker (continued)*

The business combination was completed on December 2, 2014. The excess of the purchase price over tangible assets, identifiable intangible assets acquired, and liabilities assumed was recorded as goodwill. The acquired identifiable intangible assets were valued by various approaches, including the income approach and the replacement cost approach, as appropriate. As of December 31, 2014, no measurement period adjustment had been recorded. Acquisition related costs were immaterial and were included in general and administrative expenses for the year ended December 31, 2014.

Pro forma results of operations related to the acquisition have not been presented because they are not material to the Group's consolidated statements of operations and comprehensive income.

As the acquisition date was close to year end, the standalone revenue and earnings after the acquisition date of Zhengrenqiang and Dubooker is not material to the Group's consolidated statements of operations and comprehensive income.

There were no indemnification assets involved. Total identifiable intangible assets acquired upon acquisition mainly included brand names, cooperation agreements, copyrights of teaching materials and non-compete agreements, which have an estimated useful life of nine, three, five and five years, respectively. Total goodwill of RMB195.9 million primarily represents the expected synergies from combining operations of Zhengrenqiang and Dubooker with those of the Group, which were expected to be complementary to each other. In accordance with ASC350, goodwill is not amortized but is tested for impairment and is not deductible for tax purposes.

#### *Acquisition of Xingxue and Chuangzhi*

On December 23, 2014, the Group acquired 100% of the equity interests of Xingxue and Chuangzhi for a fixed cash consideration of RMB128.1 million. The principal business of Xingxue and Chuangzhi is the operation of online

vocational training platform. The purpose of the acquisition was to expand the Group's own educational service offerings from online English courses to a variety of online vocational training courses. On the acquisition date, the allocation of the consideration of the assets acquired and liabilities assumed based on their fair value was as follows:

	RMB
Net liabilities assumed	(8,549 )
Identifiable intangible assets acquired	
- Brand names	43,620
- Other	4,792
Goodwill	100,382
Deferred tax liabilities	(12,103 )
Total	128,142

The business combination was completed on December 23, 2014. The excess of the purchase price over tangible assets, identifiable intangible assets acquired, and liabilities assumed was recorded as goodwill. The acquired identifiable intangible assets were valued by various approaches, including the income approach and the replacement cost approach, as appropriate. As of December 31, 2014, no measurement period adjustment had been recorded. Acquisition related costs were immaterial and were included in general and administrative expenses for the year ended December 31, 2014.

Pro forma results of operations related to the acquisition have not been presented because they are not material to the Group's consolidated statements of operations and comprehensive income.

As the acquisition date was close to year end, the standalone revenue and earnings after the acquisition date of Xingxue and Chuangzhi is not material to the Group's consolidated statements of operations and comprehensive income.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****4. Business combination (continued)***Acquisition of Xingxue and Chuangzhi (continued)*

There were no indemnification assets involved. Total identifiable intangible assets acquired upon acquisition mainly included brand names, and software, which have an estimated useful life of fifteen and five years, respectively. Total goodwill of RMB100.4 million primarily represents the expected synergies from combining operations of Xingxue and Chuangzhi with those of the Group, which were expected to be complementary to each other. In accordance with ASC350, goodwill is not amortized but is tested for impairment and is not deductible for tax purposes.

**5. Cash and cash equivalents**

Cash and cash equivalents represent cash on hand and demand deposits placed with banks or other financial institutions. Cash and cash equivalents balance as of December 31, 2013 and 2014 primarily consist of the following currencies:

	December 31, 2013		December 31, 2014	
	Amount	RMB equivalent	Amount	RMB equivalent
RMB	715,316	715,316	394,214	394,214
US\$	2,342	14,282	13,205	80,814
Total		729,598		475,028

**6. Short-term deposits**

Short-term deposits represent time deposits placed with banks with original maturities of less than one year. Short-term deposits balance as of December 31, 2013 and 2014 primarily consist of the following currencies:

	December 31, 2013		December 31, 2014	
	Amount	RMB equivalent	Amount	RMB equivalent
RMB	1,432,863	1,432,863	1,921,520	1,921,520
US\$	-	-	374,685	2,293,056
Total		1,432,863		4,214,576

### 7. Restricted short-term deposits

As of December 31, 2014, the Group had restricted short-term deposits balance of RMB100 million representing pledged deposit for one pending litigation in which the Group is the claimant and has applied to the court to freeze the assets of the defendant. Pursuant to relevant PRC laws and regulations, the Group had to deposit a certain amount of cash as pledged deposit in order to submit the application to the court requesting to freeze the defendant's assets.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

(All amount in thousands, except share and per share data, unless otherwise stated)

**8. Accounts receivable, net**

	December 31,	
	2013	2014
	RMB	RMB
Accounts receivable, gross	131,315	314,778
Less: allowance for doubtful receivables	(31,214 )	(57,342 )
Accounts receivable, net	100,101	257,436

The following table summarized the details of the Company's allowance for doubtful accounts:

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Balance at beginning of the year	-	(5,716 )	(31,214 )
Additions charged to general and administrative expenses	(6,884 )	(31,987 )	(26,246 )
Write-off during the year	1,168	6,489	118
Balance at end of the year	(5,716 )	(31,214 )	(57,342 )

**9. Prepayments and other current assets**

	December 31,	
	2013	2014
	RMB	RMB
Interests receivable	25,381	98,355
Prepayments and deposits to vendors and content providers	33,603	54,330
Loans receivable	-	34,502
Others	8,549	16,952
Total	67,533	204,139



**10. Investments**

	December 31	
	2013	2014
	RMB	RMB
Cost investments (i)(ii)(iii)(iv)(v)	47,110	153,024
Equity investments	14,919	33,630
Total	62,029	186,654

In June 2013, the Group made an investment with an equity interest of 20% in a company with consideration of RMB15 million. The investment was not an investment in common stock or in-substance common stock and therefore was precluded from applying the equity method of accounting. It has been accounted for as an investment under cost method.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 10. Investments (continued)

In 2013, the Group entered into agreements to acquire minority stake of preferred shares of two companies with total consideration of approximately RMB28 million. Given the fact that the Company cannot unilaterally demand redemption of both of the preferred stocks as the Group only owns less than or equal to 10% of the preferred stocks respectively, these investments have been accounted for as an investment in an equity security under cost method since both of the equity securities do not have a readily determinable fair value.

In 2014, the Group entered into agreements to acquire minority stake of preferred shares of three companies with total consideration of approximately RMB59 million. Given the fact that the Company cannot unilaterally demand redemption of all of the preferred stocks as the Company only owns less than or equal to 10% of the preferred stocks respectively, these investments have been accounted for as an investment in an equity security under cost method since all of the equity securities do not have a readily determinable fair value.

The Group has developed and launched a mobile application called Weihui in 2014. Users of this application can make telephone calls with other users free of charge. In October 2014, the Group entered into an agreement with its CEO to inject Weihui into Bigo Technology Pte Ltd. ("Bigo"), a company set up and controlled by the CEO. The Group and the CEO agreed that Weihui shall be priced at US\$6 million (equivalent to RMB36,714). The board of directors of the Company has engaged two third party valuation firms in the evaluation of fair value of Weihui using both cost approach and market approach. In the opinion of the two third party valuation firms, the price of Weihui is fair and reasonable to the Group. As the cash contribution injected by the CEO and other investors into Bigo is US\$15.6 million, the Group holds 27.78% and the CEO and other investors hold 72.22% of equity interests of Bigo, respectively. The shareholding percentage of the Group and the CEO and other investors are in proportionate to their capital injection. As part of the agreement, the Group is entitled to receive an amount equal to 100% of its original investment in the event of liquidation in preference to other common shareholders. As a result, the investment was not an investment in common stock or in-substance common stock and therefore was precluded from applying the equity method of accounting. It was accounted for the investment under the cost method.

Considering that the substance of this transaction was that the Group transferred a group of assets that constitute a business to Bigo in exchange for a non-controlling interest in Bigo and the Group accounted for its investment over Bigo using the cost method, the entire difference between the fair value and carrying value of the assets given up was recognised in other non-operating income. As the carrying amount of Weihui on the Group's accounting book was zero, the non-operating income being recognised is RMB 36,714.

In addition to the above, the Group also made several cost investments in 2014. Save as disclosed above, none of these investments are, individually or in aggregate, material to the Group's financial statements.

