

SHANDA INTERACTIVE ENTERTAINMENT LTD  
Form 20-F  
June 30, 2009

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

FORM 20-F

(Mark One)

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

OR

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

For the fiscal year ended December 31, 2008

OR

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

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

OR

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

Date of event requiring this shell company report \_\_\_\_\_.

Commission file number: 000-50705

SHANDA INTERACTIVE ENTERTAINMENT LIMITED

(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)

No. 208 Juli Road

Pudong New Area

Shanghai 201203, People's Republic of China

(Address of principal executive offices)

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Shanda Interactive Entertainment Limited  
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(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

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

(Title of each class)	(Name of each exchange on which registered)
American Depositary Shares, each representing 2 ordinary shares, par value US\$0.01 per share	The NASDAQ Stock Market LLC The NASDAQ Global Select Market

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

None

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

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 136,931,734 ordinary shares, par value US\$0.01 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transaction report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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.

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 Standard Boards  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

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Introduction

CONVENTIONS WHICH APPLY TO THIS FORM

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

- “advanced casual game” refers to a more sophisticated sub-category of casual games which are generally less time consuming and require less focus and attention than MMORPGs but possess certain elements of MMORPGs including a story line, elaborate graphics, availability of virtual items and frequent interactions among game players;
- “expansion pack” refers to an addition to an existing game that usually includes new game areas, weapons, objects, and/or an extended story line to a complete and already released game;
  - “light casual games” refers to online chess and board games and e-sports games;
  - “MMORPG” refers to a massively multi-player online role-playing game;

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- “online game” refers to MMORPGs, advanced casual games, and light casual games;
- “our PRC subsidiaries” refers to Shanda Computer and Shengqu;
- “our PRC operating companies” refers to the Shanda Networking entities and the Shulong entities;
- “the Reorganization” refers to the reorganization effort which we commenced in 2008 to provide each of our businesses with a sharper focus on its respective business operations, strategies and competitive challenges;
- “the Separation” refers to our transfer effective July 1, 2008 of substantially all of our assets and liabilities related to the MMORPG and advanced casual game business to Shanda Games, and Shengqu’s transfer of substantially all of its assets and liabilities unrelated to the MMORPG and advanced casual game business to Shanda Computer and Shanda’s other entities;
- “Shanda Games” refers to Shanda Games Limited, a Cayman Islands company, and, unless the context requires otherwise, includes its subsidiaries, including Shanda Games Holdings (HK) Limited, or Shanda Games (HK), Shanda Games International (Pte) Ltd., Shanda Games Korean Investment Limited, Actoz Soft Co., Ltd., or Actoz, and Shengqu Information Technology (Shanghai) Co., Ltd., or Shengqu, and, in the context of describing its operations, its VIEs, including the Shulong entities and Chengdu Aurora Technology Development Co., Ltd., or Chengdu Aurora;
- “Shanda Literature” refers to Shanda Literature Corporation, a Cayman Islands Company, and its consolidated subsidiaries and affiliates, including, Qidian, Jinjiang and Hongxiu;
- “Shanda Networking entities” refers to Shanda Networking and its subsidiaries, which prior to the Separation, included Hangzhou Bianfeng and Nanjing Shanda and following the Separation, included Shengfutong and Nanjing Shanda;
- “Shanda Online” refers to Shanda Online International (HK) Limited, a Hong Kong company wholly owned by us, and, unless the context requires otherwise, its subsidiaries, including Shanda Computer (Shanghai) Co., Ltd., or Shanda Computer, and, in the context of describing its operations, also includes its VIEs, including Shanghai Shanda Networking Co., Ltd., or Shanda Networking, Nanjing Shanda Networking Co., Ltd., or Nanjing Shanda, and Shanghai Shengfutong Electronic Business Co., Ltd., or Shengfutong;
- “Shulong entities” refers to Shanghai Shulong Technology Development Co., Ltd., or Shanghai Shulong, Shanghai Shulong Computer Technology Co., Ltd., or Shulong Computer, and Nanjing Shulong Computer Technology Co., Ltd., or Nanjing Shulong;
  - “VIE” refers to variable interest entities;
- “VIE agreements” refers to a series of contractual arrangements between a PRC subsidiary, on the one hand, and its VIEs and their shareholders, on the other hand, including contracts relating to the provision of services, software licenses and equipment, and certain shareholder rights and corporate governance matters; and
- “we”, “us”, “our company” and “our” refer to Shanda Interactive Entertainment Limited, its predecessor entities and its consolidated subsidiaries including our PRC subsidiaries and affiliates, including the Shulong entities, Chengdu Aurora, the Shanda Networking entities, Hangzhou Bianfeng Networking Co., Ltd., or Hangzhou Bianfeng, Wenzhou Chuangjia Technology Co., Ltd., or Gametca, Shanghai Xuanting Entertainment Technology Co., Ltd., or Qidian, Jinjiang Literature City, or Jinjiang, Hongxiu.com, or Hongxiu and Chengdu Jisheng Technology Co., Ltd.,



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This annual report contains translations of Renminbi amounts into U.S. dollars at specified rates solely for the convenience of the reader. Unless otherwise noted, for all dates and periods through December 31, 2008, exchange rates of Renminbi into U.S. dollars are based on the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York, which was RMB6.8225 to US\$1.00. For January 1, 2009 and all later dates and periods, the exchange rate refers to the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board. We make no representation that the Renminbi amounts referred to in this form could have been or could be converted into U.S. dollars at any particular rate or at all. On June 26, 2009, the exchange rate was RMB6.8330 to US\$1.00.



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## 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 selected consolidated statement of operations data for the five years ended December 31, 2008 and the consolidated balance sheet data as of December 31, 2004, 2005, 2006, 2007, and 2008 have been derived from our audited consolidated financial statements, which have been audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company, an independent registered public accounting firm. The report of PricewaterhouseCoopers Zhong Tian CPAs Limited Company on our consolidated financial statements as of December 31, 2007 and 2008 and for each of the three years in the period ended December 31, 2008 is included elsewhere in this annual report on Form 20-F. Our selected consolidated statement of operations data for the years ended December 31, 2004 and 2005 and our consolidated balance sheets as of December 31, 2004, 2005 and 2006 have been derived from our audited consolidated financial statements, which are not included in this annual report on Form 20-F. You should read the selected consolidated financial data in conjunction with those financial statements and the related notes and “Item 5. Operating and Financial Review and Prospects” included elsewhere in this annual report on Form 20-F. Our consolidated financial statements are prepared and presented in accordance with U.S. GAAP. Our historical results do not necessarily indicate our results expected for any future periods.

	For the year ended December 31,					
	2004	2005	2006	2007	2008	
	RMB	RMB	RMB	RMB	RMB	US\$(1)
(in thousands)						
Consolidated Statements of Operations and Comprehensive Income Data						
Net revenues:						
Online game related revenues:						
MMORPGs related revenues	994,664	1,255,341	1,240,096	2,040,938	2,982,335	437,132
Casual related revenues	214,513	402,968	302,800	329,655	440,949	64,632
Other revenues	89,548	238,302	111,564	96,672	145,784	21,368
Total net revenues	1,298,725	1,896,611	1,654,460	2,467,265	3,569,068	523,132
Cost of revenue	(471,184)	(614,427)	(689,805)	(807,102)	(1,020,470)	(149,574)
Gross profit	827,541	1,282,184	964,655	1,660,163	2,548,598	373,558

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	For the year ended December 31,					
	2004	2005	2006	2007	2008	
	(in thousands)					
	RMB	RMB	RMB	RMB	RMB	US\$(1)
Operating expenses	(316,579)	(660,285)	(587,023)	(658,199)	(1,106,315)	(162,157)
Income from operations	510,962	621,899	377,632	1,001,964	1,442,283	211,401
Interest income and investment income	63,171	23,127	97,104	535,622	80,771	11,839
Interest expenses	(3,524)	(18,492)	(17,490)	(13,131)	(10,295)	(1,509)
Other income, net	83,656	174,903	133,913	28,041	36,657	5,373
Income before income tax expenses, equity in loss of affiliated companies, minority interests	654,265	801,437	591,159	1,552,496	1,549,416	227,104
Income tax expenses	(38,941)	(96,711)	(36,489)	(133,836)	(276,471)	(40,524)
Equity in loss of affiliated companies.	(4,180)	(544,268)	(26,227)	(15,503)	(337)	(49)
Minority interests	(1,661)	4,825	767	(7,015)	(24,206)	(3,548)
Net income	609,483	165,283	529,210	1,396,142	1,248,402	182,983

	For the year ended December 31,					
	2004	2005	2006	2007	2008	
	(in thousands, except per share and per ADS data)					
	RMB	RMB	RMB	RMB	RMB	US\$(1)
Earnings per Share Data:						
Income attributable to preferred shareholders	(82,479)	—	—	—	—	—
Income attributable to ordinary shareholders	527,004	165,283	529,210	1,396,142	1,248,402	182,983
Earnings per share, basic	4.32	1.17	3.71	9.74	8.73	1.28
Earnings per share, diluted	4.05	1.13	3.66	9.54	8.63	1.26
Earnings per ADS, basic(2)	8.64	2.34	7.42	19.48	17.46	2.56
Earnings per ADS, diluted(2)	8.10	2.26	7.32	19.08	17.26	2.52

	As of December 31,					
	2004	2005	2006	2007	2008	
	(in thousands)					
	RMB	RMB	RMB	RMB	RMB	US\$(1)
Consolidated Balance Sheets Data:						
Cash and cash equivalents	3,123,971	949,622	1,291,901	1,985,302	3,397,844	498,035
Working capital(3)	3,200,918	2,742,420	956,672	2,133,422	3,355,817	491,875
Total assets	4,291,164	4,470,453	5,145,117	4,762,732	6,467,847	948,017
Total liabilities	2,774,386	2,829,205	2,724,813	923,017	2,544,247	372,920
Minority interests	6,879	3,389	2,910	216,298	288,765	42,325
Total shareholders' equity	1,509,899	1,637,859	2,417,394	3,623,417	3,634,835	532,772

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- (1) Translations of RMB amounts into U.S. dollars were made at a rate of RMB6.8225 to US\$1.00, the noon buying rate in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2008.
  - (2) Each ADS represents two ordinary shares.
  - (3) Working capital represents total current assets less total current liabilities.

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## EXCHANGE RATE INFORMATION

This annual report contains translations of Renminbi amounts into U.S. dollars at specific rates solely for the convenience of the reader. For all dates and periods through December 31, 2008, exchange rates of Renminbi into U.S. dollars are based on the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York. For January 1, 2009 and all later dates and periods, the exchange rate refers to the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board. These rates are provided solely for your convenience and we make no representation that any Renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rates stated below, or at all.

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

	Renminbi per U.S. Dollar Noon Buying Rate(1)			
	Average(2)	High	Low	Period End
2004	8.2770	8.2773	8.2765	8.2765
2005	8.1826	8.2765	8.0702	8.0702
2006	7.9579	8.0702	7.8041	7.8087
2007	7.5806	7.8127	7.2946	7.2946
2008	6.9193	7.2946	6.7800	6.8225
			Renminbi per U.S. Dollar Exchange Rate	
			High	Low
December 2008			6.8842	6.8225
January 2009			6.8403	6.8225
February 2009			6.8470	6.8241
March 2009			6.8438	6.8240
April 2009			6.8361	6.8180
May 2009			6.8326	6.8176
June 2009 (through June 26)			6.8371	6.8264

(1) For December 2008 and prior periods, the exchange rate refers to the noon buying rate as reported by the Federal Reserve Bank of New York. For January 2009 and later periods, the exchange rate refers to the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board.

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

On June 26, 2009, the daily exchange rate was RMB6.8330 to US\$1.00.

## B. CAPITALIZATION AND INDEBTEDNESS

Not applicable

## C. REASONS FOR THE OFFER AND USE OF PROCEEDS



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Not applicable

D. RISK FACTORS

Risks Relating to Our Business

We may not be able to successfully implement our growth strategy which may materially and adversely affect our business, financial condition and results of operations.

Our growth strategy focuses on the development of our integrated online value-added service platform which delivers a broad array of online entertainment content to a large and diverse user base. As of March 31, 2009, we offered a digital content delivery system, promotion-payment community system and customer relationship management system on our service platform, and our primary online entertainment content were MMORPGs, advanced casual games, online literature, online chess and board games, and e-sports games. Our ability to successfully implement our growth strategy will depend upon our success in attracting Internet content providers, or ICPs, to offer their content to our large and diverse user base through our service platform. In order to make our service platform more desirable to ICPs, we must increase the scope and improve the quality of the services that we offer on our service platform. Many ICPs in China may, nonetheless, regard our service platform as undesirable or the fee we charge for such service as unreasonable. We cannot assure you that we will be able to attract third parties to use our service platform on a commercially viable basis or in a timely manner, or at all. Moreover, the execution of our growth strategy requires a significant amount of managerial time and energy. If we are unable to successfully implement our growth strategy, our revenue and profitability may not grow as we expect, which may have a material adverse effect on our business, financial condition and results of operations.

If we are unable to offer additional successful interactive entertainment offerings through our platform, our business prospects, financial condition and results of operations would be materially and adversely affected.

