Annual Report 2013

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Corporate Profile

We are a leading online game developer and operator in China. We operate three main business units, namely Internet Games, Mobile Games and WVAS. Under Internet Games, We operate the largest Chinese military gaming platform under the "WAR SAGA" brand, which includes games such as World of Tanks, World of Warplanes and World of Warships. On May 15, 2014, we officially launched the most-anticipated 3D fantasy MMORPG Guild Wars 2 in China. We have the exclusive publishing rights for World of Tanks, World of Warplanes and World of Warships, Guild Wars 2, Auto Club Revolution, Blitzkrieg 3 and other titles in Mainland China. We entered the smartphone game industry in 2011 through an acquisition of smartphone game engine and has expanded its mobile game development team across 4 cities across Mainland China. We offer popular mobile games in China and overseas with over 10 smartphone games across various genres being under development, including RPG, RTS, military, fantasy and etc.

Chairman and Chief Executive Officer's Letter

Dear Shareholders:

On behalf of the Board of Directors and the management team, we are pleased to present you with our 2013 annual report.

Our corporate goal is to become a leading and differentiated online game company with a primary focus on the mainland China market with a target to realize annualized total revenues of US$ 400 mn to US$ 500 mn within the next few years based on our Internet game and mobile phone game businesses.

Within Internet games, based on the War Saga brand, with over 40.0 mn World of Tanks Chinese players, the May 2014 commercial release of World of Warplanes, the upcoming releases of World of Battleships and Blitzkrieg 3, we have created China's largest military genre online game platform.Moreover, from Internet games being primarily driven by our flagship game, World of Tanks, we have successfully diversified our Internet games business to include Guild Wars 2 and World of Warplanes, which both had successful commercial releases in May 2014. We expect to continue to develop a differentiated and diversified portfolio of Internet games in the future based on the War Saga brand and Guild Wars 2, amongst other Internet game titles.

Within mobile games, in 2013 we have begun our transition away from feature phone mobile games with a focus on a high-end smartphone games. In the 2nd half of 2014, we expect to bring 4 or 5 key titles to the China market across 4 main areas, namely (1) licensed mobile games from high-quality partners from Japan and Korean markets in the Puzzle RPG and Action RPG genres (2) Cross border co-development with an experienced Korean mobile game developer, in the Action RPG genre and (3) A self-developed game in the next generation real time strategy ("RTS") genre and (4) and a self-developed RPG title based upon the 'Kuiba' animated movies series.

In both Internet games and mobile games, we believe that high-quality content is a sustainable and differentiated strategy that has the potential to resonant with Chinese gamers against the backdrop of multiple mobile game distribution platform choices in the China market.

KongZhong Corporation also changed its NASDAQ ticker symbol to "KZ" from "KONG" to better align our company branding as an online games company versus a WVAS company. The new ticker KZ was effective as the start of trading on Monday, June 16, 2014.

- Total revenues were US$ 179.44 million for the full year 2013. Of which WVAS revenues were US$ 63.92 mn in 2013 compared to US$ 77.77 mn in 2012, mobile games revenues were US$ 17.07 mn in 2013 compared to US$ 21.19 mn in 2012 and Internet games revenues were US$ 98.45 mn in 2013 compared to US$ 87.42 mn in 2012.
- Full year gross margin was 43.1% compared to 41.6% in 2012. Of which WVAS gross margin was 31.1%, Mobile games gross margin was 53.5% and Internet games gross margin was 49.0%.
- Net income in 2013 was US$ 20.66 mn compared to US$ 25.74 mn in 2012. However, net income in 2013 included a $1.56 mn impairment loss on intangible assets and $ 2.00 mn impairment loss on long term investments.
- Non-GAAP net income was US$ 28.87 mn compared to 2012 full year Non-GAAP net income of US$ 35.92 mn

Internet Games

Our Internet games revenues increased 12.6% to US$98.4 million in 2013 from US$87.4 million in 2012. This increase was driven largely by significant growth in revenues generated from the operation of our massive multiplayer online game, the World of Tanks game, in the PRC, which saw an increase in sales of in-game items purchased by the World of Tanks game players.

Smartphone Mobile Games

Our mobile games revenues decreased by 19.4% to US$17.1 million in 2013 from US$21.2 million in 2012. This decrease was mainly due to the adoption by China Mobile of measures similar to those that have affected our WVAS business, as described above, and China Mobile's decision to de-emphasize its subscription-based mobile games download services. In addition, the decrease in our mobile games revenues was also attributable to an overall shift in the tastes and preferences of consumers in China from traditional feature phone mobile games, which are mainly Java-based, to mobile games that are developed for smartphone platforms, such as iOS and Android mobile games. Also, as we restructured our smartphone game development team in the first half of 2013, new smartphone games were only launched during the second half of 2013, which contributed to the decrease in revenues from smartphone games in 2013.

WVAS

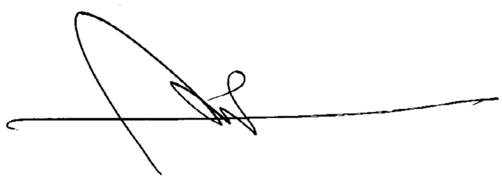
Our WVAS revenues decreased by 17.8% to US$63.9 million in 2013 from US$77.8 million in 2012. Revenues from our 2G services decreased by 13.4% to US$62.1 million in 2013 from US$71.7 million in 2012. Revenues from our 2.5G services decreased by 69.9% to US$1.8 million in 2013 from US$6.1 million in 2012. The decrease was mainly due to policies implemented by the PRC telecommunications operators since late 2010, including those policies which resulted in the suspension of billing on WAP and G+ mobile games by China Mobile and other PRC telecommunications operators on behalf of third party service providers of such services.

Transformation into a leading and differentiated online game Company

Having successful executed our 2013 operating plans with solid momentum propelling us into2014, the Company has established a strong foundation for future growth supported by our core growth strategies, (a)the establishment ofChina's largest military genre online game platformunder the War Saga brand (b) the diversification of our Internet game business with the commercial release of Guild Wars 2 and World of Warplanes to supplement World of Tanks and (c) the growth potential of our new portfolio of mobile gameswhich we expect will come to market in the 2nd half of 2014.

I would like to thank all of our shareholders, business partners and employees for their continued support and confidence.

Sincerely,



Lei Lei Wang
Chairman and Chief Executive Officer

Key Financial Information

Our audited consolidated financial statements have been prepared and presented in accordance with the generally accepted accounting principles in the United States, or U.S. GAAP.