### 11. Property and equipment, net

Property and equipment consists of the following:

	December 31,	
	2013	2014
	RMB	RMB
Gross carrying amount		
Servers, computers and equipment	152,404	304,117
Leasehold improvement	23,257	32,392
Furniture, fixture and office equipment	9,672	13,879
Motor vehicles	5,186	10,815
Construction in progress	4,652	31,786
Total	195,171	392,989
Less: accumulated depreciation	(92,535 )	(158,761)
Property and equipment, net	102,636	234,228

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****11. Property and equipment, net (continued)**

Depreciation expense for the years ended December 31, 2012, 2013 and 2014 were RMB29,074, RMB44,963 and RMB 68,035, respectively.

**12. Intangible assets, net**

The following table summarizes the Group's intangible assets:

	December 31,	
	2013	2014
	RMB	RMB
Gross carrying amount		
Software	5,477	17,304
Technology	17,121	17,145
Domain names	17,286	24,686
Brand names	-	94,120
Operating rights for licensed games	-	11,721
Others	-	18,300
Total of gross carrying amount	39,884	183,276
Less: accumulated amortization		
Software	(3,209 )	(5,944 )
Technology	(4,054 )	(6,035 )
Domain names	(2,944 )	(4,278 )
Brand names	-	(1,728 )
Operating rights for licensed games	-	(4,249 )
Others	-	(774 )
Total accumulated amortization	(10,207)	(23,008 )
Less: impairment		
Software	(550 )	(6,234 )

Intangible assets, net	29,127	154,034
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For the year ended December 31, 2014, the Group recognized impairment of intangible assets of RMB5,697, which was made against the carrying amount of the technology acquired in a business combination in 2012. The Group ceased to use this technology in its business in 2014 and believed the technology cannot bring future economic benefits to the Group. As a result, an impairment loss equal to the carrying amount of the technology was recognized.

Amortization expense for the years ended December 31, 2012, 2013 and 2014 were RMB3,369, RMB4,707 and RMB12,598, respectively.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****12. Intangible assets, net (continued)**

The estimated amortization expenses for each of the following five years are as follows:

	Amortization expense of intangible assets
2015	31,190
2016	19,874
2017	17,105
2018	14,544
2019	12,844

The weighted average amortization periods of intangible assets as of December 31, 2013 and 2014 are as below:

	<b>December 31,</b>	
	2013	2014
Domain names	15 years	15 years
Technology	5 years	5 years
Software	3 years	4 years
Brand names	-	11 years
Operating rights for licensed games	-	2 years
Others	-	4 years

**13. Goodwill**

	For the Year ended December 31,	
	2013	2014
	RMB	RMB
Balance at beginning of the year	1,604	1,577
Acquisition of Zhengrenqiang and Dubooker in 2014	-	195,893
Acquisition of Xingxue and Chuangzhi in 2014	-	100,382
Acquisition of another company in 2014	-	2,527
Foreign exchange	(27 )	3

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Balance at end of the year	1,577	300,382
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In December 2014, the Company purchased 100% equity interest of Zhengrenqiang and Dubooker. Goodwill of RMB195.9 million was recognized from this acquisition (Note 4).

In December 2014, the Company purchased 100% equity interest of Xingxue and Chuangzhi. Goodwill of RMB100.4 million was recognized from this acquisition (Note 4).

Goodwill arose from the business combination completed in the years ended December 31, 2014 has been allocated to the single reporting unit of the Group. Goodwill represents the synergy effects of the business combination.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****13. Goodwill (continued)**

The Company performed goodwill impairment tests to determine if goodwill impairment is indicated in year 2013 and 2014, and the results of these tests indicated that the Company's goodwill was not impaired.

**14. Other non-current assets**

	December 31,	
	2013	2014
	RMB	RMB
Prepayment for acquiring an office building	-	481,047
Unamortized convertible bonds issuance cost	-	42,275
Prepayments of exclusive license fee	-	31,189
Others	4,864	6,460
Total	4,864	560,971

**15. Deferred revenue**

	December 31,	
	2013	2014
	RMB	RMB
Deferred revenue, current:		
IVAS revenues	292,184	354,454
Government grants	1,682	1,696
Total current deferred revenue	293,866	356,150
Deferred revenue, non-current:		
IVAS revenues	8,457	23,850
Government grants	968	533
Total non-current deferred revenue	9,425	24,383

**16. Accrued liabilities and other current liabilities**



	December 31,	
	2013	2014
	RMB	RMB
Accrued salaries and welfare	113,302	168,300
Accrued revenue sharing fees	66,512	160,248
Accrued bandwidth costs	21,869	53,399
Business and other taxes payable	14,248	15,220
Interests payable	-	13,944
Accrued technology service fee	5,040	10,328
Deposits from advertising customers	-	7,826
Value added taxes payable	5,291	2,734
Others	24,498	46,704
Total	250,760	478,703

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 17. Convertible bonds

December 31,  
2013 2014  
RMB RMB

2019 Convertible Senior Notes - 2,447,980

On March 18, 2014, the Company issued Convertible Senior Notes due 2019 with principal amount of US\$400,000,000 (the "Notes"). The Notes bear interest at a rate of 2.25% per year, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on October 1, 2014. The Notes will mature on April 1, 2019. Holders may convert their Notes at their option at any time prior to the close of business on the second business day immediately preceding the maturity date.

Upon conversion, the Company will deliver, for each US\$1,000 principal amount of converted Notes, a number of ADSs, each representing twenty Class A common shares of YY Inc., par value of US\$0.00001 per share, equal to the conversion rate.

The conversion rate will initially be 9.0334 ADSs per US\$1,000 principal amount of Notes (equivalent to an initial conversion price of approximately US\$110.70 per ADS).

The net proceeds to the Company from the issuance of the Notes were US\$390.8 million. Debt issuance costs were US\$9.2 million and are being amortized to interest expense from the issuance date (March 18, 2014) to the first put date of the Notes (April 1, 2017).

The Notes are general senior unsecured obligations and rank (1) senior in right of payment to any of the Company's future indebtedness that is expressly subordinated in right of payment to the Notes, (2) equal in right of payment to any of the Company's future unsecured indebtedness of the Company that is not so subordinated, (3) junior in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness and (4) structurally junior to all indebtedness and other liabilities (including trade payables) of the Company's subsidiaries, VIEs and VIE's subsidiaries.

The value of the Notes is measured by the cash received. As of December 31, 2014, RMB2.4 billion (US\$400 million) has been accounted for as the value of the Notes in non-current liabilities.

The key terms of the Notes are as follows:

*Redemption*

*Contingent redemption option*

The Notes are not redeemable prior to the maturity date of April 1, 2019, except as described below. The holders of the Notes (the “Holders”) have a non-contingent option to require the Company to repurchase for cash all or any portion of their Notes on April 1, 2017. The repurchase price will equal 100% of the principal amount of the Notes to be repurchased plus accrued and unpaid interest, if any, to, but excluding, the repurchase date. If a fundamental change (as defined in the Indenture of the 2019 Convertible Senior Notes) occurs prior to the maturity date, the Holders may require the Company to purchase for cash all or any portion of the Notes at a purchase price equal to 100% of the principal amount of the Notes to be purchased plus accrued and unpaid interest, if any, to, but excluding, the fundamental change purchase date. The Holders have the option to require the Company to repurchase the Notes, in whole or in part, in the event of a fundamental change for an amount equal to the 100% of the principal amount and any accrued and unpaid interest in the event of fundamental changes. The Company believes that the likelihood of occurrence of events of a fundamental change is remote.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 17. Convertible bonds (continued)

#### *Redemption (continued)*

#### *Contingent redemption option (continued)*

The contingent redemption option is assessed in accordance with ASC 815-15-25-42. The contingent redemption option is considered clearly and closely related to its debt host and does not meet the requirement for bifurcation as the Notes were issued at par and the repurchase feature requires the issuer to settle the option by delivering par plus accrued and unpaid interest, the Notes holder would recover all of their initial investment. Additionally, since the Notes holder can only recover its initial investment upon exercise of its option, there are no interest rate scenarios under which the embedded derivative would at least double the investor's initial rate of return.