To remain competitive, we need to develop and source interactive online content that appeals to our users. We currently offer MMORPGs, advanced casual games, online literature, online chess and board games, and e-sports games on our service platform. Our ability to develop and source additional online content to supplement the current offerings available on our service platform will depend on our ability to anticipate changing consumer tastes and preferences and to adopt new technologies to our platform. However, we cannot assure you that we will be successful in executing such strategy. If we fail to do so, our business, financial condition, results of operations and business prospects would be materially and adversely affected.

Our business may be adversely affected by the global economic downturn and the slowdown of China's economy.

We rely on the spending of our users for our revenues, which may in turn depend on our users' level of disposable income, perceived future earnings capability and willingness to spend. Economies around the world have been deteriorating since 2008. Global markets have experienced significant financial turmoil and upheaval characterized by extreme volatility and declines in prices of securities and commodities, diminished credit availability, inability to access capital markets, waves of bankruptcies, rising unemployment rates and declining consumer and business confidence. In addition, China's economy experienced a slowdown after the second quarter of 2008, when the quarterly growth rate of

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China's gross domestic product reached 11.9% and was further exacerbated by the recent global financial crisis and economic downturn. In the first quarter of 2009, the growth rate of China's gross domestic product decreased to 6.1%.

It is uncertain how long the global crisis in the financial services and credit markets will continue and how much of an adverse impact it will have on the global economy in general and the economies in China and other jurisdictions where our users enjoy our online entertainment content. We cannot assure you that the various macroeconomic measures and monetary policies adopted by the PRC government, including the economic stimulus package, will be effective in sustaining the growth rate of the Chinese economy. In addition, such measures and policies, even if they benefit the overall Chinese economy in the long term, may adversely affect us if they result in a reduction of the disposable income of our users. Due to such uncertain economic conditions, our users may reduce the amount they spend on online entertainment. The occurrence of any of the foregoing would adversely affect our business, financial conditions and results of operations.

We depend substantially on Shanda Games' business, and specifically two MMORPGs, which accounted for approximately 71.6% of our net revenues in 2008 and have finite commercial lifespan.

We are dependent upon Shanda Games' business of developing, sourcing and managing intellectual property rights relating to MMORPGs and advanced casual games for the majority of our net revenues. In 2008, Shanda Games' business accounted for approximately 94.6% of our net revenues and specifically, Mir II and Wool, which are two MMORPGs, accounted for approximately 52.1% and 19.5% of our net revenues, respectively. We expect to continue to derive a substantial majority of our net revenues from Mir II and Wool in the near term. Thus, our business prospects, financial condition and results of operations would be materially and adversely affected by any factor that contributes to a decline in revenues from Mir II and Wool, including:

- any reduction in purchases of virtual items by Mir II or Wool players;
- a decrease in the popularity of either game in China due to increased competition or other factors;
- loss of our rights to operate either game due to a termination of a license or other reasons;
- failure to improve, update or enhance Mir II or Wool in a timely manner; or
- any lasting or prolonged server interruption due to network failures or other factors or any other adverse developments specific to Mir II or Wool.

As with other MMORPGs, Mir II and Wool have finite commercial lifespans. We believe that Mir II and Wool, which Shanda Games launched in 2001 and 2003, respectively, are in the mature stages of their commercial lifespan. Shanda Games was able to reverse the decreasing trend in revenues from these two games with the adoption of its item-based revenue model in November 2005 and has since been able to continue generating revenue growth for both games and extend the lifespan of the games by enhancing, expanding and upgrading Mir II and Wool to include new features that appeal to existing players and attract new players. However, we cannot assure you that revenues from these games will not decline in the future. If Shanda Games is not able to extend the commercial lifespan of Mir II and Wool, our business prospects, financial condition and results of operations may be materially and adversely affected.

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If Shanda Games is unable to develop and source additional new MMORPGs and advanced casual games, our business prospects, financial condition and results of operations would be materially and adversely affected.

Shanda Games develops and sources new MMORPGs and advanced casual games which appeal to our users, through its multi-channel strategy, including in-house development, licensing, investments and acquisitions, co-development and co-operation. However, we cannot assure you that Shanda Games will be successful in executing such strategy. If Shanda Games fails to execute this strategy, our business, financial condition, results of operations and business prospects would be materially and adversely affected. The following summarizes risks relating to in-house development, licensing and investments and acquisitions of MMORPGs and advanced casual games.

- In-house development of new MMORPGs and advanced casual games and introduction of expansion packs for existing games

Shanda Games must continue to successfully develop new MMORPGs and advanced casual games in house to expand its game portfolio and introduce expansion packs to extend the commercial lifespan of its existing games.

Shanda Games' ability to develop successful new MMORPGs and advanced casual games in house will largely depend on (i) its ability to anticipate and effectively respond to changing game player interests and preferences and technological advances in a timely manner, (ii) to attract, retain and motivate talented online game developers, and (iii) to effectively execute game development plans. In-house development requires a substantial initial investment prior to the launch of the game, as well as a significant commitment of future resources to produce updates and expansion packs, which are more substantial enhancements than updates.

Shanda Games' ability to introduce successful expansion packs for its existing MMORPGs and advanced casual games will also depend on its ability to collect and analyze user behavior data and feedback from the player community in a timely manner and to effectively incorporate features into its expansion packs to improve the variety and attractiveness of the virtual items in its games. We cannot assure you that Shanda Games will be able to collect and analyze game player behavior data on a timely basis or that such data will accurately reflect game player behavior.

- Maintaining good relationships with our licensors, extending licenses for our existing licensed games and licensing new games

Shanda Games licenses many of its MMORPGs and advanced casual games, including some of its most popular games, from third parties. In 2008, we derived approximately 64.6% of our net revenues from MMORPGs and advanced casual games that Shanda Games licenses from third parties. Shanda Games must maintain good relations with its licensors to ensure the continued smooth operation of its licensed games. Additionally, Shanda Games depends upon its licensors to provide technical support necessary for the operation of the licensed games, as well as expansion packs and updates that help to sustain interest in a game. Finally, certain marketing activities often require the consent of Shanda Games' licensors. Moreover, Shanda Games' licenses may be terminated upon the occurrence of certain events, such as a material breach by Shanda Games. Only some of its license agreements allow Shanda Games to automatically extend the term of the license without renegotiating with the licensors. Shanda Games may want to extend a license upon its expiration but may not be able to do so on terms acceptable to Shanda Games or at all. Shanda Games' licensors may also demand new royalty terms that are unacceptable to it. Shanda Games' ability to



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continue to license its MMORPGs and advanced casual games and to maintain good relationship with its licensors also affects its ability to license new games developed by the same licensors.

- Investments in and acquisitions of other companies that Shanda Games believes may benefit its business

Shanda Games intends to continue to expand its game portfolio by investing in or acquiring other game developers that complement its business or that Shanda Games believes may benefit it in terms of game player base or content offering. However, Shanda Games' ability to grow through such investments and acquisitions will depend on the availability of suitable candidates at an acceptable cost or at all and its ability to consummate such transactions on commercially reasonable terms, as well as its ability to obtain any required governmental approvals. The benefits of an investment or acquisition may take considerable time to develop and we cannot assure you that any particular transaction Shanda Games enters into will achieve the intended benefits. Moreover, the identification and completion of these transactions may require Shanda Games to expend significant management and other resources. Future acquisitions could also expose Shanda Games to potential risks, including risks associated with the assimilation of new operations, technologies and personnel, unforeseen or hidden liabilities, the inability to generate sufficient revenues to offset the costs and expenses of acquisitions and potential loss of, or harm to, our relationships with employees, customers, licensors and other suppliers as a result of integration of new businesses.

Shanda Games' new games may not be commercially successful, and Shanda Games may fail to launch new games according to –its timetable, or at all.

Shanda Games must introduce new MMORPGs and advanced casual games that can generate additional revenues and diversify its revenue sources in order to remain competitive. The games in its announced pipeline only represent its current expectations. We cannot assure you that these games, if launched, will be commercially successful, and you should not use the performance of Shanda Games' existing MMORPGs and advanced casual games as an indication of the future performance of any game in its pipeline. There are many factors that may adversely affect the popularity of Shanda Games' new MMORPGs and advanced casual games, and if its new games are not commercially successful, Shanda Games may not be able to recover its game sourcing or development costs, which can be significant.

The timing of the launch of Shanda Games' pipeline games is also critical to its business. We also cannot assure you that Shanda Games will be able to launch these online games based on its current timetable, or at all. A number of factors, including technical difficulties, a lack of sufficient game development personnel, a lack of marketing or other resources and acceptance of or interest in the new games among game players during the testing phase, and adverse developments in our relationship with the licensors of its newly licensed games could result in delayed launching of its new games. If Shanda Games fails to launch MMORPGs and advanced casual games according to its timetable, we may disappoint our user base, fail to meet our financial guidance, or lose our market leadership position in the industry to competitors, any of which may have a material adverse effect on our business, financial condition and results of operations.

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Shanda Games' new MMORPGs and advanced casual games may attract game players away from its existing games, which may have a material adverse effect on our business, financial condition and results of operations.

Shanda Games' MMORPGs and advanced casual games may attract away players of its existing games and shrink its existing games' player bases, which could in turn make these existing games less attractive to other game players, resulting in decreased revenues from its existing games. Players of existing games may also spend less money to purchase virtual items in new MMORPGs and advanced casual games than they would have spent if they had continued playing Shanda Games' existing games, which could materially and adversely affect our business, financial condition and results of operations. Furthermore, if game players migrate from existing MMORPGs and advanced casual games with a higher profit margin to new games with a lower profit margin, our business, financial condition and results of operations may be materially and adversely affected.

There are risks that the revenue models Shanda Games adopts for its MMORPGs and advanced casual games may not be suitable.

Shanda Games has currently adopted the item-based revenue model for substantially all of its MMORPGs and advanced casual games. Shanda Games currently expects that a substantial majority of its revenues, and therefore a substantial majority of our revenues, will continue to be generated under the item-based revenue model, under which its game players can play games for free, but may choose to pay for in-game virtual items and other value-added services provided by the game operator to enhance the game-playing experience. The item-based revenue model requires Shanda Games to develop or license MMORPGs and advanced casual games that not only attract game players to spend more time playing, but also encourage them to purchase virtual items. The sale of virtual items requires Shanda Games to track closely game players' tastes and preferences, especially as to in-game consumption patterns. If Shanda Games fails to develop or license virtual items so as to provide incentive to game players to purchase them, Shanda Games may not be able to effectively translate its game player base into revenues. Although the item-based revenue model is currently a prevalent revenue model for online games in China, it may not be the most suitable for every game. In addition, the item-based revenue model may cause additional concerns with PRC regulators who have been implementing regulations designed to reduce the amount of time that Chinese youth spend on online games and intended to limit the total amount of virtual currency issued by online game operators and the amount of purchase by an individual game player. A revenue model that does not charge for time may be viewed by the PRC regulators as inconsistent with this goal. Furthermore, Shanda Games may change the revenue model for some of its MMORPGs and advanced casual games if it believes the existing revenue models are not optimal. We cannot assure you that the revenue models that Shanda Games has adopted for its games will continue to be commercially successful, or that Shanda Games will not in the future need to switch its revenue models or introduce new revenue models. Any change in revenue model could result in the disruption of Shanda Games' game operations, decreases in the number of its game players or decreases in the revenues Shanda Games generates from its games.

Shanda Games faces the risk of uncertainties regarding the growth of the online game industry and market acceptance of its online games.

The growth of the online game industry and the level of demand and market acceptance of Shanda Games' MMORPGs and advanced casual games are subject to a high degree of uncertainty. Shanda Games' results of operations will depend on factors beyond its control, including:

- the growth rate in the number of users of personal computer, Internet and broadband in China and other markets in which Shanda Games offers its games;
- whether the online game industry, particularly in China and the rest of the Asia-Pacific region, continues to grow and the rate of any such growth;



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- general economic conditions, particularly economic conditions that impact the level of discretionary consumer spending;
- the availability and popularity of other forms of entertainment, particularly games of console systems, such as those made by Microsoft, Nintendo and Sony, which are already popular in many other countries and may gain popularity in China and other countries or regions in which we market our online entertainment content;
  - changes in consumer demographics and public tastes and preferences;
- the popularity and price of new games and virtual items that Shanda Games and its competitors launch and distribute; and
- its ability to timely upgrade and improve its existing games to extend their commercial lifespan and to maintain or expand their market share in the online game industry.

Shanda Games' ability to plan for product development and distribution and promotional activities will be significantly affected by its ability to anticipate and adapt to relatively rapid changes in consumer tastes and preferences. Although MMORPGs are currently popular in China, there is no assurance that they will continue to be popular in China or elsewhere. A decline in the popularity of online games in general, or the MMORPGs and advanced casual games that Shanda Games operates, would adversely affect its business prospects and results of operations, and therefore our business prospects and results of operations. Shanda Games must be able to track and respond to these changes in game players' preferences in a timely and effective manner. Furthermore, given that the item-based revenue model relies on in-game purchases, Shanda Games must be able to track and respond quickly to changes in game preferences and consumer spending trends.

Shanda Games may not be able to adapt to the rapidly evolving online game industry in China.