	For the year ended December 31,				
Consolidated statements of operations data	2009	2010	2011	2012	2013
	(in thousands of U.S. dollars, except shares and per share data)				
Revenues	US$ 131,298.2	US$ 149,583.4	US$ 160,008.4	US$ 186,379.7	US$ 179,440.4
WVAS	104,001.6	83,280.3	80,265.9	77,765.5	63,922.2
Mobile games	27,296.6	49,171.5	40,850.5	21,190.3	17,069.0
Internet games	—	17,131.6	38,892.0	87,423.9	98,449.2
Sales tax	(2,885.1)	(3,209.0)	(3,827.8)	(5,793.6)	(5,786.6)
WVAS	(2,273.6)	(1,584.4)	(1,390.9)	(1,053.2)	(969.0)
Mobile games	(611.5)	(925.1)	(621.1)	(219.3)	(160.7)
Internet games	—	(699.5)	(1,815.8)	(4,521.1)	(4,656.9)
Net revenues	128,413.1	146,374.4	156,180.6	180,586.1	173,653.8
WVAS	101,728.0	81,695.9	78,875.0	76,712.3	62,953.2
Mobile games	26,685.1	48,246.4	40,229.4	20,971.0	16,908.3
Internet games	—	16,432.1	37,076.2	82,902.8	93,792.3
Cost of revenues	(65,946.8)	(80,238.6)	(91,930.2)	(103,130.3)	(96,399.9)
WVAS	(54,258.5)	(48,329.5)	(50,758.6)	(52,655.5)	(43,085.2)
Mobile games	(11,688.3)	(29,570.8)	(25,248.0)	(10,935.0)	(7,780.3)
Internet games	—	(2,338.3)	(15,923.6)	(39,539.8)	(45,534.4)
Gross profit	62,466.3	66,135.8	64,250.4	77,455.8	77,253.9
WVAS	47,469.5	33,366.5	28,116.4	24,056.8	19,868.0
Mobile games	14,996.8	18,675.4	14,981.4	10,036.0	9,128.0
Internet games	—	14,093.9	21,152.6	43,363.0	48,257.9
Operating expenses:					
Product development	(18,272.0)	(23,964.7)	(15,416.9)	(18,382.4)	(26,401.7)
Selling and marketing	(17,821.2)	(18,975.6)	(20,891.6)	(24,586.0)	(26,674.0)
General and administrative	(10,186.9)	(10,481.8)	(11,582.2)	(11,629.3)	(8,976.2)
Impairment loss on goodwill	—	(2,998.3)	(20,255.3)	—	—
Impairment loss on intangible assets	—	(5,730.6)	(3.9)	—	(1,562.4)
Total operating expenses	(46,280.1)	(62,151.0)	(68,149.9)	(54,597.7)	(63,614.3)
Change in fair value of contingent consideration for business acquisition	—	10,894.5	(3,729.5)	—	—
Government subsidies	—	337.7	319.2	301.4	2,176.4
Income (loss) from operations	16,186.2	15,217.0	(7,309.8)	23,159.5	15,816.0
Interest income	3,114.3	2,342.8	3,569.2	5,231.3	6,764.0
Interest income from loans to third party	—	—	1,193.2	453.6	—
Interest expense	(725.9)	(1,059.9)	(487.8)	(262.7)	(693.3)
Impairment loss on cost method investment	(1,500.0)	(1,509.9)	—	—	(2,000.0)
Loss on extinguishment of debt upon prepayment of convertible senior note	—	—	(1,567.5)	—	—
Exchange gain	—	—	—	387.6	1,487.3
Investment income	206.9	883.2	85.6	261.5	—
Net income (loss) before income taxes	17,281.5	15,873.2	(4,517.1)	29,230.8	21,374.0
Income taxes expense	(4,698.1)	(3,950.0)	(3,137.8)	(3,490.8)	(712.4)
Net income (loss)	US$ 12,583.4	US$ 11,923.2	US$ (7,654.9)	US$ 25,740.0	US$ 20,661.6
Net income (loss) per share:					
Basic	US$ 0.01	US$ 0.01	US$ (0.00)	US$ 0.02	US$ 0.01
Diluted	US$ 0.01	US$ 0.01	US$ (0.00)	US$ 0.01	US$ 0.01
Weighted average shares used in calculating net income (loss) per share:					
Basic	1,385,201,479	1,466,947,693	1,607,110,119	1,661,864,846	1,714,924,612
Diluted (1)	1,537,771,051	1,547,870,678	1,607,110,119	1,721,622,756	1,751,621,340

(1)As of December 31, 2009, 2010, 2011, 2012 and 2013, we had 76 million, 76 million, 210 million, 285 million and 11 million ordinary share equivalents, respectively, outstanding that could potentially dilute income per share in the future, but that were excluded in the computation of diluted income per share in the periods as their effect would have been anti-dilutive.

Consolidated balance sheet data	As of December 31, 2009	2010	2011	2012	2013
Cash and cash equivalents	US$139,289.5	US$157,170.8	US$129,511.5	US$120,694.7	US$123,427.7
Term deposits	—	—	—	—	4,448.8
Held-to-maturity securities	—	—	17,299.1	17,465.3	51,866.5
Trading securities	100.6	20.3	7,754.6	—	—
Loans to third party	—	—	22,187.3	—	—
Accounts receivable, net	25,276.8	21,794.0	19,903.0	23,699.7	17,230.8
Property and equipment, net	3,116.0	3,738.6	3,620.3	3,065.5	5,842.5
Intangible assets, net	2,284.9	4,452.7	2,347.9	75,069.3	78,726.6
Long-term investment	1,464.5	—	—	4,000.0	2,000.0
Goodwill	23,042.3	87,705.7	72,967.1	87,551.0	90,266.6
Restricted cash	—	—	—	35,773.3	36,870.7
Total assets	200,078.6	281,445.3	280,248.0	372,784.1	419,240.3
Total current liabilities	23,565.3	63,474.7	32,526.0	71,229.6	67,370.8
Convertible note payable	3,001.0	3,552.7	1,272.6	—	—
Total shareholders' equity	173,040.7	213,940.4	246,177.7	282,884.1	332,609.5
Total liabilities and shareholders' equity	200,078.6	281,445.3	280,248.0	372,784.1	419,240.3

Consolidated cash flow data	For the year ended December 31, 2009	2010	2011	2012	2013
	(in thousands of U.S. dollars)				
Net Cash (used in) provided by:					
Operating activities	US$ 15,289.1	US$ 26,013.6	US$ 33,433.8	US$ 46,655.9	US$ 35,729.5
Investing activities	(8,282.6)	(10,314.9)	(40,284.8)	(41,206.8)	(43,944.6)
Financing activities	(3,865.7)	(776.5)	(26,335.0)	(14,313.0)	8,956.8

Business Overview

History and Development of the Company

We were incorporated on May 6, 2002 under the laws of the Cayman Islands as Communication Over The Air Inc., an exempted limited liability company. In March 2004, we changed our name to KongZhong Corporation. We are headquartered in Beijing, the PRC.