#### *Non-contingent redemption option*

On or after April 1, 2017, the Holders have the right to require the issuer to redeem, at 100% of the loan's principal amount plus accrued and unpaid interest, in which circumstance the Holders would recover substantially all of their initial investment.

#### *Conversion*

The Holders may convert their Notes in integral multiples of US\$1,000 principle amount at an initial conversion rate of 9.0334 ADS, at any time prior to the maturity date of April 1, 2019. Upon conversion of the Notes, the Company will deliver shares of the Company's ADS. The conversion rate is subject to adjustment in certain events, including, but not limited to, the issuance of certain share dividends on the Class A common shares, the issuance of certain rights or warrants, subdivisions, combinations, distributions of capital stock, indebtedness, or assets, cash dividends and certain issuer tender or exchange offers (as defined in the Indenture of the 2019 Convertible Senior Notes). In addition, upon a make-whole fundamental change (as defined in the Indenture of the 2019 Convertible Senior Notes), the Company will, under certain circumstances, increase the applicable conversion rate for a holder that elects to

convert its Notes in connection with such make-whole fundamental change.

In accordance with ASC 815-10-15-83, the conversion option meets the definition of a derivative. However, bifurcation of conversion option from the Notes is not required as the scope exception prescribed in ASC 815-10-15-74 is met as the conversion option is considered indexed to the entity's own stock and classified in shareholders' equity.

*Assessment of Beneficial Conversion Feature and Contingent Beneficial Conversion Feature:*

As the conversion options are not bifurcated, the Company has assessed the beneficial conversion feature ("BCF"), as of commitment date as defined in ASC 470-20. There was no BCF attributed to the Notes as the set conversion price for the Notes was greater than the fair value of the ordinary share price on the date of issuance.

The Holders have the option to convert upon a fundamental change, if Holders decide to convert in connection with a fundamental change; the number of shares issuable upon conversion will be increased. Upon occurrence of such adjustment, the Company will have to assess the contingent BCF using a measurement date upon issuance of the Notes. The settlement of the conversion is based on a make-whole provision resulting from a fundamental change, this feature is consistent with ASC 815-40-55-46, therefore the Company concludes that this feature is also considered indexed to its own shares.

*Accounting for Debt Issuance Costs:*

The debt issuance costs were recorded as deferred issuance costs and are amortized as interest expense, using the effective interest method, over the term of the Notes pursuant to ASC 835-30-35-2.

Interest expense being recognized during the year ended December 31, 2014 is RMB56,607.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****18. Cost of revenue**

	For the year ended		
	December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Revenue sharing fees and content costs	109,273	444,065	1,133,984
Bandwidth costs	145,037	203,238	345,913
Salary and welfare	50,009	88,456	131,773
Depreciation and amortization	25,762	37,084	59,817
Payment handling costs	22,828	24,955	55,101
Business tax and surcharges	30,026	47,755	49,233
Shared-based compensation	8,407	9,860	18,037
Other costs	24,791	26,586	55,291
Total	416,133	881,999	1,849,149

**19. Other income**

	For the year ended		
	December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Government grants	2,465	25,356	5,570
Others	-	1,722	749
Total	2,465	27,078	6,319

**20. Income tax**

(i) Cayman Islands (“Cayman”)

Under the current tax laws of Cayman Islands, the Company and its subsidiaries are not subject to tax on income or capital gains. Besides, upon payment of dividends by the Company to its shareholders, no Cayman Islands withholding tax will be imposed.

(ii) BVI

Duowan BVI is exempt from income tax on its foreign-derived income in the BVI. There are no withholding taxes in the BVI.

(iii) Hong Kong profits tax

Entities incorporated in Hong Kong are subject to Hong Kong profits tax at a rate of 16.5% on the estimated assessable profit for the years ended December 31, 2012, 2013 and 2014.

(iv) PRC Enterprise Income Tax (“EIT”)

The Company’s subsidiaries, VIEs and VIE’s subsidiaries in China are governed by the Enterprise Income Tax Law (“EIT Law”), which became effective on January 1, 2008. Pursuant to the EIT Law and its implementation rules, enterprises in China are generally subjected to tax at a statutory rate of 25%. Certified High and New Technology Enterprises (“HNTE”) are entitled to a favorable statutory tax rate of 15%, and qualified software enterprises can enjoy an income tax exemption for two years beginning with their first profitable year and a 50% tax reduction to the applicable tax rate for the subsequent three years.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 20. Income tax (continued)

(iv) PRC Enterprise Income Tax (“EIT”) (continued)

The Group’s PRC entities provided for enterprise income tax as follows:

- From 2012 to 2014, Guangzhou Huaduo accrued the EIT at a tax rate of 15% as a result of HNTE status.

Guangzhou Huanju Shidai reported tax loss from 2010 to 2013. On December 31, 2013, Guangzhou Huanju Shidai was granted the qualification as a software enterprise and started to enjoy the 0% preferential tax rate beginning from 2014.

- Other PRC subsidiaries, VIE and VIE’s subsidiaries were subject to 25% EIT for the periods reported.

According to a policy promulgated by the State Tax Bureau of the PRC and effective from 2008 onwards, enterprises engaged in research and development activities are entitled to claim 150% of the research and development expenses so incurred in a year as tax deductible expenses in determining its tax assessable profits for that year (“Super Deduction”). Certain subsidiaries and VIEs of the Group successfully claimed the Super Deduction in ascertaining the tax assessable profits for the periods reported.

In addition, according to the New EIT Law and its implementation rules, foreign enterprises, which have no establishment or place in the PRC but derive dividends, interest, rents, royalties and other income (including capital gains) from sources in the PRC shall be subject to PRC withholding tax (“WHT”) at 10% (a further reduced WHT rate may be available according to the applicable double tax treaty or arrangement). The 10% WHT is applicable to any dividends to be distributed from the Group’s PRC subsidiaries, VIEs and VIE’s subsidiaries to the Group’s overseas companies.

Aggregate undistributed earnings and reserves of the Company’s subsidiaries located in the PRC that are available for distribution to the Company as of December 31, 2013 and 2014 are approximately RMB753,975 and RMB1,819,004, respectively. The undistributed earnings and reserves of the Company’s subsidiaries, VIEs and VIE’s subsidiaries located in the PRC are considered to be indefinitely reinvested, because the Group does not have any present plan to pay any cash dividends on its common shares in the foreseeable future and intends to retain most of its available funds



and any future earnings for use in the operation and expansion of its business. Accordingly, no deferred tax liability on 10% WHT of aggregate undistributed earnings and reserves of the Company's subsidiaries located in the PRC has been accrued for the China dividend withholding taxes that would be payable upon the distribution of those amounts to the Company as of December 31, 2013 and 2014.

*Composition of income tax expense*

The current and deferred portions of income tax expense included in the consolidated statements of operations are as follows:

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Current income tax expenses	(48,357)	(125,365)	(200,034)
Deferred income tax benefits	19,316	35,414	45,751
Income tax expense for the year	(29,041)	(89,951)	(154,283)

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****20. Income tax (continued)***Reconciliation of the differences between statutory tax rate and the effective tax rate*

The reconciliation of total tax expense computed by applying the respective statutory income tax rate to pre-tax income is as follows:

	For the year ended		
	December 31,		
	2012	2013	2014
	RMB	RMB	RMB
PRC Statutory income tax rate	(25.0)%	(25.0)%	(25.0)%
Effect of preferential tax rate	10.4 %	10.5 %	13.1 %
Effect of tax-exempt entities	0.2 %	2.2 %	1.1 %
Permanent differences (i)	(13.9)%	(4.0) %	(3.5) %
Change in valuation allowance	(2.0) %	(3.0) %	(0.4) %
Effect of Super Deduction available to the Group	5.7 %	3.4 %	2.0 %
Effective income tax rate	(24.6)%	(15.9)%	(12.7)%

(i) Permanent differences mainly arise from expenses not deductible for tax purposes including primarily share-based compensation costs and expenses incurred by subsidiaries and VIEs.