China's online game industry is evolving rapidly. Shanda Games must adapt to new industry trends, including changes in game players' preferences, new revenue models, new game content distribution models, new technologies and new governmental regulations. Shanda Games evaluates these changes as they emerge and strive to adapt its business and operations in order to maintain and strengthen its leadership in the online game industry. However, we cannot assure you that Shanda Games will be able to do so successfully, which may have a material adverse effect on our business, financial condition and results of operations.

Shanda Games faces significant competition in the online game industry in China which could reduce its market share and materially and adversely affect our business, financial condition and results of operations.

The online game industry in China is increasingly competitive. In recent years, numerous competitors have entered the online game industry in China. We expect more companies to enter the market and we expect a wider range of online games to be introduced to China. Competition from other online game operators, both based in China as well as overseas, is likely to increase in the future. Other online game operators or developers, such as China-based Changyou.com Limited, Giant Interactive Group, Inc., Kingsoft Corporation Limited, or Kingsoft, NetDragon Websoft Inc., NetEase.com, Nineyou International Limited, Perfect World Co., Ltd., Tencent Holdings Limited, and The9 Limited, as well as international game developers, such as Blizzard Entertainment, Inc., Electronic Arts Inc., NCSOFT Corporation,

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Nexon Corporation, NHN Corp. and Webzen, Inc., are Shanda Games' current or potential future competitors. As the online game industry in China is constantly evolving, Shanda Games' current or future competitors may compete more successfully as the industry matures. In particular, any of these competitors may offer products and services that provide significant performance, price, creativity or other advantages over those offered by Shanda Games. These products and services may weaken Shanda Games' brand name and achieve greater market acceptance than those of Shanda Games. In addition, at or around the time when Shanda Games launches its new MMORPGs or advanced casual games, competitors may launch similar games, which may compete with Shanda Games' games for potential game players. Furthermore, any of Shanda Games' current or future competitors may be acquired by, receive investments from or enter into other strategic or commercial relationships with, larger, more established and better financed companies and therefore obtain significantly greater financial, marketing and game licensing and development resources than Shanda Games has. In addition, increased competition in the online game industry in China could make it difficult for Shanda Games to retain existing players and attract new players. Moreover, Shanda Games may face competition from console games that have achieved significant success in markets other than China but have yet to be permitted to be sold in China due to regulatory and other reasons. If these game consoles, many of which are strengthening their online game features, are permitted to be sold in China, Shanda Games would face additional competition. Shanda Games also competes with other forms of entertainment, such as television and movies. If Shanda Games is unable to compete effectively, our business, financial condition and results of operations would be materially and adversely affected.

Shanda Games' business may be materially harmed if its games are not featured in a sufficient number of Internet cafes in China.

A substantial number of game players access Shanda Games' MMORPGs and advanced casual games through Internet cafes in China. Due to limited hardware capacity, Internet cafes generally feature a limited number of games on their computers. Shanda Games thus competes with a growing number of other online game operators to have its games featured on these computers. This competition may intensify in China due to a nationwide suspension of approval for the establishment of new Internet cafes in 2007. If Shanda Games fails to feature its MMORPGs and advanced casual games prominently and sufficiently in Internet cafes in China, or fail to do so cost-effectively, our business, financial condition and results of operations may be materially and adversely affected.

Shanda Games faces risks associated with the licensing of its MMORPGs and advanced casual games internationally, and if Shanda Games is unable to effectively manage these risks, they could impair its ability to expand its business internationally.

As of March 31, 2009, Shanda Games licensed six of its MMORPGs and advanced casual games to game operators in a number of countries or regions. Shanda Games plans to further license its existing and new MMORPGs and advanced casual games in more countries and regions.

Licensing its games in the international markets exposes Shanda Games to a number of risks, including difficulties relating to:

- identifying and maintaining good relations with game operators who are knowledgeable about, and can effectively distribute and operate its online games in, international markets;
- negotiating licensing agreements with game operators on terms that are commercially acceptable to it;

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- developing games and expansion packs catering to overseas markets and renewing its license agreements with game operators upon their expiration;
- maintaining the reputation of Shanda Games and its games, given that its games are operated by game operators in the overseas markets pursuant to their own standards;
  - protecting its intellectual property rights overseas and the related costs;
  - policing and accurately calculating the royalties it is entitled to receive; and
- complying with the different commercial and legal requirements of the international markets which it offers its games, such as game import regulatory procedures, taxes and other restrictions and expenses.

For example, South Korea requires online game operators to obtain ratings classifications for online games and implement procedures to restrict minors from accessing online games. As a result, Shanda Games' plan to continue to license its MMORPGs and advanced casual games in international markets may also be adversely affected by public opinion or government policies in select markets in which Shanda Games licenses its games. Shanda Games' inability to license its games internationally would have a material adverse effect on our business, financial conditions and results of operations.

If Shanda Games fails to anticipate or successfully implement new technologies, its games may become obsolete or uncompetitive, and our business prospects and results of operations could be materially and adversely affected.

The online game industry is subject to rapid technological change. Shanda Games needs to anticipate the emergence of new technologies and assess its market acceptance. In addition, government authorities or industry organizations may adopt new standards that apply to game development. Shanda Games also needs to invest significant financial resources in product development to keep pace with technological advances. However, development activities are inherently uncertain, and Shanda Games' significant expenditures on technologies may not generate corresponding benefits. If Shanda Games falls behind in adopting new technologies or standards, its existing games may lose popularity, and its newly-developed games may not be well received by its game players. In addition, Shanda Games may incur significant cost overrun in product development. As a result, our business prospects and results of operations could be materially and adversely affected.

Errors or defects in Shanda Games' MMORPGs and advanced casual games and the proliferation of cheating programs could materially and adversely affect our business prospects and results of operations.

Shanda Games' MMORPGs and advanced casual games may contain errors or other defects. In addition, parties unrelated to Shanda Games have developed, and may continue to develop, Internet cheating programs that enable Shanda Games' players to obtain unfair advantages over other game players who do not use such programs. Furthermore, certain cheating programs could cause the loss of a character's superior features acquired by a player. The occurrence of errors or defects in its games, and –its failure to discover and disable cheating programs affecting the fairness of its game environment, could disrupt Shanda Games' operations, damage its reputation and discourage its users from playing the game. As a result, such errors, defects and cheating programs could materially and adversely affect our business, financial condition and results of operations.

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We face the risks of uncertainties regarding the growth of the online literature industry and market acceptance.

The online literature business is a relatively new and evolving industry and concept. Our online literature business is dependent on authors using our various online platforms, as opposed to the traditional paperback format, to publish their literary works. In addition, reading literary works online represents a new means of reading literary works. We cannot be certain that our users prefer to read literary works online as opposed to the traditional paperback form. In addition, we cannot be certain that the authors will prefer to publish their literary works online on one of our literature platforms, as opposed to in paperback form. The failure of authors to publish and our users to read, literary works online will likely adversely affect our business and prospects.

Our content providers depend on Shanda Online to provide services that are critical to our business.

Many of our content providers, including Shanda Games, have engaged Shanda Online to provide certain integrated platform services. These content providers depend on Shanda Online for the provision of services that are critical to the operation of their businesses, including, among others, online billing and payment, customer service, user authentication, pre-paid card marketing and distribution and data support service. If Shanda Online breaches its obligations under the contractual arrangements to provide such service to any ICP or refuses to renew these service agreements on terms acceptable to the ICP, or at all, an ICP, such as Shanda Games, may not be able to find a suitable alternative service provider or establish its own integrated service platform in a timely manner. Similarly, any failure of or significant quality deterioration in Shanda Online's integrated service platform could materially and adversely affect an ICP's business. For example, some ICPs rely on Shanda Online's customer service representatives as the first point of contact to serve its users. Shanda Online handles such customer requests such as adding virtual currencies to accounts with pre-paid cards, retrieving forgotten passwords and recovering lost user accounts, and liaising with the ICP if the inquiries involve content-related technical problems, such as recovering any in-game items for example. Some ICPs also rely on Shanda Online to provide user authentication services for their users who access their content through Shanda Online's service platform, and for pre-paid card distribution. If Shanda Online fails to address customer service requests properly and in a timely manner, our users may be unable to access the online entertainment content available on our platform or attribute any unpleasant experience with Shanda Online's customer service to us. Any negative impact to our reputation could lead to Shanda Online failing to retain current or failing to attract new users or ICPs, in which case, our business, financial condition and results of operations could be materially and adversely affected.

Because Shanda Online offers its services to other ICPs, our users may consume less on our internal content providers.

Shanda Online provides integrated services to other content providers that compete with Shanda Games' MMORPGs and advanced casual games, including Kingsoft, LineKong Entertainment Technology Co., Ltd. and Shanghai Storm, and may enter into additional similar commercial relationships with other ICPs that compete with Shanda Games' games. These commercial relationships may strengthen these online game companies' market share and enable them to achieve market acceptance for their products and services, which may have a material adverse effect on Shanda Games', and therefore our, business. In particular, the online games that Shanda Games' competitors offer through Shanda Online's integrated services platform may attract away players of Shanda Games' MMORPGs and advanced casual games and shrink its player bases, which could in turn make these MMORPGs and advanced casual games less attractive to other players. Furthermore, even though Shanda Online charges these other content providers a fee for its services, if Shanda Games' current users spend money on its competitors' games which are offered through Shanda Online's integrated





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services platform that would otherwise have been spent on Shanda Games' MMORPGs and advanced casual games, our business, financial conditions and results of operations could be materially and adversely affected.

We could be liable for failure of or disruptions in, or third-party breaches of security of Shanda Online's online payment platform, and the reduction in sales made through those channels may have a material adverse impact on our revenues.

Currently, many of the ICPs offering their online entertainment content on our service platform rely on Shanda Online's integrated service platform's online payment system to sell virtual pre-paid cards to our users. Secured transmission of confidential information, such as our users' credit card numbers and expiration dates, personal information and billing addresses, over public networks is essential to maintaining consumer confidence in such payment channels, which allow the ICPs to collect payments on a timely basis. In addition, we expect that an increasing amount of the sales of pre-paid cards will be conducted over the Internet as a result of the growing use of online payment systems. As a result, associated online crime will likely increase as well and we cannot assure you that Shanda Online's current security measures and those of the third parties with whom Shanda Online transacts business, are adequate. Security breaches of these online payment systems could result in non-collection of payments and expose us to litigation and possible liability for failing to protect confidential user information and could harm our reputation and our ability to attract users to our platform and to encourage the consumption by users of the online entertainment content available on our service platform.

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

We regard our copyrights, trademarks, service marks, trade secrets and other intellectual property as critical to our success. Unauthorized use of the intellectual property used in our business, whether owned by us or licensed to us, may adversely affect our business and reputation.

We rely on copyright, trademark, trade secret and other intellectual property law, as well as non-competition, confidentiality and license agreements with our employees, licensors, business partners and others to protect our intellectual property rights. Our employees are generally required to sign agreements acknowledging that all inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf are our property, and assigning to us any ownership rights that they may claim in those works. Despite our precautions, third parties may obtain and use intellectual property that we own or license without our consent. Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may materially and adversely affect our business.

For instance, Shanda Games continues to face challenges from pirate game servers, which are game servers that operate unauthorized copies of its games and permit users to play those games without purchasing Shanda Online's pre-paid game cards. Shanda Games has detected the operation by pirate servers of unauthorized copies of several of its leading games. In September 2002, for example, Shanda Games discovered that the server-end software of Mir II was unlawfully released into the China market. This software leak enabled unauthorized third parties to set up local server networks to operate Mir II, which Shanda Games believes continues to divert from it a significant number of users of one of its most popular MMORPGs. Although Shanda Games has made efforts to shut down pirate game servers across China, the intellectual property enforcement regime in China is not as robust as that of the United States, and Shanda

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Games continues to face considerable challenges when attempting to enforce its intellectual property rights. Enforcement actions generally require cooperation from local authorities, which are not always willing to use their limited resources to enforce the intellectual property rights of national corporations against individuals or companies in their districts. In addition, detailed comparisons of software codes and litigation proceedings are often necessary to enforce Shanda Games' intellectual property rights, which sometimes result in substantial costs. Despite Shanda Games' efforts to shut down pirate game servers, Shanda Games believes that a significant number of pirate game servers continue to operate unauthorized copies of its MMORPGs and advanced casual games. In addition, many websites publish literary works for which Shanda Literature owns the intellectual property rights. Shanda Literature has approached many of these websites to remove these literary works from their websites. However, despite these efforts, there are websites which continue to publish these literary works. The continued operation of Shanda Games' MMORPGs and advanced casual games by pirate game servers, the operation by pirate game servers of any new games that Shanda Games introduces and the continued publication of literary works by other companies may materially and adversely affect our business, financial condition and results of operations.

The validity, enforceability and scope of protection of intellectual property in Internet-related industries are uncertain and still evolving. In particular, the laws and enforcement procedures in the PRC are uncertain and do not protect intellectual property rights in this area to the same extent as do the laws and enforcement procedures in the United States and other developed countries. Policing unauthorized use of intellectual property is difficult and expensive. Any steps we take to prevent the misappropriation of our intellectual property may be inadequate. Moreover, litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our resources, and could disrupt our business, as well as have a material adverse effect on our financial condition and results of operations.