We are one of the leading providers of WVAS to mobile phone users and have been cooperating with all major telecommunications operators in the PRC since 2002. In 2005, we began providing feature phone mobile games on the networks of China Mobile with the acquisition of Tianjin Mammoth, a feature phone mobile games developer. To further expand our mobile games development capabilities, we acquired Noumena in 2012 in order to develop smartphone mobile games on smartphone mobile operating systems, such as iOS and Android.

We commenced our Internet games business in 2010 through our acquisition of Dacheng, a developer and operator of Internet games in the PRC. In addition to developing and operating our self-developed Internet games, such as Loong, Demon Code and Kung Fu Hero, we are the exclusive operator of the popular World of Tanks game for the PRC Internet games market.

We conduct substantially all of our business in the PRC through our wholly owned subsidiaries in the PRC, KongZhong Beijing, KongZhong China and Simlife Beijing. In order to meet domestic ownership requirements under PRC laws, which restrict us and our PRC subsidiaries, as either foreign or foreign-invested companies, from operating certain value-added telecommunications, Internet services and Internet games businesses. We operate WVAS, mobile games and Internet games through Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, all of which are based in the PRC and are wholly owned by PRC citizens. We do not have any equity interests in Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli or Dacheng, but enjoy the economic benefits of these companies through a series of contractual arrangements as described below.

Our principal executive office is located at 35th Floor, Tengda Plaza, No. 168, Xizhimenwai Street, Beijing, 100044, the PRC. Our telephone number is (8610) 8857-6000. The address of our primary website is www.KongZhong.com.Information contained on our website does not constitute a part of the annual report.

In July 2004, we completed the initial public offering of our ADSs representing our ordinary shares and listed the ADSs on the NASDAQ Global Market, or NASDAQ. Effective January 1, 2008, our ADSs are listed on the NASDAQ Global Select Market.

Our Internet Games Business

In January 2010, we acquired Dacheng and with it our Internet games business unit. We launched our self-developed 3D MMORPGs, Loong, EMoFaZe, XiaKeXing, ShengMoZhiXue, Kung Fu Hero, Kung Fu World and Master of Meteor Blades games from December 2009 to December 2013.

In 2010, we entered into a license agreement with WarGaming for the World of Tanks game. World of Tanks is a “freemium” 3D team-based massive multiplayer online game, featuring historic fighting vehicles from the 1930s to the 1950s. The initial term of the license is three years, commencing from the commercial release of the game. We have the exclusive right to copy, distribute, operate and sell the World of Tanks game in the PRC, Hong Kong and Macau during the term of the license. Our license payments to WarGaming consist of a fixed license fee in the amount of US$500,000 and a certain percentage of our gross revenue received from the services and merchandise related to the World of Tanks game. In 2012, we amended our license agreement with WarGaming to extend the term of the license in perpetuity. In exchange for the extension, we granted WarGaming a warrant to purchase up to 120,000,000 of our ordinary shares (equivalent to 3 million of our ADSs) and increased the percentage of our gross revenue that we pay to WarGaming if the monthly gross revenue exceeds a specified target. Since its launch, the World of Tanks game has become one of the most popular games we offer. As of December 31, 2013, the World of Tanks game had been downloaded over 13.8 million times, with over 36.7million registered users.As a result of the successful launching of the game, revenues generated from in-game items purchased by game players who play the World of Tanks game represented over 87% and 96% of our Internet games revenues in 2012and 2013, respectively. In May 2012, we entered into a strategic partnership with WarGaming under which we enjoy exclusive rights to license all of WarGaming’s future games in the PRC. Under this partnership, we licensed World of Warplanes and World of Battleships games from WarGaming.

In April 2012, we agreed to license on an exclusive basis in the PRC a multiplayer online game known as Offensive Combat from U4iA Games, Inc., or U4iA Games. In 2013, due to U4iA Games' inactive status and cessation of operations, we recognized a US$1.56 million impairment loss on intangible assets and US$2.0 million impairment loss on long term investments related to U4iA Games. As a result, our license for Offensive Combat was terminated.

In August 2012, we agreed to license on an exclusive basis in the PRC a multiplayer online game known as Hawken from Meteor Entertainment. The initial term of the license is three years, with further extensions upon our meeting certain conditions, commencing from the commercial release of the game. We have paid US$1.25 million to Meteor Entertainment as a license fee before the secure public testing of the game and are obligated to pay royalties calculated based on revenues generated from the game after the launch of the game.

In August 2012, we agreed to license on an exclusive basis in the PRC the Guild Wars 2 game from ArenaNet. The initial term of the license is three years, with further extensions to be agreed among the parties, commencing from the secure public testing of the game. We have agreed to pay license fees and additional royalties calculated based on revenue generated from the game. To guarantee our payment obligations to ArenaNet, we have arranged a standby letter of credit with a maximum guarantee amount of US$35 million from the Bank of Communications in ArenaNet's favor. We also entered into a back-to-back guarantee arrangement with the Bank of Communications.

In January 2013, we agreed to license on an exclusive basis in the PRC the Blitzkrieg 3 game from ZZima. The initial term of the license is three years, with further extensions to be agreed among the parties, commencing from the open beta test of the game. We have paid a license fee in the amount of US$1 million to ZZimabefore the secure public testing of the game and have agreed to pay royalties calculated based on revenues generated from the game after the launch of the game. As of April 16, 2014, the Blitzkrieg 3 game has not been commercially released.

In April 2013, we agreed to license on an exclusive basis in the PRC the Auto Club Revolution game from Eutechnyx. The initial term of the license is three years, with further extensions upon our meeting certain conditions, commencing from the commercial release of the game. We have paid a license fee in the amount of US$1.125 million to Eutechnyxbefore the secure public testing of the game and have agreed to pay royalties calculated based on revenues generated from the game after the launch of the game. As of April 16, 2014, the Auto Club Revolution game has not been commercially released.