*Deferred tax assets and liabilities*

Deferred taxes were measured using the enacted tax rates for the periods in which they are expected to be reversed. The tax effects of temporary differences that give rise to the deferred tax asset balances as of December 31, 2013 and 2014 are as follows:

December 31,  
2013      2014

	RMB	RMB
Deferred tax assets, current:		
Deferred revenue	32,905	37,796
Allowance for doubtful accounts receivable, accrued expense and others not currently deductible for tax purposes	39,791	82,957
Valuation allowance (i)	(5,775 )	(9,317 )
Total current deferred tax assets, net	66,921	111,436
Deferred tax assets, non-current:		
Tax loss carried forward	16,400	14,654
Deferred revenue	445	343
Impairment of investment	180	798
Others	-	705
Valuation allowance (i)	(16,400)	(15,108 )
Total non-current deferred tax assets, net	625	1,392
Deferred tax liabilities, non-current:		
Related to acquired intangible assets	-	26,709

Valuation allowance is provided against deferred tax assets when the Group determines that it is more likely than not that the deferred tax assets will not be utilized in the future. In making such determination, the Group considered factors including future taxable income exclusive of reversing temporary differences and tax loss carry forwards. Valuation allowance was provided for net operating loss carry forward because it was more likely than not that such deferred tax assets will not be realized based on the Group's estimate of its future taxable income. If events occur in the future that allow the Group to realize more of its deferred income tax than the presently recorded amounts, an adjustment to the valuation allowances will result in a decrease in tax expense when those events occur.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****20. Income tax (continued)***Tax loss carry forwards*

As of December 31, 2014, the Group had tax loss carry forwards of approximately RMB58,615, which can be carried forward to offset future taxable income. The net operating tax loss carry forwards will begin to expire as follows:

	Amount RMB
2015	-
2016	2,574
2017	685
2018	25,428
2019	29,928
Total	58,615

In accordance with PRC Tax Administration Law on the Levying and Collection of Taxes, the PRC tax authorities generally have up to five years to claw back underpaid tax plus penalties and interest for PRC entities' tax filings. In the case of tax evasion, which is not clearly defined in the law, there is no limitation on the tax years open for investigation. Accordingly, the PRC entities' tax years from 2010 to 2014 remain subject to examination by the tax authorities. There were no ongoing examinations by tax authorities as of December 31, 2014.

**21. Common shares**

On October 31, 2012, several executives of the Company converted in aggregate 5,068,000 vested restricted shares into common shares.

Upon the completion of the Company's IPO on November 21, 2012(Note 1(c)), the Company's shares were divided into Class A common shares and Class B common shares, par value of US\$0.00001. Holders of Class A common shares and Class B common shares have the same rights, except for voting rights and conversion rights. Holders of

Class A common shares are entitled to one vote per share in all shareholders' meetings, while holders of Class B common shares are entitled to ten votes per share. Each Class B common share is convertible into one Class A common share at any time at the discretion of the Class B shareholders thereof, while Class A common shares are not convertible into Class B common shares under any circumstances. The impact of dividing Class A and Class B common shares has been retroactively reflected in the Company's capital structure in the consolidated financial statements.

As of December 31, 2012, 10,000,000,000 Class A common shares and 1,000,000,000 Class B common shares had been authorized, 179,400,000 Class A common shares and 907,833,224 Class B common shares had been issued and outstanding, respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 21. Common shares (continued)

During the year ended December 31, 2013, 21,256,900 Class A common shares were issued for the exercised share options, vested restricted shares and restricted share units, 422,001,838 Class B common shares were converted to Class A common shares.

As of December 31, 2013, 10,000,000,000 Class A common shares and 1,000,000,000 Class B common shares had been authorized, 622,658,738 Class A common shares and 485,831,386 Class B common shares had been issued and outstanding, respectively.

During the year ended December 31, 2014, 25,036,140 Class A common shares were issued for the exercised share options, vested restricted shares and restricted share units and 58,478,690 Class B common shares were converted to Class A common shares.

As of December 31, 2014, 10,000,000,000 Class A common shares and 1,000,000,000 Class B common shares had been authorized, 706,173,568 Class A common shares and 427,352,696 Class B common shares had been issued and outstanding, respectively.

### 22. Convertible redeemable preferred shares

During the First Reorganization, Duowan Limited issued 54,488,000 Series A convertible preferred shares (“Series A Preferred Shares”) and warrant to a third party investor (“Series A Investor”) in exchange for an aggregate purchase price of RMB7,720, or US\$0.0184 per share. During the Second Reorganization in June 2008, Duowan BVI issued an additional 81,612,930 Series A convertible preferred shares to the Series A Investor for an aggregate purchase price of RMB13,722. The related issuance costs were RMB172.

In August 2008, Duowan BVI issued 102,073,860 Series B convertible redeemable preferred shares (“Series B Preferred Shares”) for aggregate cash consideration of RMB34,232 and issuance costs of RMB278.

In November 2009, Duowan BVI issued 16,249,870 Series C-1 convertible redeemable preferred shares (“Series C-1 Preferred Shares”) and 104,999,650 C-2 convertible redeemable preferred shares (“Series C-2 Preferred Shares”, collectively with Series C-1 Preferred Shares, “Series C Preferred Shares”), for aggregate cash considerations of RMB8,875 and RMB71,684 respectively. Series C Preferred Shares issuance costs were RMB274.

Series A Preferred Shares, Series B Preferred Shares and Series C Preferred Shares are collectively referred to as the “Preferred Shares”.

As of December 31, 2011, the Company has determined that the Preferred Shares should be classified as mezzanine equity since the Preferred Shares are contingently redeemable by the holders in the event that a qualified IPO has not occurred and the Preferred Shares have not been converted as of the redemption date.

The Company determined that there were no embedded derivatives requiring bifurcation as the economic characteristics and risks of the conversion feature embedded in derivative instrument are clearly and closely related to that of the convertible preferred shares, and the convertible and redeemable preferred shares are not readily convertible into cash as there is no market mechanism in place for trading its share.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****22. Convertible redeemable preferred shares (continued)**

As of December 31, 2011, the Preferred Shares comprised of the following:

Series	Issuance Date	Shares Issued and Outstanding	Issue Price Per Share (US\$)	Proceeds from Issuance, Net of Issuance Costs (US\$)	Carrying Amount (RMB)
A	December 1, 2006	54,488,000	0.0184	1,000	374,332
A	June 2, 2008	81,612,930	0.0245	1,975	560,681
B	August 8, 2008	102,073,860	0.0490	4,959	703,901
C-1	November 22, 2009	16,249,870	0.0800	1,300	112,556
C-2	November 22, 2009	104,999,650	0.1000	10,460	729,464

All Preferred Shares' par value is US\$0.00001. The rights, preferences and privileges of the Preferred Shares are as follows:

***Conversion***

Each Preferred Share was convertible, at the option of the holders, at any time after the date of issuance of such preferred shares into such number of common shares according to a conversion price. Each share of Series A, Series B, Series C Preferred Shares was convertible into one common share and was subject to adjustments for certain events, including but not limited to additional equity securities issuance, share dividends, subdivisions, redemptions, combinations, or consolidation of common shares. The conversion price is also subject to adjustment in the event the Company issues additional common shares at a price per share that is less than such conversion price. In such case, the conversion price shall be reduced to adjust for dilution.

Each Preferred Share was automatically converted into common shares at the then effective conversion price with respect to such Preferred Share (i) at the closing of a Qualified IPO, or (ii) at the election of the majority Series A, Series B, and Series C Preferred Shares holders (each voting or consenting as a separate class).