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

We cannot be certain that any of the online entertainment content available on our service platform does not and will not infringe upon patents, copyrights, trademarks or other intellectual property rights held by third parties. For example, of the 22 games that Shanda Games operated as of March 31, 2009, 13 are developed in-house, 7 are licensed from third parties and 2 are invested in or acquired from third parties. Shanda Games or any of its licensors, co-developers or online game developers and operators in which Shanda Games has invested may infringe upon patents, copyrights, trademarks or other intellectual property rights held by third parties and become subject to legal proceedings and claims from time to time relating to the intellectual property rights of others. For example, in 2003, Actoz and Wemade Entertainment Co., Ltd. filed a lawsuit against Shanda in the Beijing First Intermediate People's Court alleging copyright infringement and unfair competition claims with respect to Wool, an in-house developed game. These claims were settled in February 2007. Furthermore, while many of Shanda Literature's online authors represent to Shanda Literature that the literary works that they post online are original works, such representations may not be true and accurate as the authors may have already published such works through other mediums, including through another online literature platform. In such event, Shanda Literature's publication of the literary work may infringe the intellectual property rights of such other online literature platforms.

Some of our employees were previously employed at other companies, including some of our current and potential competitors. To the extent these employees or any employees we may hire in the future are involved in research that is

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similar to the research that they performed at their former employers, we may become subject to claims that these employees violated the intellectual property rights, such as trade secret rights, of their former employers. In addition, our competitors may file lawsuits or initiate proceedings against us. Although we are not aware of any pending or threatened claims alleging these types of violations of intellectual property rights, if any such claim arises in the future, litigation or other dispute resolution proceedings may be necessary to retain our ability to offer our current and future content offerings, which could result in substantial costs and diversion of our financial and management resources.

If we are found to have violated the intellectual property rights of others, we may be subject to monetary damages and be enjoined from using such intellectual property, and we may incur new or additional licensing costs if we desire to continue using the infringing content, be forced to develop or license alternatives or be forced to stop using such infringing intellectual property, any of which may materially and adversely affect our business and results of operations. In addition, we may incur substantial expenses and require significant attention of management in defending against these third-party infringement claims, regardless of their merit.

Network interruptions, security breaches or computer virus attacks could have a material adverse effect on our business prospects and results of operations.

Any failure to maintain the satisfactory performance, reliability, security and availability of our network infrastructure, including as a result of natural disasters such as earthquakes and floods, may cause significant harm to our reputation and our ability to attract and maintain users. We maintain a distributed server network architecture with third-party service providers hosting servers in more than one hundred cities throughout China. We do not maintain full backup for our server network hardware.

Major risks involved in such network infrastructure include:

- any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures which may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware; and
- any disruption or failure in the national backbone network, which would prevent our players outside Shanghai from logging on to any of our games or other content, or playing the games, for which the servers are all located in Shanghai.

In the past, our server network has experienced unexpected outages for several hours and occasional slower performance in a number of locations in China as a result of failures by third-party service providers. Our network systems are also vulnerable to damage from fire, flood, power loss, telecommunications failures, computer virus, hackings and similar events. Any network interruption or inadequacy that causes interruptions in the availability of the online entertainment content on our service platform or deterioration in the quality of access to our online entertainment content could reduce our users' satisfaction. In addition, any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could have a material adverse effect on our business, financial condition and results of operations. We do not maintain insurance policies covering losses relating to our systems and we do not have business interruption insurance.

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Any failure to maintain a stable and efficient distribution and payment network could have a material and adverse impact on our business, financial condition and results of operations.

Online payment systems in China are at a developmental stage and are not as widely available or acceptable to consumers in China as in the United States. As a result, Shanda Online relies heavily on a multi-layer distribution and payment network composed of third party distributors for sales to, and collection of payment from, our users. As Shanda Online does not enter into long-term agreements with any of its distributors, we cannot assure you that Shanda Online will continue to maintain favorable relationships with them. If Shanda Online fails to maintain a stable and efficient distribution and payment network, our business, financial condition and results of operations could be materially and adversely affected.

The successful operation of our business and implementation of our growth strategies, including our ability to accommodate additional ICPs and users in the future, depend upon the performance and reliability of the Internet infrastructure and fixed line and wireless telecommunications networks in China.

Although there are private sector Internet service providers in China, almost all access to the Internet is maintained through state-owned telecommunications operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or the MIIT. We rely on this infrastructure to provide data communications capacity primarily through local telecommunications lines and wireless telecommunication networks. In addition, the national networks in China are connected to the Internet through international gateways controlled by the PRC government. These international gateways are the only channels through which a domestic user can connect to the Internet. Although the PRC government has announced plans to develop aggressively the national information infrastructure, we cannot assure you that this infrastructure will be developed as planned or at all. In addition, we have no access to alternative networks and services on a timely basis, if at all, in the event of any infrastructure disruption or failure. The Internet infrastructure in China may not support the demands necessary for the continued growth in Internet usage.

The limited use of personal computers in China and the relatively high cost of Internet access may limit the development of the Internet in China and impede our growth.

Although the use of personal computers in China has increased in recent years, the penetration rate for personal computers in China is still much lower than compared with the United States. In addition, despite a decrease in the cost of Internet access in China due to a decrease in the cost of personal computers and the wider availability of broadband Internet access, the cost of personal Internet access, in contrast with Internet access through Internet cafes, remains relatively high in comparison to the average per capita income in China. These factors may limit the growth of our business. Furthermore, any Internet access or other telecommunications fee increase could reduce the number of users that enjoy our online entertainment content.

Our business could suffer if we do not successfully manage our growth.

Our recent growth has placed significant strain on our management, operational, financial and other resources. For example, the total number of our employees increased from 562 as of December 31, 2003 to

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3,124 employees as of December 31, 2008. As a result of our growth we need to continue to develop and expand our financial and management controls and our reporting systems and procedures. We cannot assure you that we will be able to efficiently or effectively manage the growth of our operations, and any failure to do so may limit our future growth and materially and adversely affect our business, financial condition and results of operations.

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

Our future success is heavily dependent upon the continued service of our key executives and other key employees. In particular, we rely on the expertise, experience and leadership ability of Tianqiao Chen, our founder, chairman of our board of directors and chief executive officer, in our business operations, and rely on his personal relationships with our employees, the relevant regulatory authorities, the ICPs who offer their online entertainment content on our service platform and service suppliers. We also rely on a number of key technology officers and staff for the development and operation of the online entertainment content available on our service platform.

If one or more of our key personnel are unable or unwilling to continue in their present positions, we may not be able to easily replace them and may incur additional expenses to recruit and train new personnel, our business could be severely disrupted, and our financial condition and results of operations could be materially and adversely affected. Furthermore, since our industry is characterized by high demand and intense competition for talent, we may need to offer higher compensation and other benefits in order to attract and retain key personnel in the future. We cannot assure you that we will be able to attract or retain the key personnel that we will need to achieve our business objectives. Furthermore, we do not maintain key-man life insurance for any of our key personnel.

You should not place undue reliance on our financial guidance, nor should you rely on our quarterly operating results as an indication of our future performance because our quarterly operating results may be subject to significant fluctuations.

We may experience significant fluctuations in our quarterly operating results due to a variety of factors, many of which are beyond our control. Significant fluctuations in our quarterly operating results could be caused by any of the factors identified in this section, including, but not limited to:

- our ability to retain existing users, attract new users at a steady rate and maintain user satisfaction;
- the announcement or introduction of new games or updates to existing games by us or our competitors;
- technical difficulties, system downtime or Internet failures;
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure;
- governmental regulations;
- seasonality effect for our business, such as during and around the Chinese New Year holidays in the first quarter and the National Day holidays in the fourth quarter, when fewer of our users consume our online entertainment content;

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- a shortfall in our revenues relative to our forecasts and a decline in our operating results due to our inability to adjust our users' spending quickly;
- the introduction and nationwide roll-out of the third-generation wireless telecommunication network in China; and
  - general economic conditions and economic conditions specific to the online game industry and China.

As a result, you should not rely on our financial guidance or quarter-to-quarter comparisons of our operating results as indicators of likely future performance. Our operating results may be below our expectations or the expectations of public market analysts and investors in one or more future quarters. If that occurs, the price of our ADSs could decline and you could lose part or all of your investment.

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

Prior to January 1, 2008, our PRC operating companies and our PRC subsidiaries, or our PRC companies, were governed by the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises and the Provisional Regulations of the People's Republic of China on Enterprises Income Tax, or the Old EIT Law. Under the Old EIT Law, our PRC companies were generally subject to a 33% income tax rate, which was subject to certain tax holidays and preferential tax rates. On March 16, 2007, the National People's Congress of China enacted a new enterprise income tax law, or the New EIT Law, as supplemented by various detailed implementation guidance, which became effective as of January 1, 2008. Under the New EIT Law, a preferential tax rate of 15% is applicable to enterprises that qualify as "high and new technology enterprises", a status reassessed every three years. In addition, an enterprise is entitled to a 10.0% income tax rate for the year in which it is recognized as a "national key software enterprise", a status reassessed every year. Shengqu, Shanda Computer, Shanda Networking, Hangzhou Bianfeng, Shanghai Shulong, Chengdu Aurora, Haofang and Chengdu Jisheng were recognized as "high and new technology enterprises" in 2008 and are entitled to a 15.0% preferential income tax rate for the three-year period ending December 31, 2010. In addition, Shengqu has been recognized as a national key software enterprise for 2008. However, we cannot assure you that these enterprises will be able to maintain their status as "high and new technology enterprises" and/or "national key software enterprises". If any of these enterprises that qualified as a "high and new technology enterprise" or "national key software enterprise" fails to continue to qualify for such status, our income tax expenses would increase, which would have a material adverse effect on our net income and results of operations.

Furthermore, pursuant to the New EIT Law, certain enterprises established prior to March 16, 2007 that are entitled to reduced tax rates in accordance with the then prevailing tax laws and regulations shall be eligible for a five-year transition period beginning from January 1, 2008 in accordance with the stipulations of the State Council. On December 26, 2007, the State Council issued "Notice by the PRC State Council on the Implementation of the Grandfathering Preferential Policies under the PRC Enterprise Income Tax Law", or Notice No. 39. Under the New EIT Law and Notice No.39, it is uncertain whether the transitional tax rates would apply to the companies that enjoyed preferential tax rates of 15.0% under a local preferential tax policy. If our PRC companies cannot enjoy the grandfathering treatment, our income tax expenses would increase, which would have a material adverse effect on our net income and results of operations.

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In 2006, 2007, and 2008, we received aggregate government financial incentives of RMB83.9 million, RMB57.5 million and RMB62.3 million (US\$9.1 million), respectively, which were calculated with reference to taxable revenue and taxable income. To be eligible for the government financial incentives, we are required to continue to meet a number of financial and non-financial criteria and to be further subject to the discretion of the municipal government. If we had not received these government financial incentives in 2006, our income before tax expenses, equity in loss of affiliated companies and minority interests would have been RMB507.3 million, a decrease of 14.2% from the reported amount. If we had not received these government financial incentives in 2007, our income before income tax expenses, equity in loss of affiliated companies, and minority interests would have been RMB1,495.0 million, a decrease of 3.7% from the reported amount. If we had not received these government financial incentives in 2008, our income before tax expenses, equity in loss of affiliated companies and minority interests would have been RMB1,487.2 million (US\$218.0 million), a decrease of 4.0% from the reported amount. As the receipt of these government financial incentives are subject to periodic time lags and inconsistent municipal government practice on payment times, for so long as we continue to receive these government financial incentives, our net income in a particular quarter may be higher or lower relative to other quarters based on the potentially uneven receipt by us of these government financial incentives, in addition to any business or operating related factors we may otherwise experience. Moreover, the central government or municipal government could determine at any time to eliminate or reduce these government financial incentives, generally with prospective effect. We cannot assure you that we will continue to enjoy these preferential tax treatments or government financial incentives in the future. The discontinuation or reduction of these preferential tax treatments or government financial incentives could materially and adversely affect our business, financial condition and results of operations.

There are significant uncertainties under the New EIT Law relating to our PRC enterprise income tax liabilities.

Under the New EIT Law, the profits of a foreign invested enterprise arising in 2008 and onwards which are distributed to its immediate holding company outside the PRC will be subject to a withholding tax rate of 10.0%. Pursuant to a special arrangement between Hong Kong and the PRC, such rate is lowered to 5.0% if a Hong Kong resident enterprise owns over 25% of the PRC company. However, according to a tax circular issued by the State Administration of Taxation in February 2009, if the main purpose of an offshore arrangement is to obtain a preferential tax treatment, the PRC tax authorities have the discretion to adjust the preferential tax rate enjoyed by the relevant offshore entity. In addition, under the New EIT Law, enterprises established under the laws of jurisdictions outside China with their “de facto management bodies” located within China may be considered to be PRC tax resident enterprises for tax purposes.

Although we are a Cayman Islands company with wholly-owned subsidiaries incorporated in Hong Kong, the PRC tax authorities may regard the main purpose of these Hong Kong entities as obtaining a lower withholding tax rate of 5.0%. As a result, the PRC tax authorities could levy a higher withholding tax rate to dividends received by our wholly-owned subsidiaries incorporated in Hong Kong from our PRC subsidiaries. In addition, a substantial majority of the members of our management team are located in China. Under current PRC laws and regulations, it is uncertain whether we would be deemed PRC tax resident enterprises under the New EIT Law. If we are deemed PRC tax resident enterprise, our global income will be subject to PRC enterprise income tax at the rate of 25.0% and we may be required to withhold PRC income tax from certain payments to non-PRC holders of our ordinary shares or ADSs. See “— Risks Relating to Our ADSs— We may be required to withhold PRC income tax on the dividends we pay you (if any), and any gain you realize on the transfer of our ordinary shares and/or ADSs may also be subject to PRC withholding tax” .