In July 2013, we agreed to license on an exclusive basis in the PRC the Guozhan Online game from Guangzhou Sixiang. The term of the license is three years commencing from July 1, 2013 and ending on June 30, 2016. We have agreed to pay royalties calculated based on net revenues generated from the game after the commercial release of the game, which occurred in the fourth quarter of 2013.

In August 2013, we obtained adaptation rights on an exclusive and worldwide basis from Beijing Qingqingshu Animation Technology Co., Ltd., or Beijing Qingqingshu, to adapt and develop the KuiBa series of animated movies into Internet games and mobile games. The term of our agreement with Beijing Qingqingshu is 10 years, commencing from August 21, 2013 and ending on August 20, 2023. We have agreed to pay a license fee in the amount of RMB5 million in the aggregate to Beijing Qingqingshu, of which 50% has been paid and the remaining RMB2.5 million will be paid after the commercial release of the first game developed by us based on adaption of the KuiBa series of animated movies. We have also agreed to pay royalties calculated based on net revenues generated from the games. Beijing Qingqingshu agreed to pay royalties to us calculated based on the box office revenues of the Kuiba series of movies. As of April 16, 2014, the KuiBa games have not been commercially released.

In addition to licensed games, we also develop Internet games internally based mainly on our proprietary technologies, which include our proprietary game engine (Dazzler 3D), game development platforms and online game billing system, all developed by our internal team. In particular, our Dazzler 3D game engine enables us to create high-quality 3D graphics and visual effects, and provides the technical foundation for creating innovative features in our games. Furthermore, our game development platforms give us the capacity to develop Internet games within approximately six to 24 months and to update our Internet games frequently in response to players' preferences. Based on these platforms, we made publicly available our newest self-developed game, Master of Meteor Blades, in August 2013 for secured beta testing.

We use an item-based revenue model for our games, whether internally developed or licensed, under which players can play our games on the Internet free of charge, but have to pay for purchases of in-game virtual items, such as in-game currencies, performance-enhancing clothing, weapons, accessories and pets. We distribute our electronic prepaid game cards and game points, which can be used to purchase in-game virtual items, to players through multiple payment channels. Although we expect a substantial portion of our Internet games revenues to be generated in the PRC, we have licensed our games to leading game operators outside the PRC and plan to license them in additional countries and regions.

Our Mobile Games Business

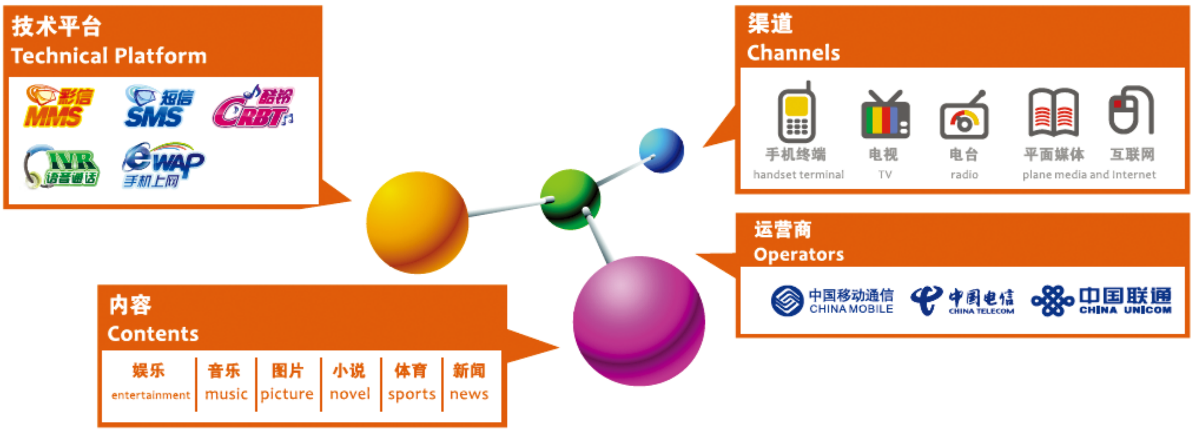
We are a leading developer and publisher of mobile games for mobile phone users in the PRC. Our internal development team develops mobile games based primarily on the Java™ technology, but more recently we have broadened our development of mobile games to include smartphone mobile operation systems, such as iOS and Android. The mobile games we develop include action, role-playing and leisure games.

We established a dedicated mobile games product development team, and acquired Tianjin Mammoth, a mobile games developer, in 2005. In 2009, we acquired Simlife, a leading mobile games developer in the PRC. In 2012, we acquired Noumena, a developer of cross-platform smartphone mobile game engines. We believe the integration of the Noumena team into our existing mobile game development team will enable us to create new smartphone mobile games that can take advantage of the Handymo game engine technologies developed by Noumena. We believe these new smartphone mobile games will enable us to leverage our existing mobile game distribution channels in China and capture market share in the nascent PRC smartphone mobile games market.

We provide interactive entertainment, media and other interactive services to mobile phone users in China through various second generation standard, or 2G, technology platforms, including SMS, IVR and color ring back tone, or CRBT, and through various "second and a half" generation standard, or 2.5G, technology and operating platforms, including WAP and MMS, which offer higher quality graphics, richer content and more interactivity than 2G wireless services. Our WVAS are tailored to the technical or other requirements of our telecommunications operator partners, through whom we deliver most of our WVAS, and to various billing systems for WVAS. Our WVAS are also delivered and marketed through various media partners, including handset manufacturers, television stations, radio stations, print media and Internet sites. Our WVAS revenues accounted for 50.2%,41.7% and 35.6%of our total revenues in 2011, 2012 and 2013, respectively.

We offer a variety of WVAS, such as mobile games, pictures, karaoke, electronic books, mobile phone personalization features, and entertainment news, chat and message boards. Customers can access these services directly from their mobile phones: (i) by using our access code or by choosing a feature pre-loaded in select models of handsets; and (ii) from a telecommunications operator's portal or website. Substantially all of our WVAS are ordered or accessed by users directly through their mobile phones, and all services are delivered through mobile phones.