As of December 31, 2010, the Qualified IPO is defined as a firm-commitment public offering of common shares of the Company in the United States that has been registered under the Securities Act and on a recognized securities exchange such as NASDAQ or the New York Stock Exchange, or in a similar public offering of common shares in a jurisdiction and on a recognized securities exchange outside of the United States, including without limitation, the Hong Kong Stock Exchange, provided that (a) the market capitalization of the Company upon completion of such initial public offering shall be no less than US\$400,000 and such public offering and the aggregate proceeds (before deduction of underwriting discounts and registration expenses) is approved by majority of the board of directors (including the affirmative consent of the majority of the Series A, Series B, and Series C Preferred Shares director), or (b) such public offering and the aggregate proceeds (before deduction of underwriting discounts and registration expenses) is approved by majority of the board of directors (including the affirmative consent of each of the Preferred Shares' directors), and provided further that such public offering is made at an equivalent price and yields equivalent offering proceeds and there is regulatory approval for such offering. Subsequent to the Series D Common Share Financing in January 2011, the Qualified IPO is defined as a firm-commitment public offering of common shares of the Company in the United States that has been registered under the Securities Act and on a recognized securities exchange such as NASDAQ or the New York Stock Exchange, or in a similar public offering of common shares in a jurisdiction and on a recognized securities exchange outside of the United States, including without limitation, the Hong Kong Stock Exchange, provided that (a) the market capitalization of the Company upon completion of such initial public offering shall be no less than US\$1,500,000 and such public offering and the aggregate proceeds (before deduction of underwriting discounts and registration expenses) is approved by majority of the board of directors (including the affirmative consent of the majority of the Series A Director, the Series B Director, the Series C Director and the Series D director), or (b) such public offering and the aggregate proceeds (before deduction of underwriting discounts and registration expenses) is approved by majority of the board of directors (including the affirmative consent of each of the Series A Director, the Series B Director, the Series C Director and the Series D Director, if applicable), and provided further that such public offering is made at an equivalent price and yields equivalent offering proceeds and there is regulatory approval for such offering.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 22. Convertible redeemable preferred shares (continued)

#### *Conversion (continued)*

On September 19, 2012, the board of directors of the Company resolved to approve to raise additional capital through an underwritten initial public offering of its shares in the United States of America as a Qualified IPO.

Upon the completion of the IPO on November 21, 2012, each Preferred Share was automatically converted into one Class B common share. As a result, 359,424,310 Class B common shares were issued, and the balance of Preferred Shares was transferred to Class B common shares and additional paid-in capital on the same day.

#### *Redemption Right*

As of December 31, 2010, at any time after the date that is the earlier of i) the date of the occurrence of a Default Redemption Event, and ii) five years following the Series C-1 original issue date and Series C-2 original issue date, at the election of the majority of Series C holders, the Company shall redeem all or any lesser portion of its then outstanding Preferred Shares. A Default Redemption Event shall be deemed to occur if the Company's corporate structure as a whole, including without limitation the VIE documents, is invalidated or otherwise challenged by any PRC governmental authority, court or other official governmental body as a result of the application of or interpretation of the PRC law. In connection with the Series D Common Share Financing in January 2011, the Default Redemption Event was removed and the redemption date was changed to any time after June 30, 2015.

The redemption date above is subject to postponement until the Company meets the financial thresholds of having at least US\$3,000 of cash or cash equivalents on the balance sheet or the Company has generated over US\$1,000 in free cash flows in the preceding twelve months.

The redemption price of Series A Preferred Shares is equal to (i) the fair market value of the Series A Preferred Shares as of the redemption date, or (ii) 150% of the original issue price of Series A Preferred Shares, plus all declared or accrued but unpaid dividends up until the date of redemption, plus an amount that would give the holders of the Series

A Preferred Shares an internal rate of return of no less than 10% per annum.

The redemption price of Series B Preferred Shares is equal to (i) the fair market value of the Series B Preferred Shares as of the redemption date, or (ii) 100% original issue price of Series B Preferred Shares, plus all declared or accrued but unpaid dividends up until the date of redemption, plus an amount that would give the holders of the Preferred Shares an internal rate of return of no less than 10%.

The redemption price of Series C Preferred Shares is equal to (i) the fair market value of the Series C Preferred Shares as of the redemption date, or (ii) 100% original issue price of Series C-1 or C-2 Preferred Shares, plus all declared or accrued but unpaid dividends up until the date of redemption, plus an amount that would give the holders of the Series C-1 or C-2 Preferred Shares an internal rate of return of no less than 10% per annum.

### ***Modification***

Upon its issuance, Series A Preferred Shares were classified as permanent equity and were not redeemable. In association with the issuance of Series B Preferred Shares in August 2008, Series A Preferred Shares were granted redemption at the option of the holders and drag-along rights and accordingly were reclassified as mezzanine equity of the Company. The Company concluded that the addition of the redemption and drag-along rights is a modification of the terms of the Series A Preferred Shares. The incremental value received by the Series A Preferred Shareholders amounted to RMB916 which was deemed to be a wealth transfer between the preferred shareholders and the common shareholders and was charged to additional paid-in capital.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****22. Convertible redeemable preferred shares (continued)***Modification (continued)*

Upon its issuance, Series B Preferred Shares had a redemption right beginning on or after the seventh anniversary following the issuance of Series B Preferred Shares. In association of the issuance of Series C Preferred Shares, the redemption right for Series A and Series B Preferred Shares and drag-along rights were amended. The Company concluded amendment of the redemption and drag-along rights is a modification of the terms of the Series A and Series B Preferred Shares. The incremental value received by Series A and Series B Preferred Shareholders amounted to RMB19 and RMB176, respectively, which were deemed to be a wealth transfer between the preferred shareholders and the common shareholders and were charged to additional paid-in capital.

*Accretion (Decretion)*

Due to the redemption features described above, the Company classified the Preferred Shares in the mezzanine equity section of the consolidated balance sheets. The Company recognized the changes in the redemption value immediately as they occurred and adjusted the carrying amount of the Preferred Shares to equal the redemption value at the end of each reporting period. The fair market values of the Preferred Shares as of December 31, 2010 and 2011 were greater than the redemption value as of December 31, 2009 and 2010, while the fair market value of the Preferred Shares prior to conversion on November 21, 2012 was lower than the redemption value as of December 31, 2011. As a result, the Company recorded accretion (decretion) to the redemption value immediately and adjusted the carrying amount of the instrument to equal to the redemption value at the end of each reporting period. The accretion was recorded against retained earnings, or in the absence of retained earnings, by charging against additional paid-in capital. Once additional paid-in capital has been exhausted, additional charges were recorded by increasing accumulated deficit. The decretion was recorded against the previous accretion originally recognized in retained earnings or additional paid-in capital, where applicable.

The following table sets forth the changes of each of the convertible redeemable preferred shares for years ended December 31, 2012, 2013 and 2014:

**Series A Preferred Shares**

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Beginning balance	935,013	-	-
Decretion to redemption value	(485,517)	-	-
Conversion of convertible redeemable preferred shares into Class B common shares	(449,496)	-	-
Ending balance	-	-	-

**Series B Preferred Shares**

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Beginning balance	703,901	-	-
Decretion to redemption value	(366,785)	-	-
Conversion of convertible redeemable preferred shares into Class B common shares	(337,116)	-	-
Ending balance	-	-	-

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

## 22. Convertible redeemable preferred shares (continued)

## Accretion (Decretion) (continued)

## Series C Preferred Shares

	For the year ended		
	December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Beginning balance	842,020	-	-
Decretion to redeemable value	(441,573)	-	-
Conversion of convertible redeemable preferred shares into Class B common shares	(400,447)	-	-
Ending balance	-	-	-

Prior to the completion of the IPO, the Company engaged an independent valuation firm to assist them in determining the fair values of the preferred and common shares which were estimated as of the date of issuance and at each financial statement reporting date using the “Discounted Cash Flow Method”, the “Guideline Transaction Method” and the “Backsolve Method”, where methodologies, approaches and assumptions are consistent with the current working draft of the American Institute of Certified Public Accountants practice aid *Valuation of Privately Held Company Equity Securities Issued as Compensation*. The Guideline Transaction Method is a form of market approach based on the enterprise value to revenue multiples of the Group’s own equity transactions close to the valuation date. The Backsolve Method is a form of market approach to valuation that derives the implied equity value for one type of equity security (e.g. common equity) from a contemporaneous transaction involving another type of equity security (e.g., preferred share). The Discounted Cash Flow Method, a form of income approach, estimates the fair value based on projected cash flows at each of the valuation dates. The followings are assumptions in the Discounted Cash Flow Method:

December 31, 2011

Risk-free interest rate	2.53	%
Volatility	66.1	%
Dividend yield	-	

Discount rate                    16                    %

The Company estimated the risk-free interest rate based on yield-to-maturities in continuous compounding of the China Government Bond with the time to maturities similar to the Preferred Shares. The Company estimated volatility at the dates of appraisal based on average of historical volatilities of the comparable companies in the same industry. The Company has no history or expectation of paying dividend on the Preferred Shares. Discount rate is estimated by weighted average cost of capital as at each appraisal date. In addition to the above assumptions adopted, the Company's projections of future performance were also factored into the determination of the fair value of each Preferred Share.