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We may become a passive foreign-investment company, or PFIC, which could result in adverse U.S. tax consequences to U.S. investors.

Although it is not clear how the contractual arrangements between us and our PRC operating companies will be treated for PFIC purposes, based upon the composition of our income and assets, including goodwill, and the market price of our ADSs, we believe we were not a passive foreign investment company, or PFIC, for 2008. If we were or were to become a PFIC, such characterization could result in adverse U.S. tax consequences to you if you are a U.S. investor. For example, if we are a PFIC, our U.S. investors will be subject to increased tax liabilities under U.S. tax laws and regulations and will become subject to additional reporting requirements. The determination of whether or not we are a PFIC is made on an annual basis and will depend on the composition of our income and assets from time to time. Specifically, we will be classified as a PFIC for U.S. tax purposes if either: (i) 75% or more of our gross income in a taxable year is passive income, or (ii) the average percentage of our assets, by value, in a taxable year which produce or are held for the production of passive income (which includes cash) is at least 50%. The calculation of the value of our assets may be based, in part, on the quarterly market value of our ordinary shares and ADSs, which is subject to change. We cannot assure you that we were not a PFIC for 2008 or that we will not be a PFIC for 2009 or any future taxable year. For more information on the U.S. tax consequences to you that would result from our classification as a PFIC, please see the section entitled “Taxation—United States Federal Income Taxation Consideration—Passive Foreign Investment Company Rules”.

We may be required to take significant actions that are contrary to our business objectives to avoid being deemed an investment company as defined under the Investment Company Act.

Generally, the Investment Company Act provides that a company is not an investment company and is not required to register under the Investment Company Act as an investment company if:

- the company is primarily engaged, directly or through a wholly owned subsidiary or subsidiaries, in a business or businesses other than those of investing, reinvesting, owning, holding or trading in securities; and
- 40% or less of the fair market value of the company’s assets is represented by investment securities.

We believe that we are engaged primarily in the business of, among other things, developing and operating an integrated service platform for the distribution, payment and customer servicing of online entertainment content, including MMORPGs, advanced casual games, online literature, online chess and board games and e-sports games. In addition, less than 40% of the fair market value of our assets is represented by investment securities. As a result, we believe that we are not an investment company as that term is defined under the Investment Company Act. We may, however, be required to take significant actions that are contrary to our business objectives to avoid being deemed an investment company in the future. We may, for example, need to hold a significant portion of our assets and invest portions of our cash flows in low-yielding investments or we may need to acquire additional income or loss generating assets that we might not otherwise have acquired. In addition, we may need to forego opportunities to acquire minority interests in other companies that could be important to our growth strategy.



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The Investment Company Act also contains substantive regulations with respect to investment companies, including restrictions on their capital structure, operations, transactions with affiliates and other matters which would be incompatible with our operations. If we were to be deemed an investment company in the future, we would, among other things, effectively be precluded from making public offerings in the United States. We could also be subject to other adverse consequences.

We may need to record impairment charges to earnings if our acquisition goodwill, investments in affiliate companies or acquired intangible assets are determined to be impaired, which would adversely affect our results of operations.

We acquire, invest in or license content from various content providers and record any acquisition goodwill, investments in affiliate companies and acquired intangible assets on our balance sheet in connection with such acquisitions, investments and licenses, respectively. We are required to review our acquisition goodwill for impairment at least annually and review our investments in affiliate companies and acquired intangible assets for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable, including a decline in stock price and market capitalization and slow down in our industry, which may result from the recent global economic slowdown. If the carrying value of our acquisition goodwill, investments in affiliate companies or acquired intangible assets were determined to be impaired, we would be required to write down the carrying value. For example, we completed the purchase of an 29.9% equity stake in Actoz, the co-owner of Mir II, in February 2005, for a total consideration of RMB878 million (US\$106.1 million), which represented an 81% premium over the open market price at the time that we entered into the purchase agreement in October 2004. In the fourth quarter of 2005, however, we recorded a non-cash impairment charge of RMB521.5 million (US\$64.6 million) to reflect the fair value of our then 38.1% stake in Actoz. We recognized the impairment charge primarily as a result of the continued decline in royalties payable to Actoz from our operation of Mir II in China. The decision to recognize impairment was also influenced by the decline in the market price for shares of Actoz, which in the fourth quarter of 2005 was determined to be other than temporary, mainly due to the continued decline in Mir II royalties.

We cannot assure you that we will have the ability to effectively integrate the operation of the acquired companies and achieve the synergies contemplated at the time of entering into these transactions. If we are unable to achieve the synergies contemplated at the time of acquiring these companies, the carrying value of the acquired companies may not be recoverable. We are required by U.S. GAAP to review the impairment of goodwill at least on an annual basis. If an impairment is determined and charged to the earnings in our financial statements, we would be required to record charges to earnings in our financial statements during the period and our financial condition and results of operations would be materially and adversely affected.

We have limited business insurance coverage in China.

The insurance industry in China is still at an early stage of development. In particular, PRC insurance companies do not offer extensive business insurance products. As a result, we do not have any business liability or disruption insurance coverage for our operations in China. Any business disruption, litigation or natural disaster might result in our incurring substantial costs and the diversion of resources.

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While we believe that we currently have adequate internal control procedures in place, we are still exposed to potential risks from legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002.

We are subject to the reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required under Section 404 of the Sarbanes-Oxley Act of 2002, has adopted rules requiring public companies to include a report of management on the effectiveness of such companies' internal control over financial reporting in their respective annual reports. In addition, an independent registered public accounting firm for a public company must issue an attestation report on the effectiveness of such company's internal control over financial reporting. Our management conducted an evaluation of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting was effective as of December 31, 2008. In addition, PricewaterhouseCoopers Zhong Tian CPAs Limited Company, our independent registered public accounting firm, reported that our internal control over financial reporting was effective as of December 31, 2008. If we fail to maintain the effectiveness of our internal control over financial reporting, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal control over financial reporting is necessary for us to produce reliable financial reports. As a result, any failure to maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could negatively impact the trading price of our ADSs. Furthermore, we may need to incur additional costs and use additional management and other resources in an effort to comply with Section 404 of the Sarbanes-Oxley Act and other requirements going forward.

## Risks Relating to Regulation of the Internet and to Our Structure

If the PRC government finds that the agreements that establish the structure for operating our China business do not comply with PRC government restrictions on foreign investment in the online game industry, we could be subject to severe penalties.

On December 11, 2001, the PRC State Counsel promulgated the Regulations for the Administration of Foreign-invested Telecommunications Enterprises, or the FITE Regulations, which became effective on January 1, 2002 and were subsequently amended on September 10, 2008. Under the FITE Regulations, foreign ownership of companies that provide value-added telecommunication services, which includes online game operation, is limited to 50%. In addition, foreign and foreign-invested enterprises are currently not able to apply for the licenses required to operate online games in China or to provide Internet information content, such as online advertising. We are a Cayman Islands exempted company and we conduct our operations in China primarily through Shengqu and Shanda Computer, our indirect wholly owned subsidiaries. We, Shengqu and Shanda Computer are foreign or foreign-invested enterprises under PRC law and accordingly are ineligible to apply for certain licenses required to operate our business. In order to comply with foreign ownership restrictions, except as otherwise disclosed in "— The laws and regulations governing the online game industry and related businesses in China are developing and subject to future

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changes. If we or any of our PRC operating companies fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected”, Shanghai Shulong which is wholly owned by two PRC citizens holds the licenses and approvals that are required to operate Shanda Games’ MMORPG and advanced casual game business and Shanda Networking which is wholly owned by two PRC citizens holds the licenses and approvals that are required to operate Shanda Online’s integrated service platform business. Shengqu and Shanda Computer have entered into VIE agreements with Shanghai Shulong and its shareholders, and Shanda Networking and its shareholders, respectively. As a result of these contractual arrangements, we are considered the primary beneficiary of the Shanda Networking entities and the Shulong entities and accordingly, we consolidate the results of operations of the Shanda Networking entities and the Shulong entities in our financial statements.

On July 13, 2006, the MIIT issued the Circular on Strengthening the Administration of Foreign Investment in Value-added Telecommunication Services, or the MIIT Circular 2006. According to the MIIT Circular 2006, since the FITE Regulations went into effect, some foreign investors had engaged in value-added telecom services illegally by conspiring with domestic value-added telecom enterprises to circumvent the requirements of the FITE Regulations by delegating domain names and licensing trademarks. In order to further strengthen the administration of foreign investors that conduct value-added telecommunications business, the MIIT Circular 2006 provides that any domain name or trademark used by a value-added telecom carrier shall be legally owned by such carrier or its shareholders. The MIIT Circular 2006 also provides that the operation site and facilities of a value-added telecom carrier shall be installed within the scope as prescribed by operating licenses obtained by the carrier and shall correspond to the value-added telecom services that the carrier has been approved to provide. In addition, value-added telecom carriers are required to establish or improve the measures of ensuring network security. As to the companies which have obtained the operating licenses for value-added telecom services, they are required to conduct self-examination and self-correction according to the said requirements and report the result of such self-examination and self-correction to the provincial branches of the MIIT. As some of the domain names and trademarks that Shanda Games uses in its operations are not owned by Shanghai Shulong or its shareholders, Shanda Games may be in violation of the provisions of the MIIT Circular 2006. As a result, we or Shanda Games may be subject to various penalties, including fines and the discontinuation of or restrictions on our operations.

In the opinion of our PRC counsel, (1) the ownership structures of our company, Shanda Computer, Shengqu, and our PRC operating companies are in compliance with existing PRC laws and regulations; (2) our contractual arrangements with Shanda Networking, Shanghai Shulong and their respective shareholders are valid, binding and enforceable, and will not result in any violation of PRC laws or regulations currently in effect; and (3) the business operations of our company, Shanda Computer, Shengqu, and our PRC operating companies, as described in this annual report, are in compliance with existing PRC laws and regulations in all material aspects, except for the failure to obtain certain Internet Publishing Licenses as disclosed in “— The laws and regulations governing the online game industry and related businesses in China are developing and subject to future changes. If we or any of our PRC operating companies fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected”. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, we cannot assure you that the PRC regulatory authorities will not ultimately take a view that is contrary to our view. If we, Shengqu, Shanda Computer, or any of our PRC operating companies are found to be in violation of any existing or future PRC laws or regulations, the relevant regulatory authorities would have broad discretion in dealing with such violations, including:

- revoking our PRC operating companies’ business and operating licenses;

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- discontinuing or restricting our PRC operating companies' operations;
- imposing conditions or requirements with which we, Shengqu, Shanda Computer or our PRC operating companies may not be able to comply;
- requiring us, Shengqu, Shanda Computer or our PRC operating companies to restructure the relevant ownership structure or operations; or
- taking other regulatory or enforcement actions, including levying fines, that could be harmful to our business.

Any of these actions could cause our business, financial condition and results of operations to suffer and the price of our ADSs to decline.

The contractual arrangements related to critical aspects of our operations with Shanda Networking, Shanghai Shulong and their respective shareholders may not be as effective in providing operational control as direct ownership.

We rely on the VIE agreements which are contractual arrangements with Shanda Networking and Shanghai Shulong and their respective shareholders that provide us with the substantial ability to control the Shanda Networking entities and the Shulong entities. These contractual arrangements may not be as effective as direct ownership in providing us control over our PRC operating companies. Direct ownership would allow us, for example, to directly or indirectly exercise our rights as a shareholder to effect changes in the boards of the Shanda Networking entities and the Shulong entities, which, in turn, could effect changes, subject to any applicable fiduciary obligations, at the management level. However, under the current contractual arrangements, as a legal matter, if Shanda Networking, Shanghai Shulong or their respective shareholders fails to perform its, his or her respective obligations under these contractual arrangements, we may have to incur substantial costs and expend significant resources to enforce those arrangements and rely on legal remedies under PRC law. These remedies may include seeking specific performance or injunctive relief, and claiming damages, any of which may not be effective.

Pursuant to equity pledge agreements, the shareholders of Shanghai Shulong and Shanda Networking pledged their equity interests in Shanghai Shulong and Shanda Networking to Shengqu and Shanda Computer, respectively. According to the PRC Property Rights Law, which became effective October 1, 2007, a pledge is created only when such pledge is registered with the relevant Administration for Industry and Commerce office. We have registered the equity pledge by the shareholders of Shanda Networking and Shanghai Shulong with the relevant Administration for Industry and Commerce. However, all of these contractual arrangements are governed by PRC laws and provide for the resolution of disputes through either arbitration or litigation in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC laws and any disputes would be resolved in accordance with PRC legal procedures. The legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. In the event we are unable to enforce these contractual arrangements, we may be unable to exert effective control over our PRC operating companies, and our ability to conduct our business may be materially and adversely affected.

Shareholders of Shanda Networking and Shanghai Shulong may potentially have a conflict of interest with us, and they may breach their contracts with us or cause such contracts to be amended in a manner contrary to the interest of our company.