We provide our services mainly pursuant to our cooperation arrangements with the telecommunications operators and their



provincial subsidiaries, the terms of which are generally for one year or less. We do not directly bill our users, and depend on the billing systems and records of the telecommunications operators to bill and collect all fees. We generally do not have the ability to independently verify the accuracy of the billing systems of the telecommunications operators. As the telecommunications operators do not provide us with a detailed revenue breakdown on a service-by-service basis, we depend on our internal data management system to monitor revenues derived from each of our services. We make our business decisions based on our internal data, taking into account our historical experience in reconciling our internal data to our actual results of operations and other factors, including strategic considerations.

Operation and Financial Review and Prospects

Business Overview

We are one of the leading providers of digital entertainment services for consumers in the PRC. We operate three main business units, namely WVAS, mobile games and Internet games. We are one of the leading providers of WVAS to mobile phone users and have been in cooperation with all major telecommunications operators in the PRC since 2002. In 2005, we began providing feature phone mobile games on the networks of China Mobile with the acquisition of Tianjin Mammoth, a feature phone mobile games developer. To further expand our mobile games development capabilities, we acquired Noumena in 2012 in order to develop smartphone mobile games on smartphone mobile operating systems, such as iOS and Android. We commenced our Internet games business in 2010 through our acquisition of Dacheng, a developer and operator of Internet games in the PRC. In addition to developing and operating our self-developed Internet games, such as Loong, Demon Code and Kung Fu Hero, we are the exclusive operator of the popular World of Tanks game for the PRC Internet games market. In May 2012, we entered into a strategic partnership with WarGaming, which granted us the exclusive license to all of WarGaming's future games in the PRC, including but not limited to World of Tanks, World of Warplanes and World of Warships. In addition, as of December 31, 2013, we were also the exclusive licensee in the PRC for the Guild Wars 2 game developed by ArenaNet, Hawken game developed by Meteor Entertainment, Blitzkrieg 3 game developed by ZZima International Sarl, or ZZima, Auto Club Revolution game developed by Eutechnyx Limited, or Eutechnyx, and Guozhan Online game developed by Guangzhou Sixiang Internet Technology Co., Ltd., or Guangzhou Sixiang.

Revenues

The following table sets forth the revenues attributable to services derived from the WVAS, mobile games and Internet games segments in terms of amount and as a percentage of our total revenues for the periods indicated:

	For the year ended December 31,					
	2011		2012		2013	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
	(in thousands of U.S. dollars, except percentages)					
WVAS	US$ 80,265.9	50.2%	US$ 77,765.5	41.7%	US$ 63,922.2	35.6%
Mobile games	40,850.5	25.5	21,190.3	11.4	17,069.0	9.5
Internet games	38,892.0	24.3	87,423.9	46.9	98,449.2	54.9
Total	US$ 160,008.4	100.0%	US$ 186,379.7	100.0%	US$ 179,440.4	100.0%

The following table sets forth the revenues attributable to services derived from each of our 2G and 2.5G technology platforms in terms of amount and as a percentage of our total revenues for the periods indicated:

	For the year ended December 31,					
	2011		2012		2013	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
	(in thousands of U.S. dollars, except percentages)					
2G services						
SMS	US$ 37,096.5	23.2%	US$ 39,178.1	21.0%	US$ 32,334.6	18.0%
IVR	12,661.9	7.9	13,438.0	7.2	14,884.2	8.3
CRBT and others	21,578.9	13.5	19,069.2	10.3	14,870.5	8.3
Subtotal	71,337.3	44.6	71,685.3	38.5	62,089.3	34.6
2.5G services						
WAP	US$ 2,355.4	1.5	US$ 2,688.1	1.4	US$ 719.9	0.4
MMS	6,573.2	4.1	3,392.1	1.8	1,113.0	0.6
Subtotal	US$ 8,928.6	5.6	US$ 6,080.2	3.2	US$ 1,832.9	1.0
Total WVAS revenues	US$ 80,265.9	50.2%	US$ 77,675.5	41.7%	US$ 63,922.2	35.6%

WVAS Revenues

We generate our WVAS revenues from fees paid by mobile phone users who use our services through the networks of China Mobile, China Unicom and China Telecom. Our dependence on China Mobile decreased in 2013, asChina Mobile continued to de-emphasize their WVAS businesses. As a percentage of our total WVAS revenues, WVAS revenues generated from China Mobile represented approximately 66% and 57% in 2012 and 2013, respectively. Due to our dependence on China Mobile for a substantial portion of our WVAS revenues, our working relationship with China Mobile is critical to the financial condition and results of operations of our WVAS business.

We allocate our WVAS resources based on the geographic concentration of our customers. Due to our customer base being primarily concentrated in the coastal regions of the PRC, we generally allocate more of our WVAS resources to these regions, including maintaining sales offices in most of the coastal regions of the PRC.

We recognize revenues derived from our services before deducting the service fees and the net transmission charges that we pay to the telecommunications operators. Fees for our services are charged on either a single-transaction or monthly subscription basis and vary according to the type of services delivered. We recognize all revenues in the period in which the services are perform.

Mobile Games Revenues

We generate a majority of our mobile games revenues by distributing mobile games through the networks of China Mobile. As a percentage of our total mobile games revenues, mobile games revenues received through China Mobile accounted for 97.1%,71.7% and 59.9% in 2011, 2012 and 2013, respectively. Due to our dependence on China Mobile for substantially all of our mobile games revenues, our working relationship with China Mobile is critical to the operation of our mobile games business. We expect to supplement these streams of revenues in 2014with revenues that we expect to generate from sales of our internally developed smartphone mobile games, which we distribute through digital distribution platforms, such as app stores developed by smartphone handset manufacturers.

Our mobile games revenues decreased from US$40.8 million in 2011to US$21.2 million in 2012, and further decreased to US$17.1 million in 2013. The decreases were primarily due to the adoption by China Mobile of measures similar to those that have affected our WVAS business, as described above, and China Mobile's decision to de-emphasize its subscription-based mobile games download services. In addition, as we restructured our smartphone game development team in the first half of 2013, new smartphone games were only launched during the second half of 2013, which contributed to the decrease in revenues from smartphone games in 2013. The decrease in 2013 was also attributable to impact created by the overall market shift in the tastes and preferences of consumers in China from traditional feature phone mobile games, which are mainly Java-based, to mobile games that are developed for smartphone mobile operating systems, such as iOS and Android mobile games. We believe this shift in tastes and preferences of consumers in China will continue in 2014.