### *Liquidity Preference*

In the event of any liquidation, dissolution or winding up of the Company or any deemed liquidation event (e.g., change in control), the holders of Series B Preferred Shares and Series C Preferred Shares were entitled to receive an amount per share equal to 100% of the original issuance price plus all dividends accrued, or declared and unpaid. Series A Preferred Shares were entitled to receive an amount per share equal to 150% of the original issuance price plus all declared or accrued but unpaid dividends.

If the assets and funds distributed among the holders are insufficient to permit the payment of the full preferential amounts, then the holders of Series C Preferred Shares shall be entitled to be paid first, followed in sequence by Series B Preferred Shares, Series A Preferred Shares and common shares. After payment of the full amounts from above, the remaining assets of the Company available for distribution shall be distributed ratably among the holders of preferred shares and common shares in proportion to the number of outstanding shares held by each holder on an as converted basis.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 22. Convertible redeemable preferred shares (continued)

#### *Dividends*

Each holder of Preferred Shares was entitled to receive dividends when and if declared by the board of directors of the Company. As long as the Preferred Shares were outstanding, the Company might not pay any dividend to common shareholders until all dividends declared and payable to the preferred shareholders had been paid. In the event the Company shall declare a dividend to the holders of common shares, then in each such case, the holders of the Preferred Shares shall be entitled to a proportionate share of such dividend on an as-converted basis.

#### *Voting rights*

Each Preferred Share conveys the right to the shareholder of one vote for each common share upon conversion.

### 23. Share-based compensation

#### (a) Share options

Pre-2009 Scheme Options

#### *Grant of options*

Before the adoption of the Employee Equity Incentive Scheme (the “2009 Incentive Scheme”), 12,705,700 and 8,499,050 share options were granted to employees through individually signed share option agreements, to acquire common shares of Duowan BVI on a one-to-one basis on January 1, 2008 and 2009 respectively. In addition, on January 1, 2008, 3,832,290 share options were granted to one non-employee for the provision of consulting services to the Group (collectively defined as “Pre-2009 Scheme Options”).



*Vesting of options*

These Pre-2009 Scheme Options will vest over a four years' service period, with 25% of the options vesting after the first anniversary of the vesting inception date and the remaining 75% in six equal installments over the following 36 months. The options may be exercised provided that both the service conditions and a performance condition are met. The performance condition is defined to be i) an initial public offering, ii) completion of a financing meeting certain criteria, iii) an internal reorganization, or iv) a voluntary winding up of Duowan BVI. The performance condition that is tied to completion of a financing fulfilling certain criteria was met in June 2008 or November 2009.

The following table summarizes the activities of the Pre-2009 Scheme Options for employees and non-employee for the years ended December 31, 2012, 2013 and 2014:

	Number of options	Weighted average exercise price (US\$)	Weighted average remaining contractual life (years)	Aggregate intrinsic value (US\$)
Outstanding, January 1, 2012	17,889,535	0.0055	6.37	19,366
Forfeited	(19,110 )	0.0067	6.25	
Outstanding, December 31, 2012	17,870,425	0.0055	5.37	12,642
Exercised	(4,648,420 )	0.0045	4.30	
Outstanding, December 31, 2013	13,222,005	0.0059	4.40	33,162
Exercised	(5,841,660 )	0.0057	3.24	
Outstanding, vested and exercisable, December 31, 2014	7,380,345	0.0061	3.52	22,959

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 23. Share-based compensation (continued)

#### (a) Share options (continued)

Forfeitures are estimated at the time of grant. If necessary, forfeitures are revised in subsequent periods if actual forfeitures differ from those estimates.

The aggregate intrinsic value in the table above represents the difference between the Company's common shares as of December 31, 2012, 2013 and 2014 and the exercise price.

Prior to the completion of the IPO, the Binomial option pricing model is used to determine the fair value of the share options granted to employees and the non-employee.

Upon the completion of the IPO, the fair value of share options granted to a non-employee with nil exercise price was assessed to be equivalent to the fair value of the Company's common share. These share options were remeasured at the stock price of the Company's common share as of December 31, 2013 and 2014.

The total intrinsic value of options exercised during the year ended December 31, 2012, 2013 and 2014 amounted to nil, RMB64,195 and RMB134,844, respectively. For the years ended December 31, 2012, 2013 and 2014, the Company recorded share-based benefit of RMB89, share-based compensation of RMB14,004 and nil, respectively, using the graded-vesting attribution method for employees and non-employee.

As of December 31, 2014, there was no unrecognized compensation cost and expense related to Pre-2009 Scheme Options granted to employees and non-employee.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****23. Share-based compensation (continued)****(b) Restricted shares**

Since January 1, 2010, Duowan BVI granted 61,250,677 restricted shares to employees and 100,000 restricted shares to a non-employee pursuant to the 2009 Incentive Scheme. As of December 31, 2014, the restricted shares granted to employees and the non-employee were fully vested.

*Vesting of restricted shares*

The restricted shares have vesting conditions and will vest 50% after 24 months of the grant date and the remaining 50% will vest in two equal installments over the next 24 months. Under the restricted shares agreement, no shares may be sold or transferred prior to the occurrence of an exit event, as defined in the respective restricted share agreements as: i) a listing on any recognized stock exchange, ii) a sale by Duowan BVI of all or substantially all of its assets, iii) a sale of all of the issued capital of Duowan BVI, or iv) passing for court order of winding up of Duowan BVI.

If the employee terminates employment, the service vested portion of the restricted shares may be subject to: (i) repurchase (subject to Company's sole discretion) by Duowan BVI at fair value of common shares of Duowan BVI which is assessed by the Company with the assistance of an independent valuation firm; or (ii) be held by a person who is an existing employee of the Group and is designated by the leaving restricted share holder according to a properly signed escrow agreement to hold such shares for and on his/her behalf. If the leaving employee fails to deliver a properly signed agreement to Duowan BVI within 30 days from receipt of the notification from Duowan BVI, such service vested shares shall automatically lapse and expire.

The following table summarizes the restricted shares activity for the years ended December 31, 2012, 2013 and 2014:

Number of restricted shares	Weighted average grant-date fair value (US\$)
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Outstanding, January 1, 2012	43,285,101	0.4885
Forfeited	(3,673,580 )	0.4945
Vested	(21,380,720)	0.4864
Outstanding, December 31, 2012	18,230,801	0.4898
Forfeited	(1,581,789 )	0.8726
Vested	(11,975,287)	0.3906
Outstanding, December 31, 2013	4,673,725	0.6144
Forfeited	(159,410 )	0.9362
Vested	(4,514,315 )	0.6030
Outstanding, December 31, 2014	-	
Expected to vest at December 31, 2014	-	

Forfeitures are estimated at the time of grant. If necessary, forfeitures are revised in subsequent periods if actual forfeitures differ from those estimates.

For the years ended December 31, 2012, 2013 and 2014, the Company recorded share-based compensation of RMB36,371, RMB7,300 and RMB3,771, respectively, using the graded-vesting method for employees and non-employee.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****23. Share-based compensation (continued)****(c) Share-based awards granted to CEO and Chairman of the Company**

On February 23, 2010, the CEO and the Chairman of the Company, also directors and shareholders were granted 13,369,813 and 29,678,483 restricted shares, respectively. The Chairman's shares have a service condition that vest over a four year period (50% after the second anniversary and 25% each year thereafter). Both the CEO's and the Chairman's shares are subject to a performance condition which relates to the number of peak concurrent users on the YY Client. Such performance condition was met as of December 31, 2010.

Pursuant to the provisions stipulated in the grant document relating to these restricted shares grant, upon the occurrence of an Acceleration Event, the restricted shares granted to the Chairman would also become fully vested. An "Accelerated Event" is defined as (i) a Listing, (ii) a sale of all or substantially all of the issued share capital of Duowan BVI, (iii) a sale by Duowan BVI of all or substantially all of its assets, (iv) the passing of an effective resolution or the making of an order of a competent court for the winding up of Duowan BVI.

The following table summarizes information regarding the restricted shares granted to the CEO and the Chairman:

	Number of restricted shares	Weighted average grant-date fair value (US\$)
Outstanding, January 1, 2012	29,678,483	0.1875
Vested	(29,678,483 )	0.1875
Outstanding, December 31, 2012, 2013 and 2014	-	

The fair value of the share-based awards above was determined at the respective grant dates by the Company with the assistance of an independent valuation firm.