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We conduct substantially all of our operations, and generate substantially all of our revenues, through our PRC operating companies. Our control over these entities is based upon the VIE agreements. The shareholders of our PRC operating companies may potentially have a conflict of interest with us, and they may breach their contracts with us or cause such contracts to be amended in a manner contrary to the interest of our company.

For example, the two shareholders of Shanda Networking, Tianqiao Chen and Danian Chen, are among our principal shareholders. As a result, they may be able to cause the contractual arrangements they have entered into with us to be amended in a manner to maximize their interest, economically or otherwise, even if such amendment is contrary to the interest of our company and our other shareholders. Although our audit committee charter requires the approval of our audit committee, which is comprised of our independent directors, to make any amendment to these agreements, we cannot assure you that such mechanism will be effective in preventing such amendment. Furthermore, the shareholders of Shanda Networking and Shanghai Shulong may decide to breach their contracts with us if they believe such action furthers their own interest, or if they otherwise act in bad faith. In particular, the two shareholders of Shanghai Shulong, Dongxu Wang and Yingfeng Zhang, are our employees. They are not our directors or principal shareholders. Therefore, they do not owe any fiduciary duty to our company and given that their economic stake in us is relatively small compared to their ownership interest in Shanghai Shulong, they may take actions that adversely affect us. If the shareholders of Shanda Networking or Shanghai Shulong breach their contracts with us or otherwise have disputes with us, we may have to initiate legal proceedings, which involves significant uncertainty. Such disputes and proceedings may significantly disrupt our business operations, adversely affect our ability to control the Shanda Networking entities and the Shulong entities, and we cannot assure you that the outcome of such disputes and proceedings will be in our favor.

Our arrangements with our PRC operating companies may be subject to scrutiny by the PRC tax authorities for transfer pricing adjustments.

We also could face material and adverse tax consequences if the PRC tax authorities determine that the VIE agreements with Shanda Networking and Shanghai Shulong were not entered into based on arm's length negotiations. Although we based our contractual arrangements on those of similar businesses, if the PRC tax authorities determine that these contracts were not entered into on an arm's length basis, they may adjust our income and expenses for PRC tax purposes in the form of a transfer pricing adjustment. A transfer pricing adjustment could result in a reduction, for PRC tax purposes, of deductions recorded by our PRC operating companies, which could adversely affect us by:

- increasing our PRC operating companies' tax liability without reducing our PRC subsidiaries' tax liability, which could further result in late payment fees and other penalties to our PRC operating companies for under-paid taxes; or
- limiting our PRC subsidiaries' ability to maintain preferential tax treatments and government financial incentives, if the transfer pricing adjustment is significant.

As a result, any transfer pricing adjustment could have a material and adverse impact upon our financial condition.

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Our corporate structure may restrict our ability to receive dividends from, and transfer funds to, our PRC companies, which could restrict our ability to act in response to changing market conditions and reallocate funds from one Chinese affiliated entity to another in a timely manner.

We are a Cayman Islands holding company and substantially all of our operations are conducted through our PRC operating companies. We rely principally on dividends and other distributions on equity paid by our PRC subsidiaries for our cash requirements, including the funds necessary to allow us to pay dividends on the shares underlying our ADSs and the funds necessary to service any debt we may incur or financing we may need for operations. If our PRC subsidiaries incur debt on their own behalf in the future, the instruments governing the debt may restrict our PRC subsidiaries' ability to pay dividends or make other distributions to the intermediate holding company and thus to us. We generate substantially all of our revenues through contractual arrangements with our PRC operating companies. However, PRC governmental authorities may require us to amend these contractual arrangements in a manner that would materially and adversely affect our PRC subsidiaries' ability to pay dividends and other distributions to us. Furthermore, PRC legal restrictions permit payments of dividends by our PRC subsidiaries only out of their retained earnings, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, our PRC subsidiaries are also required to set aside a portion of their net income each year to fund certain reserve funds. These reserves are not distributable as cash dividends. As a result of these and other restrictions under PRC laws and regulations, our PRC subsidiaries and our PRC operating companies are restricted in their ability to transfer a portion of their net assets to us in the form of dividends, loans or advances, which restricted portion amounted to approximately RMB1,950.0 million (US\$285.8 million), or 53.7%, of our total consolidated net assets as of December 31, 2008. Any limitation on the ability of our PRC subsidiaries and our PRC operating companies to transfer funds to us in the form of dividends, loans or advances could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay debt or dividends, and otherwise fund and conduct our business.

In addition, any transfer of funds from us to any of our PRC subsidiaries, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval of PRC governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. It is not permitted under PRC law for our PRC companies to directly lend money to each other. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our PRC subsidiaries. These limitations on the free flow of funds between us and our PRC companies could restrict our ability to act in response to changing market conditions and reallocate funds from one Chinese entity to another in a timely manner.

Regulations relating to offshore investment activities by PRC residents may subject us to fines or sanctions imposed by the PRC government, including restrictions on our PRC subsidiaries' ability to pay dividends or make distributions to us and our ability to increase our investment in our PRC subsidiaries.

In October 2005, the State Administration of Foreign Exchange, or SAFE, promulgated the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment Through Offshore Special Purpose Vehicles, or Circular 75, which states that if PRC residents use assets or equity interests in their PRC entities as capital contributions to establish offshore companies or inject assets or equity interests of their PRC entities into offshore companies to raise capital overseas, they must register with local SAFE branches with respect to their overseas investments in offshore companies. They must also file amendments to their registrations if their offshore companies experience material events

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involving capital variation, such as changes in share capital, share transfers, mergers and acquisitions, spin-off transactions, long-term equity or debt investments or uses of assets in China to guarantee offshore obligations. Under this regulation, their failure to comply with the registration procedures set forth in such regulation may result in fines or sanctions imposed by the PRC government including restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on the capital inflow from the offshore entity to the PRC entity.

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

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

The Internet industry, including the operation of online games, in China is highly regulated by the PRC government. Various regulatory authorities of the PRC government, such as the State Council, the MIIT, the State Administration of Industry and Commerce, or the SAIC, the Ministry of Culture, or the MOC, the General Administration of Press and Publication, or the GAPP, the State Administration of Radio, Film and Television, or the SARFT, and the Ministry of Public Security, are empowered to promulgate and implement regulations governing various aspects of the Internet and the online game industry.

Our PRC operating companies are required to obtain applicable permits or approvals from different regulatory authorities in order to provide their services. For example, an ICP must obtain a value-added telecommunications business operation license, or ICP license, from the MIIT or its local offices in order to engage in any commercial operations online within China. An online game operator must also obtain an Internet culture operation license from the MOC, an Internet publishing license from the GAPP in order to distribute games through the Internet and approval from the MIIT to provide online bulletin board services. Shanghai Shulong currently holds an ICP license as well as an Internet culture operation license. Chengdu Aurora is in the process of applying to extend its Internet culture operation license since its old license expired on October 24, 2008. Shanghai Shulong currently does not hold an Internet publishing license and publishes its online games through cooperation with Shanda Networking, which holds such a license. In addition, Shanghai Shulong and Chengdu Aurora are in the process of applying for approval to provide online bulletin board services. If any of our PRC operating companies fails to obtain or maintain any of the required permits or approvals or if our practice is later challenged by government authorities, they may also be subject to various penalties, including fines and the discontinuation of or restriction on our operations. Any such disruption in business operations would materially and adversely affect our financial condition and results of operations.

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As the online game industry is at an early stage of development in China, new laws and regulations may be adopted in the future to address new issues that arise from time to time, such as online advertising and the use of virtual currency. Also, different regulatory authorities may have different views regarding the licensing requirements for the operation of online games and related businesses. As a result, substantial uncertainties exist regarding the interpretation and implementation of current and any future PRC laws and regulations applicable to the online game industry and related businesses. While we believe that we comply with all material respects with all applicable PRC laws and regulations currently in effect, we cannot assure you that we will not be found in violation of any current or future PRC laws and regulations.

If we are required to comply with or are found to violate any laws or regulations governing virtual currency, pre-paid card issuance and usage, online payment or money laundering, we may have to obtain additional licenses or approvals, be forced to change our current business practice, or be subject to certain penalties.

On April 16, 2009, the People's Bank of China, or PBOC, issued a notice regarding the payment and clearance business carried out by non-financial institutions, or the PBOC Notice. The PBOC Notice requires non-financial institutions which engage in payment and clearance business to register with PBOC before July 31, 2009. Because certain services currently provided by Shanda Online may be subject to the requirements of the PBOC Notice, Shanda Online intends to register with PBOC. However, if PBOC requires Shanda Online to obtain additional licenses or approvals for its services, there is no guarantee that Shanda Online will be able to obtain such licenses or approvals. In the event that Shanda Online fails to obtain any or all of the licenses or approvals required by PBOC, our business and financial condition, operations results and business prospects may be materially and adversely affected.

On June 4, 2009, the Ministry of Culture and the Ministry of Commerce jointly issued a notice regarding strengthening online game virtual currency administration, or the Virtual Currency Notice. The Virtual Currency Notice requires enterprises which issue online game virtual currency (in the form of pre-paid card, pre-payment or pre-paid card point) or provide online game virtual currency transaction services, to apply for approval from the Ministry of Culture through its provincial branches within 3 months following the date of the Virtual Currency Notice. Any enterprises which fail to submit the application will be subject to sanctions. In addition, the Virtual Currency Notice regulates, among other items, the amount of virtual currency an enterprise can issue, the retention period of user record, the function of virtual currency, and the return of unused virtual currency upon termination of online services. The Virtual Currency Notice prohibits enterprises, which provide online game virtual currency transaction services, from providing transaction services to players under the age of 18. It also prohibits online game operators from awarding in-game items or virtual currency to players based on random selection through lucky draws, wagers or lotteries. Shanda Games intends to apply for the above mentioned approval for our online game virtual currency related businesses. However, we cannot guarantee you that we will be able to obtain such approval. If we fail to obtain such approval or our current or future operations are found to violate the Virtual Currency Notice or any other related regulations, our business and financial condition, operation results and business prospects may be materially and adversely affected.

Additional government regulations resulting from negative publicity in China regarding online games or otherwise may have a material adverse effect on our business, financial condition and results of operations.



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The media in China has reported incidents of violent crimes allegedly provoked by, or committed in connection with, online games. In addition, there have been widespread negative media reports that focus on how online games are addictive and how excessive game playing could distract students and interfere with their education. Certain non-governmental organizations may also organize protests or publicity campaigns against online game companies in order to protect youth from the risk of becoming addicted to certain online games. The PRC government may decide to adopt more stringent policies to monitor the online game industry as a result of adverse public reaction to perceived addiction to such games, particularly by minors. In 2007, eight PRC government authorities, including the GAPP, the Ministry of Education and the MIIT, jointly issued a notice requiring all Chinese online game operators to adopt an “anti-fatigue compliance system” in an effort to curb addiction to online games by minors. Under the anti-fatigue compliance system, three hours or less of continuous play is defined to be “healthy”, three to five hours is defined to be “fatiguing”, and five hours or more is defined to be “unhealthy”. Game operators are required to reduce the value of game benefits for minor game players by half when those game players reach the “fatigue” level, and to zero when they reach the “unhealthy” level. In addition, online game players in China are now required to register their identity card numbers before they can play an online game. This system allows game operators to identify which game players are minors. It is unclear whether these restrictions would be expanded to apply to adult game players in the future. More stringent government regulations, including stricter anti-fatigue rules, could discourage game players from playing our games, which could have a material adverse effect on our business, financial condition and results of operations.

In addition, the PRC State Administration of Taxation recently announced that it will tax game players on the income derived from the trading of virtual currencies at the rate of 20.0%. However, it is currently unclear how the tax will be collected or if there will be any effect on our game players or our business.

Furthermore, similar adverse public reaction may arise, and similar government policies may be adopted, in other jurisdictions where we license out our online games, which could materially and adversely affect our overseas licensing revenues.

Shanda Games may be required to reapply for approvals for imported games.

The MOC issued a Circular Concerning the Examination and Declaration of Imported Online Game Products on April 24, 2009. According to this circular, in the event of a change of the operator of an imported online game, the game’s existing import approval will be automatically revoked and the new operator must apply to the MOC for a new approval for the same game. As this circular is newly issued, it remains unclear how and to what extent this circular will be implemented or enforced.

Shanda Games currently operates substantially all of its imported MMORPGs and advanced casual games under import approvals granted by the MOC to Shanda Networking. Under this new circular, Shanda Games may be required to reapply to the MOC for approvals for imported games granted to any of its affiliates. Shanda Games is committed to complying with the requirements of this circular. However, we cannot assure you that Shanda Games will succeed in obtaining all the approvals as required by this circular in time or at all. If Shanda Games fails to comply with the requirements of this circular or fail to obtain all the approvals for its imported games, Shanda Games may be subject to fines, revocation of our operating licenses, the discontinuation or restrictions on its operations and other sanctions that may be imposed by the MOC. As a result, our business, financial condition and results of operations could be materially and adversely affected.

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The PRC government has tightened its regulation of Internet cafes, which are currently one of the primary venues for our users to play Shanda Games' MMORPGs and advanced casual games. Intensified government regulation of Internet cafes could restrict our ability to maintain or increase our revenues and expand our game player base.