Internet Games Revenues

The Internet games revenues are primarily derived from Internet games operation revenues and licensing revenues. We earn Internet games operation revenues through the provision of Internet games services to players under an item-based revenue model, whereby players are able to play the Internet games free of charge for an unlimited amount of time, but are charged for purchasing in-game items, such as in-game performance-enhancing items, mechanised vehicles, clothing, accessories and pets. In 2013, we derived a majority of our Internet games revenues from revenues generated through the operation of our licensed Internet games, especially the World of Tanks game, which generated over 95.5% of our Internet games revenues from the in-game items purchased for the World of Tanks game for 2013. We expect revenues generated from the World of Tanks game to continue to be a major driver for growing our Internet games revenues in 2014. Due to our dependence on the World of Tanks game for a majority of our Internet games revenues, our business relationship with WarGaming is critical to the continued operation of the World of Tanks game.

Revenues from the sales of in-game items are recognized when items are consumed by customers or over the estimated lives of the items. The revenue recognition policy for the item-based games relies on the useful lives of various items associated with each of our item-based games. The in-game items have different life patterns: one-time use items, limited life items with useful life ranging from three days to 90 days and permanent life items. To determine whether an in-game item has a limited or permanent life, we consider whether such in-game items are offered with unlimited lasting benefit, which means that players may use such in-game items at will without any usage or time limits as long as such players are active. Limited life in-game items have usage or time limits while permanent life in-game items offer unlimited lasting benefit to the players. Revenues from the sales of one-time use in-game items are recognized upon consumption. Revenues from the sales of limited life in-game items are recognized ratably based on the extent of time passed until expiration. Revenues from the sales of permanent life in-game items are recognized ratably based on the estimated lives of the in-game items, which is the period during which the player is expected to continue to play the game.

We take into account player behavior patterns in estimating the lives of permanent life in-game items, including the average period that the typical player plays our games based on log-on data, which are affected by various factors such as acceptance and popularity of the game, game updates and other in-game items, promotional events launched, future operating strategies and market conditions. Based on the above considerations for all active games, we have determined the estimated life for all permanent life in-game items is six months. We review, at least annually, the average playing periods of game players for all active games to determine if the six-month estimated life for permanent in-game items remains reasonable. Based on our latest review, such estimated life remains reasonable and has not changed over time. We revise our estimates as we continue to collect operating data and refine our estimation process and results accordingly. All paying users' data collected since the launch of the games are used to perform the relevant assessments. Historical behavior patterns of these paying users during the period between their first log-on date and last log-on date are used to estimate the lives of the permanent life in-game items.

Under the item-based revenue model, proceeds received from sales of game points to players, which can be converted into in-game currencies to purchase in-game items, are initially recorded as advances from customers as game points are refundable. As players convert game points into in-game currencies, proceeds received from sales of those game points are transferred from advances from customers to deferred revenues. Deferred revenues are recognized as revenues when in-game items purchased with in-game currencies are consumed by players over the estimated lives of such items. In addition to game points that we sell and distribute by ourselves, a portion of our game points are sold and distributed through third party vendors. As we do not have control and generally do not know the ultimate selling price of the prepaid game cards or game points sold by the distributors, net proceeds from distributors are recorded as advances from customers. Upon activation of the game cards or the game points, these advances from customers are immediately transferred to deferred revenues.

In addition, we entered into licensing arrangements with various licensees to operate our games in the PRC and in other countries and regions. These licensing agreements provide for two revenue streams: the initial fees and the usage-based royalty fees. In certain licensing arrangements, we provide free upgrades, maintenance support and training, which are our post-sale customer support, or PCS, for the first year. The licensees have the option to purchase PCS in subsequent years at specified renewal rates. In these arrangements, we allocate the initial fee into two parts. The first part represents the license of the game and is recognized as license revenue immediately upon the launch of the games in foreign countries or regions. The second part represents fees for the PCS and is recognized ratably over the contractual period of the PCS. In other licensing arrangements, we provide PCS over the full licensing period for no additional charge. In such cases, the total amount of the initial fee is recognized ratably over the full contractual licensing period.

According to our license agreements, we are also entitled to ongoing usage-based royalties determined based on the amount of fees charged to the players' accounts or services payable by players in a given country or region. The usage-based royalties are recognized when they are earned, provided that collection is probable.

Our Internet games revenues were US$98.5 million in 2013, of which 97.5% was generated from game operations and 2.5% was generated from licensing our Internet games to third party licensees.

Cost of Revenues

Our cost of revenues includes WVAS cost of revenues, mobile games cost of revenues and Internet games cost of revenues.

WVAS Cost of Revenues

Our WVAS cost of revenues includes the following:

- *Service fees payable by us to the telecommunications operators. In the case of China Mobile and its subsidiaries, service fees are generally 15% to 60% of the revenues, while in the case of China Unicom and China Telecom, service fees are in the range of 15% to 70%, varying according to the service platform. We are not obligated to pay the service fees to the telecommunications operators if customers cannot be billed or do not pay the telecommunications operators;*
- *Net transmission charges payable by us to the telecommunications operators, calculated as the number of messages we send to customers in any given month, minus the number of messages we receive from customers regarding our services in that month, and multiplied by a per-message transmission fee. We are obligated to pay the telecommunications operators the net transmission charges even if customers cannot be billed or do not pay the telecommunications operators;*
- *Payments to content providers for the use of their content, and to mobile handset manufacturers and other industry partners with whom we have cooperation arrangements, in the form of a fixed fee or a percentage of our aggregate net revenues received from the telecommunications operators with respect to services provided through the cooperation arrangements;*
- *Bandwidth leasing charges and depreciation and facility costs relating to equipment used to provide WVAS; and*
- *Depreciation and facility maintenance.*

Our total WVAS cost of revenues in 2011, 2012 and 2013 was US$50.8 million,US$52.7 million and US$43.1 million, respectively. As a percentage of our WVAS revenues, our WVAS cost of revenues in 2011, 2012 and 2013 was 63.2%,67.7% and 67.4%, respectively. In 2013, as a percentage of our WVAS cost of revenues, service fees to the telecommunications operators represented approximately 21.2%, payments to handset manufacturers represented approximately 5.3%, net transmission charges to the telecommunications operators represented approximately 2.8%, payments to content providers represented approximately 5.7%, payments to other cooperation partners represented approximately 27.1% and bandwidth leasing charges, depreciation and other facility costs represented approximately 5.3%.