The Company recognized these awards as employee share-based compensation awards using fair value of the awards on the grant date. As of December 31, 2010, the performance condition was met. The compensation expense for the CEO's restricted shares was fully recognized and the compensation expense for the Chairman's restricted shares is recognized over the requisite service period using the graded vesting method. Upon the completion of the IPO, the restricted shares granted to the Chairman were fully vested and all remaining compensation expenses were recognized immediately.

The total fair value of restricted shares vested during the year ended December 31, 2012, 2013 and 2014 amounted to RMB35,924, nil and nil, respectively.

Share-based compensation expenses related to the awards granted to the CEO and Chairman of RMB9,624, nil and nil were recognized in general and administrative expenses in the consolidated statements of operations for the years ended December 31, 2012, 2013 and 2014.

As of December 31, 2014, there was no unrecognized compensation cost and expense related to the restricted shares.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****23. Share-based compensation (continued)****(d) Restricted Share Units**

On September 16, 2011, the board of the directors of the Company approved the 2011 Share Incentive Plan, which permits the grant of share options, restricted shares and restricted share units of up to 43,000,000 shares, to any qualified persons, as determined by the board of the directors of the Company. On the same date, the Company granted 9,097,000 restricted share units to employees pursuant to the 2011 Share Incentive Plan, that are subject to vesting over a four to five years' period. During the year ended December 31, 2012, the Company granted 18,295,221 restricted share units to employees pursuant to the 2011 Share Incentive Plan, which are subject to vesting over a two to four years' period. No restricted share units were granted to non-employees up to December 31, 2012.

In October 2012, the board of directors of the Company resolved that the maximum aggregate number of Class A common shares which may be issued pursuant to all awards under the 2011 Incentive Scheme shall be 43,000,000 plus an annual increase of 20,000,000 on the first day of each fiscal year, beginning from 2013, or such lesser amount of Class A common shares as determined by the board of directors of the Company.

During the year ended December 31, 2013, the Company granted 29,917,989 restricted share units to employees and 48,000 restricted share units to non-employee pursuant to the 2011 Share Incentive Plan, which are subject to vesting over a three to five years' period.

During the year ended December 31, 2014, the Company granted 9,912,595 restricted share units to employees pursuant to the 2011 Share Incentive Plan, which are subject to vesting over a 18 months to five years' period. No restricted share units were granted to non-employees during the year ended December 31, 2014.

The following table summarizes the restricted share units activity for the years ended December 31, 2012, 2013 and 2014:

Number of restricted	Weighted average
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	shares	grant-date fair value (US\$)
Outstanding, January 1, 2012	8,996,300	1.0630
Granted	18,295,221	1.0324
Forfeited	(595,900 )	1.0876
Outstanding, December 31, 2012	26,695,621	1.0415
Granted	29,965,989	0.9338
Forfeited	(3,522,992 )	1.0699
Vested	(8,836,018 )	1.0429
Outstanding, December 31, 2013	44,302,600	0.9639
Granted	9,912,595	3.5805
Forfeited	(3,125,430 )	1.1859
Vested	(12,283,670)	1.0144
Outstanding, December 31, 2014	38,806,095	1.5984
Expected to vest at December 31, 2014	36,892,103	1.5647

For the years ended December 31, 2012, 2013 and 2014, the Company recorded share-based compensation of RMB54,445, RMB95,792 and RMB130,718, using the graded-vesting attribution method.

As of December 31, 2014, total unrecognized compensation expense relating to the restricted share units was RMB204,514. The expense is expected to be recognized over a weighted average period of 1.27 years using the graded-vesting attribution method.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****24. Basic and diluted net income per share**

Basic and diluted net income per share for the years ended December 31, 2012, 2013 and 2014 are calculated as follows:

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Numerator:			
Net income attributable to the Company	89,177	477,727	1,064,472
Decretion to convertible redeemable preferred shares redemption value	1,293,875	-	-
Allocation of net income to participating preferred shareholders	(478,754 )	-	-
Numerator of basic net income per share	904,298	477,727	1,064,472
Dilutive effect of preferred shares	(815,121 )	-	-
Numerator for diluted income per share	89,177	477,727	1,064,472
Denominator:			
Denominator for basic calculation—weighted average number of Class A and Class B common shares outstanding	604,703,810	1,122,475,688	1,153,140,699
Dilutive effect of preferred shares	320,142,965	-	-
Dilutive effect of share options	17,782,885	16,362,048	10,372,442
Dilutive effect of restricted shares	30,594,877	14,400,670	2,604,789
Dilutive effect of restricted share units	4,802,491	27,882,891	32,425,543
Dilutive effect of share-based awards granted to CEO and Chairman	14,441,808	-	-
Denominator for diluted calculation	992,468,836	1,181,121,297	1,198,543,473
Basic net income per Class A and Class B common share	1.50	0.43	0.92
Diluted net income per Class A and Class B common share	0.09	0.40	0.89
Basic net income per ADS*	29.91	8.51	18.46
Diluted net income per ADS*	1.80	8.09	17.76

The Company was listed on November 21, 2012 with issuance of a total of 8,970,000 ADS at a public offering price of US\$10.50 per ADS. Each ADS represents 20 Class A common shares. The net income per ADS for the years ended December 31, 2012, 2013 and 2014 were calculated using the same conversion ratio assuming the ADSs had been in existence during these periods.

The Company's preferred shares are participating securities and as such would be included in the calculation of basic earnings per share under the two-class method. According to the contractual terms of the preferred shares, the preferred shares do not have a contractual obligation to share in the losses of the Company. Therefore, net income was allocated to the preferred shares in the computation of basic net income per share for the year ended December 31, 2012.

The weighted average number of ordinary shares outstanding which could potentially dilute basic earnings per share in the future related to the 2019 Convertible Senior Notes was 57,219,783 for the year ended December 31, 2014. The 2019 Convertible Senior Notes were excluded in the computation of diluted earnings per share in 2014 because the inclusion of such instrument would be anti-dilutive.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****25. Related party transactions**

The table below sets forth the related parties and their relationships with the Group:

<b>Related Party</b>	<b>Relationship with the Group</b>
Zhuhai Daren Computer Technology Co., Ltd. (“Zhuhai Daren”)	Equity investment
Guangzhou Shanghang Information Technical Co., Ltd. (“Shanghang”)	Significant influence exercised by the Chairman
Kingsoft Corporation (“Kingsoft”)	Significant influence exercised by the Chairman
Xiaomi Corporation (“Xiaomi”)	Significant influence exercised by the Chairman
Zhuhai Lequ Technology Co., Ltd. (“Zhuhai Lequ”)	Equity investment
Agora, Inc. <sup>(1)</sup>	Controlled by the director and the chairman of technology committee of the Group
Guangzhou Kuyou Information Technology Co., Ltd. (“Guangzhou Kuyou”)	Equity investment
Shenzhen Qingdou Network Technology Co., Ltd. (“Shenzhen Qingdou”)	Cost investment with significant influence
Guangzhou Muyou Network Technology Co., Ltd. (“Guangzhou Muyou”)	Cost investment with significant influence
Bigo <sup>(3)</sup>	Controlled by the CEO
Chengdu Xishanju Entertainment Technology Co., Ltd. (“Xishanju”)	Significant influence exercised by the Chairman

(1) In December 2013, the Group made a minority interest investment to form a new company, Agora, Inc., with the director and the chairman of technology committee of the Group and other strategic investors.

(2) In March 2014, the Group made a further capital injection of RMB15 million to Guangzhou Kuyou and owned 20% of the equity interests in the company.