Internet cafes are one of the primary places where Shanda Games' MMORPGs and advanced casual games are played. In March 2001, the PRC government began tightening its regulation and supervision of Internet cafes. In particular, a large number of unlicensed Internet cafes have been closed. The PRC government has also imposed higher capital and facility requirements for the establishment of Internet cafes. Furthermore, the PRC government's policy, which encourages the development of a limited number of national and regional Internet cafe chains and discourages the establishment of independent Internet cafes, may slow down the growth of Internet cafes. In February 2004, the government agencies in charge of Internet cafe licensing jointly issued a notice suspending the issuance of new Internet cafe licenses for a period of six months. In February 2007, 14 PRC government departments jointly issued a circular to strengthen the regulation of Internet cafes and online games. According to the circular, local authorities were banned from issuing new Internet cafe licenses for the remainder of 2007. Since this ban was imposed in 2007, to our knowledge, local authorities have not issued new Internet cafe licenses and it is unclear when local authorities will start issuing new licenses again. Governmental authorities may from time to time impose stricter requirements, such as the customers' age limit and hours of operation, among others, as a result of the occurrence and perception of, and the media attention on, gang fights, arson and other incidents in or related to Internet cafes. Since a substantial portion of our users play Shanda Games' MMORPGs and advanced casual games in Internet cafes, any reduction in the number, or slowdown in the growth, of Internet cafes in China, or any new regulatory restrictions on its operations, could limit our ability to maintain or increase our revenues and expand our game player base, thereby adversely affecting our results of operations and growth prospects.

The PRC government may prevent us from distributing, and we may be subject to liability for, content deemed to be inappropriate.

China has enacted laws and regulations governing Internet access and the distribution of news, information or other content, as well as products and services, through the Internet. In the past, the PRC government has stopped the distribution of information through the Internet that it believes violates PRC law. The MIIT, the GAPP and the MOC have promulgated regulations that prohibit games from being distributed through the Internet if the games contain content that is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of China, or compromise state security or secrets. In addition, certain PRC social organizations have recently discussed the possibility of implementing a rating system for online games. The effect that such a system could have on our business is unclear.

If any games Shanda Games offers were deemed to violate any such content restrictions, Shanda Games would not obtain the GAPP approval, may not be able to continue such offerings and/or could be subject to penalties, including confiscation of income, fines, suspension of business and revocation of its license for operating online games, which would materially and adversely affect our business, financial condition and results of operations.

We may also be subject to potential liability for unlawful actions of our users or for content we offer through our service platform is deemed inappropriate. Furthermore, we may be required to delete content that violates the laws of the PRC and report

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content that we suspect may violate PRC law. It may be difficult to determine the type of content that may result in liability for us, and if we are wrong, we may be prevented from operating our games or other services in China.

In February 2007, the Ministry of Public Security, the MOC, the MIIT and the GAPP jointly issued a circular regarding online gambling. In order to clamp down on online games that involve gambling and online betting as well as address concerns that “virtual money” might be used for money laundering or illicit trade, the circular (i) requires that online game operators shall not charge commissions that employ “virtual money” or other means in relation to winning or losing of games; (ii) requires online game operators to set up quantity limits in guessing and betting games by using virtual currency; (iii) bans the exchange of “virtual money” into real currencies or properties; and (iv) bans the provision of services for virtual currency transfer among game players. In February 2007, 14 PRC regulatory authorities jointly promulgated a circular with regard to further strengthening management of Internet cafe and online games, according to which “virtual money” shall be strictly regulated by the PBOC, and in particular: (i) the aggregate amount of “virtual money” issued by online game operators and the amount of “virtual money” purchased by each individual online game player shall be restricted; (ii) “virtual money” issued by online game operators can only be used for purchasing virtual products and services provided by the online game operators and shall not be used for purchasing tangible or physical products; (iii) the price for converting “virtual money” back into the official currency by consumers shall not exceed the respective original purchase price; and (iv) trading of “virtual money” is banned. Shanda Games believes its operations are in compliance with the provisions of these two circulars in all material aspects. There are, however, substantial uncertainties regarding the interpretation and application of these two circulars, and we cannot assure you that the PRC regulatory authorities will not take a view contrary to that of Shanda Games. If the PRC regulatory authorities deem its online operations to be in violation of either of these two circulars, the PBOC may confiscate the revenues generated through these illegal activities and/or impose fines on Shanda Games in accordance with the Law of the PBOC and our business will be materially and adversely affected. It is unclear whether we will be subject to other penalties under current PRC laws.

Currently there are no laws or regulations in the PRC specifically governing virtual asset property rights and therefore, it is not clear what liabilities, if any, online game operators may have for virtual assets.

In the course of playing online games, some virtual assets, such as special equipment, player experience grades and other features of a user’s game characters, are acquired and accumulated. Such virtual assets can be important to online game players and in some cases are exchanged between players for monetary value. 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 or by a network crash. Currently, there are no PRC laws and regulations specifically governing virtual asset property rights. As a result, it is unclear who is the legal owner of virtual assets and whether and how the ownership of virtual assets is protected by law. In case of a loss of virtual assets, Shanda Games may be sued by online game players and may be held liable for damages, which may negatively affect our business, financial condition and results of operations. Shanda Games has been involved in a number of lawsuits related to in-game items in its games, some of which are ongoing.

In addition, it is unclear under PRC law whether an operator of online games such as Shanda Games would have any liability to game players or other interested parties (whether in contract, tort or otherwise) for loss of such virtual assets by game players. Based on several judgments by PRC courts regarding the liabilities of online game operators for loss of virtual

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assets by game players, the courts have generally required the online game operators to return the virtual items or be liable for the loss and damage incurred therefrom.

We may be subject to, and may expend significant resources in defending against, government actions and civil suits based on the advertising content provided in our virtual advertising space; we may also be penalized by the governmental authority for such content.

Our wholly-owned subsidiary, Shanghai Shengyue Advertisement Co., Ltd., or Shengyue, acts as our advertising agent to sell the virtual advertising space in our online entertainment content to third-party advertisers. Civil claims may be filed against Shengyue or us for fraud, defamation, subversion, negligence, copyright or trademark infringement or other violations due to the nature and content of the information displayed in the virtual advertising space. Offensive and objectionable content and legal standards for defamation and fraud in China are less defined than in other more developed countries and we may not be able to properly screen out unlawful content. If such activities result in damages to any third party or violates any other regulation related to advertising business, PRC governmental authority may penalize us by revoking our game licenses, imposing fines, suspending our business license or imposing criminal liability on us, which would materially and adversely affect our business, financial condition and results of operations.

Due to our leading position in the industry, we may be subject to claims under the Anti-Monopoly Law. Any claims which are resolved against us may have an adverse impact on our business, financial condition and results of operations.

The new Anti-Monopoly Law (“AML”) was passed by the National People’s Congress on August 30, 2007 and came into effect on August 1, 2008. While certain aspects of the AML are unclear and dependent on subsequent interpretation and development, the law sets forth the prohibited conduct (referred to as “Monopolistic Acts”), the enforcement mechanisms, and the penalties for those who violate its provisions. In essence, the AML prohibits “Monopolistic Acts,” which include “monopoly agreements,” abuse of a dominant market position, and certain “concentrations”, which result or could result in the elimination or restriction of competition. The law also provides that the State Council will establish an Anti-Monopoly Commission with authority to make competition policy, publish guidelines, and lead and coordinate anti-monopoly enforcement work.

So far the AML has only been tested by a limited number of cases. It remains to be seen how the AML will be implemented in practice and what it will mean for us and other companies in China. Nevertheless, given the leading position we have in the Chinese market, it is likely that some of our competitors and our users may seek to take advantage of the AML to make claims against or solve disputes with us, which may have an adverse impact on our business, operation and financial conditions.

The PRC government may unintentionally restrict access to Shanda Games’ MMORPGs and advanced casual games.

The MIIT issued a Circular regarding the Pre-installment of Green Web Filter Software on Computers on May 19, 2009. According to this circular, starting from July 1, 2009, all computers sold in China are required to be installed with

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government-designated software to block “unhealthy words or pictures”. However, according to certain media reports, testing by experts suggest that the software, called Green Dam - Youth Escort, may be used to censor other websites deemed inappropriate by the government, disable programs when people input sensitive words, monitor personal communications and track where people surf on the Internet.

It is unclear how and to what extent it may be implemented by the MIIT. Although this circular is not intended to block access to online games, if it is strictly implemented, it could potentially discourage or restrict the use of internet by the players of Shanda Games’ MMORPGs and advanced casual games, and consequently have an adverse impact on our business, operation and financial conditions.

Risks Relating to the People’s Republic of China

Substantially all of our assets are located in China and substantially all of our revenues are derived from our operations in China. Accordingly, our business, financial condition, results of operations and prospects are subject, to a significant extent, to economic, political and legal conditions and developments in China.

The PRC’s economic, political and social conditions, as well as government policies, could affect our business.

The PRC economy differs from the economies of most developed countries in many respects, including in the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth since the late 1970’s, growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented numerous measures to encourage economic growth and to guide the allocation of resources. Some of these measures may benefit the overall PRC economy, but also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us.

The PRC economy has been transitioning from a planned economy to a more market-oriented economy. Although the PRC government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over China’s economic growth through the allocation of resources, controlling payment of foreign currency denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. These actions, as well as future actions and policies of the PRC government, could materially affect general economic conditions in China and could have a material adverse effect on our business and results of operations.

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

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

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comprehensive system of laws and regulations governing general economic and business matters. The overall effect of legislation since 1979 has been a significant enhancement of the protections afforded to various forms of foreign-invested enterprises in mainland China. Our PRC subsidiaries are wholly foreign owned enterprises, or WFOEs, which are enterprises incorporated in mainland China and wholly owned by foreign investors. Our PRC subsidiaries are subject to laws and regulations applicable to foreign investment in mainland China in general and laws and regulations applicable to WFOEs in particular. However, these laws, regulations and legal requirements are constantly changing, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us and other foreign investors, including you. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws.

Restrictions on currency exchange may limit our ability to utilize our revenues effectively.

Substantially all of our revenues and operating expenses are denominated in Renminbi. The Renminbi is currently freely convertible under the “current account”, which includes dividends, trade and service-related foreign exchange transactions, but not under the “capital account”, which includes foreign direct investment and loans.

Currently, our PRC subsidiaries may purchase foreign exchange for settlement of “current account transactions”, including payment of dividends to us and payment of license fees to foreign game licensors, and our PRC operating companies may purchase foreign exchange for payment of license fees to foreign game licensors without the approval of SAFE. Our PRC subsidiaries may also retain foreign exchange in its current account, subject to a ceiling approved by SAFE, to satisfy foreign exchange liabilities or to pay dividends. However, we cannot assure you that the relevant PRC governmental authorities will not limit or eliminate our ability to purchase and retain foreign currencies in the future.

Since a significant amount of our future revenues will be denominated in Renminbi, the existing and any future restrictions on currency exchange may limit our ability to utilize revenues generated in Renminbi to fund our business activities outside China, if any, or expenditures denominated in foreign currencies.

Foreign exchange transactions under the capital account are subject to limitations and require registration with or approval by the relevant PRC governmental authorities. In particular, if we finance our PRC subsidiaries by means of foreign currency loans, those loans cannot exceed certain statutory limits and must be registered with SAFE, and if we finance our PRC subsidiaries by means of capital contributions, those capital contributions must be approved by the MOC. Our ability to use the U.S. dollar proceeds of the sale of our equity or debt to finance our business activities conducted through our PRC subsidiaries will depend on our ability to obtain these governmental registrations or approvals. In addition, because of the regulatory issues related to foreign currency loans to, and foreign investment in, domestic PRC enterprises, we may not be able to finance our PRC operating companies’ operations by loans or capital contributions. We cannot assure you that we can obtain these governmental registrations or approvals on a timely basis, if at all.

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

Substantially all of our revenues are denominated in Renminbi, while a portion of our expenditures are denominated in foreign currencies, primarily the U.S. dollar. Fluctuations in exchange rates, particularly those involving

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the U.S. dollar, may affect our costs and operating margins. For example, we began consolidating the financial results of Actoz beginning in the third quarter of 2007. We pay royalty fees to Actoz in U.S. dollars, and Actoz reports its financial results in Korean Won. When we determine our financial results for any period, Actoz's financial results are converted into U.S. dollars. Therefore, any depreciation of the Korean Won against the U.S. dollars would have the effect of increasing our costs. Since January 1, 2008 through March 31, 2009, the Korean Won has depreciated against the U.S. dollar by 46.5%. In addition, these fluctuations could result in exchange losses and increased costs in Renminbi terms. Where our operations conducted in Renminbi are reported in U.S. dollars, such fluctuations could result in changes in reported results which do not reflect changes in the underlying operations. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in a more than 21% appreciation of the Renminbi against the U.S. dollar as of September 9, 2008. While the international reaction to the Renminbi revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the U.S. dollar. On the other hand, as substantially all of our revenues are denominated in Renminbi, any potential future devaluation of the Renminbi against U.S. dollars could negatively impact our results of operations. Moreover, we have material monetary assets and liabilities denominated in U.S. dollars, which mainly consists of our bank deposits and US\$175.0 million in aggregate principal amount of our 2% convertible senior notes due 2011, or the convertible notes. The fluctuation of foreign exchange rate affects the value of these monetary assets and liabilities denominated in U.S. dollars. Generally, an appreciation of the Renminbi against U.S. dollars results in a foreign exchange loss for monetary assets denominated in U.S. dollars, and a foreign exchange gain for monetary liabilities denominated in U.S. dollars. On the contrary, a devaluation of the Renminbi against U.S. dollars results in a foreign exchange gain for monetary assets denominated in U.S. dollars, and a foreign exchange loss for monetary liabilities denominated in U.S. dollars. Very limited hedging transactions 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 successfully hedge all or part of 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 U.S. dollars. Conversely, an increase in the value of the Renminbi could increase our reported earnings in U.S. dollar terms without a fundamental change in our business or operating performance.