Our WVAS cost of revenues decreased in 2013 primarily as a result of decreases in the servicefees we paid to our content providers and media partners in 2013. As our overall WVAS revenues decreased, the amount that we paid to telecommunications operators in service fees also decreased.

As part of our business strategy, we expect to continue to pursue more cooperation arrangements with business partners, such as handset manufacturers, because these arrangements make it easier for customers to access our products and services and are a cost-effective way to increase our market share as compared to traditional advertising. However, as we generally pay higher rates of service fees, in terms of percentages of revenues generated from cooperation arrangements, to such business partners than those paid to telecommunications operators, this strategy may result in a decrease in our gross profit margin.

Mobile Games Cost of Revenues

Our mobile games cost of revenues consists mainly of service fees and net transmission charges to the telecommunications operators, payments to content providers for the use of their content, bandwidth leasing charges and payments to mobile application platforms (such as iOS and Android distribution platforms) for the distribution of smartphone games.

Total mobile games cost of revenues in 2011, 2012 and 2013 was US$25.2 million,US$10.9 million and US$7.8 million, respectively. The decrease in mobile games cost of revenues in 2013 resulted largely from a decrease in our overall mobile games business and associated service fees paid to telecommunications operators. In 2011, we began offering subscription-based mobile games download services through our partnership with China Mobile. Based on our agreement with China Mobile, we share approximately 50% of our subscription-based revenues with China Mobile, compared to approximately 15% for single-download games. Largely as a result of the adoption by China Mobile of similar measures that have affected our WVAS business and China Mobile's de-emphasizing of its feature phone mobile games services, our mobile games cost of revenues in 2013 has decreased by 28.9% from 2012. To a lesser extent, the decrease was also due to a decrease in the payments to content providers and licensors and lower bandwidth leasing charges associated with our online mobile games. We expect our mobile games cost of revenues to remain stable in 2014. We further expect our mobile games cost of revenues to correspondingly increase as a result of higher sales of our internally developed smartphone mobile games, which we plan to distribute through digital distribution platforms, such as app stores developed by smartphone handset manufacturers. However, we expect such increase to be offset by continued decreases in the costs of distributing our mobile games through China Mobile as China Mobile continues to de-emphasize feature-phone mobile games.

We intend to develop internally the majority of our mobile games, which generally have lower cost of revenues. However, in order to expand our mobile games business and increase our market share, we also plan to actively identify quality mobile games to be acquired or licensed from third parties, which generally have higher cost of revenues.

Internet Games Cost of Revenues

Our Internet games cost of revenues consists mainly of revenue sharing paid to third party Internet game licensors, labor costs, warrant amortization, bandwidth leasing charges, depreciation and facility costs relating to equipment used to provide Internet games services. Total Internet games cost of revenues in 2011, 2012 and 2013 was US$15.9 million,US$39.5 million and US$45.5 million, respectively. As a percentage of our Internet games cost of revenues, revenue sharing paid to third party Internet game licensors accounted for 68.8%,76.9% and 86.2% in 2011, 2012 and 2013, respectively. The increase in Internet games cost of revenues in 2013 was primarily due to increases in our overall Internet games business and associated revenue sharing paid to third party Internet game licensors. We began acquiring licenses to operate Internet games from other Internet games developers in 2011, as part of our plan to grow our portfolio of licensed Internet games that complement our internally developed games. We expect our Internet games cost of revenues to increase in 2014 as we expect revenues generated from the World of Tanks game to continue to be a major driver for growing our Internet games revenues in 2014. To a lesser extent, we expect our Internet games cost of revenues to increase in 2014 as a result of the launch of certain new games that we licensed in 2013.

Operating Expenses

	For the year ended December 31,					
	2011		2012		2013	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
	(in thousands of U.S. dollars, except percentages)					
Product development	US$ 15,416.9	9.6%	US$ 18,382.4	9.9%	US$ 26,401.7	14.7%
Selling and marketing	20,891.6	13.1	24,586.0	13.2	26,674.0	14.9
General and administrative	11,582.2	7.2	11,629.3	6.2	8,976.2	5.0
Goodwill and intangible assets impairment loss	20,259.2	12.7	-	-	1,562.4	0.9
Total	US$ 68,149.9	42.6%	US$ 54,597.7	29.3%	US$ 63,614.3	35.5%

Product Development Expenses

Our product development expenses consist primarily of compensation and benefits for our product and development team. Our product development expenses in 2011, 2012 and 2013 were US$15.4 million,US$18.4 million and US$26.4 million, respectively. We expect our product development expenses to increase in 2014, as we continue to expand our offerings in mobile games and Internet games.

Sales and Marketing Expenses

Our sales and marketing expenses consist mainly of expenses associated with sponsoring promotional events and compensation and benefits for our sales, marketing and customer service teams. Our sales and marketing expenses in 2011, 2012 and 2013 were US$20.9 million, US$24.6 million and US$26.7 million, respectively. We expect our sales and marketing expenses to increase in 2014, as we plan to continue to promote our Internet and mobile games and to launch several licensed Internet games in 2014.

General and Administrative Expense

Our general and administrative expenses consist primarily of compensation and benefits for general management, finance and administrative personnel, professional fees and other office expenses. Our general and administrative expenses in 2011, 2012 and 2013 were US$11.6 million, US$11.6 million and US$9.0 million, respectively. We expect our general and administrative expenses to increase if our business grows in future periods as we may also incur more expenses relating to employee compensation and other administrative and professional fees.

Impairment of Goodwill and Intangibles

In 2011, we experienced significant fluctuations in the prices of our ADSs, which resulted in our market capitalization falling below our book value during certain periods of the year and made it necessary for us to perform an impairment review of our business units. In the third quarter of 2011, we performed a goodwill impairment test and found that the goodwill and our intangible assets of our WVAS unit were impaired, resulting in a total impairment charge of US$20.3 million and US$4,000, respectively. In the annual goodwill impairment test conducted in December 2012 and 2013, the fair value of each reporting unit substantially exceeded its carrying value. As a result, no goodwill impairment was recorded in 2012 or 2013.

As a result of the expected cessation of one game in 2013, the carrying amount of the corresponding game license exceeded the sum of undiscounted future cash flows expected to be generated from the use and eventual disposition of such license. Accordingly, the Company recognized an impairment loss of US$1.56 million in 2013.

Results of Operations

The following table sets forth certain data from our consolidated results of operations for the periods indicated. This information should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this annual report.