(3) The Group has developed and launched a mobile application called Weihui in 2014. Users of this application can make telephone calls with other users free of charge. In October 2014, the Group entered into an agreement with its CEO to inject Weihui into Bigo, a company set up and controlled by the CEO. Please refer to note 10 to this consolidated financial statements for more details of this transaction.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(All amount in thousands, except share and per share data, unless otherwise stated)****25. Related party transactions (continued)**

During the years ended December 31, 2012, 2013 and 2014, significant related party transactions were as follows:

	For the year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Payment on behalf of Bigo	-	-	61,000
Bandwidth service provided by Shanghang	11,776	21,272	42,470
Online games revenue shared from Guangzhou Kuyou	-	-	37,001
Online games revenue shared from Zhuhai Daren	7,547	24,452	25,597
Purchase of operating rights for licensed games from Guangzhou Kuyou	-	-	6,836
Online games revenue shared from Zhuhai Lequ	-	5,076	2,631
Disposal of an equity investment to Xishanju	-	-	1,563
Interest-free loan to Shenzhen Qingdou	-	-	1,000
Repayment of interest-free loan from Shenzhen Qingdou	-	-	1,000
Interest-free loan to Guangzhou Muyou	-	-	500
Repayment of interest-free loan from Guangzhou Muyou	-	-	500
Online games revenue shared from Xishanju	-	-	18
Purchase of intangible assets from Kingsoft	-	6,010	-
Advertising revenue from Xiaomi	-	1,154	-
Repayment of interest-free loan from Zhuhai Lequ	500	1,000	-
Membership subscription fee revenue from Xiaomi	227	-	-
Repayment of interest-free loan from Zhuhai Daren	2,000	-	-
Interest-free loan to Zhuhai Lequ	1,200	-	-
Disposal of a cost investment to the Chairman and Co-founder, who is also a director of the Company	1,000	-	-
Disposal of an equity investment to Xiaomi	2,000	-	-

As of December 31, 2013 and 2014, the amounts due from/to related parties were as follows:

	December 31,	
	2013	2014
	RMB	RMB

Amounts due from related parties		
Other receivables from Bigo (*)	-	61,000
Other receivables from Zhuhai Lequ	73	73
Total	73	61,073

Amounts due to related parties		
Accounts payable to Guangzhou Kuyou	-	24,454
Accounts payable to Zhuhai Daren	1,479	2,020
Other payables to Shanghang	822	4,342
Accounts payable to Zhuhai Lequ	339	41
Accounts payable to Xishanju	-	35
Total	2,640	30,892

\*As of the date of this report, other receivables from Bigo amounting to RMB61,000 were fully repaid by Bigo.

The other receivables/payables from/to related parties are unsecured, interest-free and payable on demand.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 26. Fair value measurements

Fair value reflects the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the assets or liabilities.

The Group applies a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. This guidance specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

Level 1—Valuation techniques in which all significant inputs are unadjusted quoted prices from active markets for assets or liabilities that are identical to the assets or liabilities being measured.

Level 2—Valuation techniques in which significant inputs include quoted prices from active markets for assets or liabilities that are similar to the assets or liabilities being measured and/or quoted prices for assets or liabilities that are identical or similar to the assets or liabilities being measured from markets that are not active. Also, model-derived valuations in which all significant inputs and significant value drivers are observable in active markets are Level 2 valuation techniques.

Level 3—Valuation techniques in which one or more significant inputs or significant value drivers are unobservable. Unobservable inputs are valuation technique inputs that reflect the Group's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair value guidance describes three main approaches to measure 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.

When available, the Group uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Group will measure fair value using valuation techniques that use, when possible, current market-based or independently sourced market parameters, such as interest rates and currency rates. The Group did not have any financial instruments that were required to be measured at fair value on a recurring basis as of December 31, 2013.

The following table summarizes the Company’s liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy as of December 31, 2014:

	As of December 31, 2014			
	Level 1	Level 2	Level 3	Total
Liabilities				
Long-term payable:				
Contingent consideration in relation to a business acquisition	-	-	183,000	183,000

As disclosed in note 4, the Company used the trinomial model in determining the fair value of the contingent consideration. In applying this model, the Company performs a scenario analysis and the fair value of the contingent consideration was determined based on present value of the total contingent consideration under different scenarios and the probability of each scenario. In order to discount the contingent consideration in future years to its present value, a risk free interest rate of 4.14% and a discount rate of 16% are adopted.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**(All amount in thousands, except share and per share data, unless otherwise stated)**

**26. Fair value measurements (continued)**

Apart from the contingent consideration in relation to a business acquisition, the Group’s other financial instruments consist principally of cash, short-term deposits, accounts receivable, amounts due to/from related parties, accounts payable, certain accrued expenses and convertible bonds. The recorded values of cash, accounts receivable, amounts due to/from related parties, accounts payable, certain accrued expenses and convertible bonds are recorded at cost which approximates fair value. The fair value of convertible bonds is within level 2 of the fair value hierarchy.

**27. Commitments and contingencies**

**(a) Operating lease commitments**

The Group leases facilities in the PRC under non-cancellable operating leases expiring on different dates. Payments under operating leases are expensed on a straight-line basis over the periods of the respective leases.

Total office rental expenses under all operating leases were RMB16,670, RMB19,423 and RMB28,144 for the years ended December 31, 2012, 2013 and 2014, respectively.

As of December 31, 2014, future minimum payments under non-cancellable operating leases consist of the following:

	Office rental
	RMB
2015	29,413
2016	8,315
2017	2,502
	40,230

**(b) Capital commitment**



As of December 31, 2014, the Group did not have any significant capital commitment.

(c)

**Litigation**

In October 2014, Guangzhou NetEase Computer System Co., Ltd. (“NetEase”) brought a copyright infringement claim against the Group in the Intermediate People’s Court of Guangzhou, alleging that the Group’s live game broadcasting program has infringed the copyright of one of their online games called Fantasy Westward Journey. The claimant is seeking RMB100 million for their potential damages, requesting YY to cease the copyright infringement practices and apologize publicly. This case is still in early stage and the Group is not able to make a reliable estimate of the potential loss, if any, at this stage.

**28. Subsequent events**

(a) In December 2014, the Company entered into an agreement to acquire 70% of equity interests of a private company, which is principally engaged in e-commerce business. The total amount YY shall pay includes a fixed cash payment of approximately RMB39.2 million in total, plus additional variable cash payment that is contingent upon the achievement of specified performance metrics for years 2015 through 2017. The base contingent payment to be made is RMB219 million when the private company achieves 100% of the performance metrics. Pursuant to the agreement, the actual contingent payment would be adjusted based on the degree of how the actual net profit is higher or lower than the base performance milestone from 2015 through 2017. The acquisition was completed in March 2015.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amount in thousands, except share and per share data, unless otherwise stated)

### 28. Subsequent events (continued)

(b) The Company has commenced the open market ADS repurchases pursuant to its announced share repurchase programs. Up to the date of this report, the Company's board of directors has approved share repurchase programs under which the Company may repurchase up to US\$200 million worth of its outstanding ADSs.

Up to the date of this report, the Company has repurchased approximately its outstanding ADSs amounting to US\$169.5 million.

### 29. Restricted net assets

Relevant PRC laws and regulations permit payments of dividends by the Group's subsidiaries and the VIEs and VIE's subsidiaries incorporated in the PRC only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. In addition, the Company's subsidiaries and the VIEs and VIE's subsidiaries in the PRC are required to annually appropriate 10% of their net after-tax income to the statutory general reserve fund prior to payment of any dividends, unless such reserve funds have reached 50% of their respective registered capital. As a result of these and other restrictions under PRC laws and regulations, the Group's subsidiaries and the VIEs and VIE's subsidiaries incorporated in the PRC are restricted in their ability to transfer a portion of their net assets to the Company either in the form of dividends, loans or advances, which restricted portion as calculated under US GAAP amounted to approximately RMB303,366 and RMB343,090 as of December 31, 2013 and 2014, respectively. There are no differences between US GAAP and PRC accounting standards in connection with the reported net assets of the legally owned subsidiaries in the PRC and the VIEs and VIE's subsidiaries. Even though the Company currently does not require any such dividends, loans or advances from the PRC entities for working capital and other funding purposes, the Company may in the future require additional cash resources from them due to changes in business conditions, to fund future acquisitions and development, or merely to declare and pay dividends or distributions to our shareholders. Except for the above, there is no other restriction on use of proceeds generated by the Group's subsidiaries and the VIEs and VIE's subsidiaries to satisfy any obligations of the Company.

The Company performed a test on the restricted net assets of consolidated subsidiaries and VIEs in accordance with Securities and Exchange Commission Regulation S-X Rule 4-08 (e) (3), "General Notes to Financial Statements" and concluded that the restricted net assets did not exceed 25% of the consolidated net assets of the Company as of December 31, 2014 and the condensed financial information of the Company are not required to be presented.