Since our revenues are primarily denominated in Renminbi, our valuation could be materially and adversely affected by the devaluation of the Renminbi if U.S. investors analyze our value based on the U.S. dollar equivalent of our financial condition and results of operations.

Inflation in China and measures to contain inflation could negatively affect our profitability and growth.

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

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Such austerity measures can lead to a slowing of economic growth. A slow down in the PRC economy could also materially and adversely affect our business and prospects.

You may experience difficulties in effecting service of process, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us or our management.

We conduct substantially all of our operations in China and substantially all of our assets are located in China. In addition, most of our directors and executive officers reside within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon some of our directors and senior executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, the PRC does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts.

We face risks related to natural disasters, health epidemics and other outbreaks of contagious diseases, including avian influenza, or avian flu, SARS and H1N1 influenza, or H1N1 flu.

Our business could be adversely affected by natural disasters, avian flu, SARS, H1N1 flu, also known as swine flu, or other epidemics or outbreaks. On May 12, 2008, China experienced an earthquake with a reported magnitude of 8.0 on the Richter scale in Sichuan Province, resulting in the death of tens of thousands of people. As a result of the earthquake, we observed a three-day period of national mourning for the victims, during which period we suspended our online entertainment content, in accordance with a public notice issued by the PRC government. There have been recent reports of outbreaks of a highly pathogenic avian flu caused by the H5N1 virus, in certain regions of Asia and Europe. In 2005 and 2006, there have been reports on the occurrences of avian flu in various parts of China, including a few confirmed human cases. Since April 2009, there have been reports on the occurrences of H1N1 flu in Mexico, the United States, China and certain other countries and regions around the world. An outbreak of avian flu or H1N1 flu in the human population could result in a widespread health crisis that could adversely affect the economies and financial markets of many countries, particularly in Asia. Additionally, any recurrence of SARS, a highly contagious form of atypical pneumonia, similar to the occurrence in 2003 that affected China, Hong Kong, Taiwan, Singapore, Vietnam and certain other countries and regions, would also have similar adverse effects. These natural disasters, outbreaks of contagious diseases, and other adverse public health developments in China could severely disrupt our business operations and adversely affect our financial condition and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future natural disasters or outbreak of avian flu, H1N1 flu, SARS or any other epidemic.

We may be subject to fines and legal sanctions if we or our Chinese employees fail to comply with recent PRC regulations relating to employee stock options granted by overseas listed companies to PRC citizens.

On March 28, 2007, the SAFE issued the Application Procedure for Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plans or Stock Option Plans of Overseas Listed Companies, or Notice 78. Under Notice 78, PRC individuals who participate in an employee stock option holding plan or a stock option plan of an overseas listed company are required, through a PRC domestic agent or PRC subsidiary of the overseas listed company, to register with SAFE and complete certain other procedures. We and our Chinese employees who have been granted restricted shares or stock options pursuant to our share incentive plan are subject to Notice 78 because we are an overseas listed company. However, in practice, there exist significant uncertainties with regard to the





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interpretation and implementation of Notice 78. We are committed to complying with the requirements of Notice 78. However, we cannot provide any assurance that we or our Chinese employees will be able to complete, qualify under, or obtain any registration required by Notice 78. In particular, if we and/or our Chinese employees fail to comply with the provisions of Notice 78, we and/or our Chinese employees may be subject to fines and legal sanctions imposed by the SAFE or other PRC government authorities, as a result of which our business operations and employee option plans could be materially and adversely affected.

Risks Relating to Our ADSs

One shareholder has significant control over the outcome of our shareholder votes.

As of December 31, 2008, Premium Lead Company Limited, or Premium Lead, whose beneficial owner is Tianqiao Chen, our chairman and chief executive officer, owned approximately 43.8% of our outstanding equity interests. Accordingly, Premium Lead has and is expected to maintain significant control over the outcome of any corporate transaction or other matter submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets.

If Premium Lead, which holds approximately 43.8% of our ordinary shares as of December 31, 2008, or any other major shareholder chooses to dispose of a material portion of the ordinary shares that it holds, the prevailing market price for our securities may decline.

On September 19, 2007, Skyline Media Limited, or Skyline Media, sold 9,131,878 of our ordinary shares pursuant to Rule 144 under the Securities Act of 1933. On the day of this sale, the market price for our ordinary shares decreased by approximately 6.8%. If Premium Lead, to whom Skyline Media transferred 60,000,000 of our ordinary shares on December 27, 2007 and whose beneficial owner is Tianqiao Chen, our chairman and chief executive officer, or any other major shareholder, chooses to sell a material portion of the ordinary shares that it holds, or indicate its intention to do so, the prevailing market price for our securities may decline.

The price of our ADSs has been volatile historically and may continue to be volatile, which may make it difficult for holders to resell the ADSs when desired or at attractive prices.

The trading price of our ADSs has been and may continue to be subject to wide fluctuations. Since we completed our initial public offering in May 2004, the sale prices of our ADSs on the NASDAQ Global Select Market ranged from US\$10.58 to US\$63.66 per ADS and the last reported sale price on June 26, 2009 was US\$60.63.

Our ADS price may fluctuate in response to a number of events and factors, including among other factors:

- announcements of technological or competitive developments;
- regulatory developments in our target markets affecting us, our customers or our competitors;

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- announcements regarding intellectual property rights litigation;
- actual or anticipated fluctuations in our quarterly operating results;
- changes in financial estimates by securities research analysts;
- changes in the economic performance or market valuations of our products;
- addition or departure of our executive officers and key research personnel; and
- sales or perceived sales of additional ordinary shares or ADSs.

In addition, the financial markets in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the price of our ADSs, regardless of our operating performance.

The price of our ADSs also could be affected by possible sales of our ordinary shares or ADSs by investors who view the convertible notes as a more attractive means of equity participation in our company and by hedging or arbitrage activity involving our ordinary shares and ADSs that we believe has developed as a result of the issuance of the convertible notes.

We may be unable to raise the funds to pay interest on the convertible notes or to purchase the convertible notes on the purchase dates or upon a fundamental change.

The convertible notes bear interest at an annual rate of 2.0%, payable semi-annually, and we in certain circumstances are obligated to pay additional interest. If a fundamental change occurs, holders of the convertible notes may require us to repurchase, for cash, all or a portion of their convertible notes. In addition, upon conversion of the convertible notes, we will pay the principal amount in cash. We used all of the net proceeds from the sale of the convertible notes, together with cash on hand, to repurchase US\$175.0 million worth of our ADSs pursuant to an accelerated share repurchase program. We may not have sufficient funds for any required repurchase of the convertible notes or required payment of principal or interest, and we may have to obtain financing to make payments under the convertible notes. If we fail to pay interest or principal on the convertible notes or repurchase the convertible notes when required, we will be in default under the indenture governing the convertible notes.

The accounting treatment for convertible notes is subject to uncertainty.

The accounting for convertible debt securities, such as the convertible notes, is subject to frequent scrutiny by various accounting regulatory bodies and is subject to change. We cannot predict if or when any such change could be made and any such change could have an adverse impact on our reported or future financial results.

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Any such impacts could adversely affect the trading price of our ADSs and in turn negatively impact the trading price of the convertible notes.

Conversion of the convertible notes may dilute the ownership interest of existing holders of our ordinary shares and ADSs.

Under certain circumstances, upon conversion of the convertible notes, we have the right to deliver our ordinary shares or ADSs representing such ordinary shares, in lieu of cash. If we decide to deliver ordinary shares or ADSs representing such ordinary shares, the ownership interests of existing holders of ADSs may be diluted. Any sales in the public market of our ADSs issuable upon such conversion could adversely affect prevailing market prices of our ADSs. In addition, the anticipated conversion of the notes into any ordinary shares or ADSs representing such ordinary shares could depress the price of our ADSs.

Provisions of the convertible notes could discourage an acquisition of us by a third party.

Certain provisions of the convertible notes could make it more difficult or more expensive for a third party to acquire us. Upon the occurrence of certain transactions constituting a “fundamental change”, holders of the convertible 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 \$1,000. We may also be required to issue additional shares upon conversion or provide for conversion into the acquirer’s capital stock in the event of certain fundamental changes.

As a foreign private issuer with ADSs listed on the NASDAQ Global Select Market, we follow certain home country corporate governance practices instead of certain NASDAQ requirements.

As a foreign private issuer whose ADSs are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of certain NASDAQ requirements. A foreign private issuer that elects to follow its home country practice must submit to the NASDAQ Stock Market LLC a written statement from an independent counsel in such issuer’s home country certifying that the issuer’s practices are not prohibited by the home country’s laws. In addition, a foreign private issuer must disclose in its annual reports filed with the SEC each NASDAQ requirement with which it does not comply followed by a description of its applicable home country practice.

As a company incorporated in the Cayman Islands with ADSs listed on the NASDAQ Global Select Market, we intend to follow our home country practice instead of NASDAQ requirements that mandate that:

- our board of directors be comprised of a majority of independent directors;
- our directors be selected or nominated by a majority of the independent directors or a nomination committee comprised solely of independent directors;
- our board adopt a formal written charter or board resolution addressing the director nominations process and such related matters as may be required under the U.S. federal securities laws; and

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- the compensation of our executive officers be determined or recommended by a majority of the independent directors or a compensation committee comprised solely of independent directors.

As we are a Cayman Islands company, you may face difficulties in protecting your interests, and our ability to protect our rights through the U.S. federal courts may be limited.

Our corporate affairs are governed by our memorandum and articles of association, the Companies Law (2007 Revision) and common law of the Cayman Islands. The rights of our shareholders to take action against the directors, actions by minority shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as that from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities law as compared to the United States, and provides significantly less protection to investors. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action in the federal court of the United States.

In addition, most of our directors and officers are nationals and residents of countries other than the United States. Substantially all of our assets and a substantial portion of the assets of these persons are located outside the United States.

The Cayman Islands courts are also unlikely:

- to recognize or enforce against us judgments of courts of the United States based on certain civil liability provisions of U.S. securities laws; and
- to impose liabilities against us, in original actions brought in the Cayman Islands, based on certain civil liability provisions of U.S. securities laws that are penal in nature.

There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will generally recognize and enforce a non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits.

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

In addition, Cayman Islands companies may not have standing to sue before the federal courts of the United States. As a result, our ability to protect our interests if we are harmed in a manner that would otherwise enable us to sue in a United States federal court may be limited.

You may have difficulties in enforcing judgments obtained against us.

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We are a Cayman Islands company and substantially all of our assets are located outside of the United States. Substantially all of our current operations are conducted in the PRC. In addition, most of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, most of whom are not residents in the United States and the substantial majority of whose assets are located outside of the United States. In addition, there is uncertainty as to whether the courts of the Cayman Islands or the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state due to the lack of reciprocal treaty in the Cayman Islands or the PRC providing statutory recognition of judgments obtained in the United States. Furthermore, it is uncertain whether such Cayman Islands or PRC courts would be competent to hear original actions brought in the Cayman Islands or the PRC against us or such persons who reside outside the United States predicated upon the securities laws of the United States or any state.

Anti-takeover provisions in our organizational documents may discourage our acquisition by a third party, which could limit your opportunity to sell your shares at a premium.

Our amended and restated memorandum and articles of association include provisions that could limit the ability of others to acquire control of us, modify our structure or cause us to engage in change of control transactions, including, among other things, the following:

- provisions that restrict the ability of our shareholders to call meetings and to propose special matters for consideration at shareholder meetings; and
- provisions that authorize our board of directors, without action by our shareholders, to issue preferred shares and to issue additional ordinary shares, including ordinary shares represented by ADSs.

These provisions could have the effect of depriving you of an opportunity to sell your ADSs at a premium over prevailing market prices by discouraging third parties from seeking to acquire control of us in a tender offer or similar transactions.

The voting rights of holders of ADSs are limited by the terms of the deposit agreement.

A holder of our ADSs may only exercise the voting rights with respect to the underlying ordinary shares in accordance with the provisions of the deposit agreement. Upon receipt of voting instructions of a holder of ADSs in the manner set forth in the deposit agreement, the depositary will endeavor to vote the underlying ordinary shares in accordance with these instructions. Under our amended and restated memorandum and articles of association and Cayman Islands law, the minimum notice period required for convening a general meeting is ten days. When a general meeting is convened, you may not receive sufficient notice of a shareholders' meeting to permit you to withdraw your ordinary shares to allow you to cast your vote with respect to any specific matter. In addition, the depositary and its agents may not

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

We may be re