	For the year ended December 31,					
	2011		2012		2013	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
	(in thousands of U.S. dollars, except percentages)					
Revenues						
WVAS	$80,265.9	50.2%	$77,765.5	41.7%	$63,922.2	35.6%
Mobile games	40,850.5	25.5	21,190.3	11.4	17,069.0	9.5
Internet games	38,892.0	24.3	87,423.9	46.9	98,449.2	54.9
Total revenues	160,008.4	100.0%	186,379.7	100.0%	179,440.4	100.0%
Sales tax						
WVAS	(1,390.9)	(0.9)%	(1,053.2)	(0.6)%	(969.0)	(0.5)%
Mobile games	(621.1)	(0.4)	(219.3)	(0.1)	(160.7)	(0.1)
Internet games	(1,815.8)	(1.1)	(4,521.1)	(2.4)	(4,656.9)	(2.6)
Total sales tax	(3,827.8)	(2.4)%	(5,793.6)	(3.1)%	(5,786.6)	(3.2)%
Net revenues						
WVAS	78,875.0	49.3%	76,712.3	41.1%	62,953.2	35.1%
Mobile games	40,229.4	25.1	20,971.0	11.3	16,908.3	9.4
Internet games	37,076.2	23.2	82,902.8	44.5	93,792.3	52.3
Total net revenues	156,180.6	97.6%	180,586.1	96.9%	173,653.8	96.8%
Cost of revenues						
WVAS	(50,758.6)	(31.7)%	(52,655.5)	(28.2)%	(43,085.2)	(24.0)%
Mobile games	(25,248.0)	(15.8)	(10,935.0)	(5.9)	(7,780.3)	(4.3)
Internet games	(15,923.6)	(10.0)	(39,539.8)	(21.2)	(45,534.4)	(25.4)
Total cost of revenues	(91,930.2)	(57.5)%	(103,130.3)	(55.3)%	(96,399.9)	(53.7)%
Gross profit						
WVAS	28,116.4	17.6%	24,056.8	12.9%	19,868.0	11.1%
Mobile games	14,981.4	9.4	10,036.0	5.4	9,128.0	5.1
Internet games	21,152.6	13.2	43,363.0	23.3	48,257.9	26.9
Total gross profit	64,250.4	40.2%	77,455.8	41.6%	77,253.9	43.1%
Operating expenses:						
Product development	(15,416.9)	(9.6)%	(18,382.4)	(9.9)%	(26,401.7)	(14.7)%
Selling and marketing	(20,891.6)	(13.1)	(24,586.0)	(13.2)	(26,674.0)	(14.9)
General and administrative	(11,582.2)	(7.2)	(11,629.3)	(6.2)	(8,976.2)	(5.0)
Impairment loss on goodwill	(20,255.3)	(12.7)	—	—	—	—
Impairment loss on intangible assets	(3.9)	—	—	—	(1,562.4)	(0.9)
Total operating expenses	(68,149.9)	(42.6)%	(54,597.7)	(29.3)%	(63,614.3)	(35.5)%
Change in fair value of contingent consideration for business acquisition	(3,729.5)	(2.3)	—	—	—	—
Government subsidies	319.2	0.2	301.4	0.2	2,176.4	1.2
Income (loss) from operations	(7,309.8)	(4.5)%	23,159.5	12.4%	15,816.0	8.8%
Interest income	$3,569.2	2.2	$5,231.3	2.8	$6,764.0	3.7
Interest income from loans to third party	1,193.2	0.7	453.6	0.2	—	—
Interest expense	(487.8)	(0.3)	(262.7)	(0.1)	(693.3)	(0.4)
Impairment loss on cost method investment	—	—	—	—	(2,000.0)	(1.1)
Impairment loss on Intangible assets	—	—	—	—	—	—
Loss on extinguishment of debt upon prepayment of convertible senior note	(1,567.5)	(1.0)	—	—	—	—
Exchange gain	—	—	387.6	0.2%	1,487.3	0.8%
Investment income	85.6	0.1	261.5	0.1	—	—
Net income (loss) before income taxes	(4,517.1)	(2.8)%	29,230.8	15.7%	21,374.0	11.9%
Income taxes expense	(3,137.8)	(2.0)	(3,490.8)	(1.9)	(712.4)	(0.4)
Net income (loss)	$ (7,654.9)	(4.8)%	$25,740.0	13.8%	$20,661.6	11.5%

Year ended December 31, 2013 compared to year ended December 31, 2012

Revenues. Our total revenues decreased by 3.7% to US$179.4 million in 2013 from US$186.4 million in 2012. This decrease was primarily due to a decrease in revenues generated from our WVAS and mobile games businesses.

Our WVAS revenues decreased by 17.8% to US$63.9 million in 2013 from US$77.8 million in 2012. Revenues from our 2G services decreased by 13.4% to US$62.1 million in 2013 from US$71.7 million in 2012. Revenues from our 2.5G services decreased by 69.9% to US$1.8 million in 2013 from US$6.1 million in 2012. The decrease was mainly due to policies implemented by the PRC telecommunications operators since late 2010, including those policies which resulted in the suspension of billing on WAP and G+ mobile games by China Mobile and other PRC telecommunications operators on behalf of third party service providers of such services.

Our mobile games revenues decreased by 19.4% to US$17.1 million in 2013 from US$21.2 million in 2012. This decrease was mainly due to the adoption by China Mobile of measures similar to those that have affected our WVAS business, as described above, and China Mobile's decision to de-emphasize its subscription-based mobile games download services. In addition, the decrease in our mobile games revenues was also attributable to an overall shift in the tastes and preferences of consumers in China from traditional feature phone mobile games, which are mainly Java-based, to mobile games that are developed for smartphone platforms, such as iOS and Android mobile games. Also, as we restructured our smartphone game development team in the first half of 2013, new smartphone games were only launched during the second half of 2013, which contributed to the decrease in revenues from smartphone games in 2013.

Our Internet games revenues increased 12.6% to US$98.4 million in 2013 from US$87.4 million in 2012. This increase was driven largely by significant growth in revenues generated from the operation of our massive multiplayer online game, the World of Tanks game, in the PRC, which saw an increase in sales of in-game items purchased by the World of Tanks game players. Our Internet games revenues are primarily derived from Internet games operation revenues and licensing revenues. We earn Internet games operation revenues through the provision of Internet games services to players under an item-based revenue model, whereby players are able to play the Internet games free of charge for an unlimited amount of time, but are charged for purchasing in-game items, such as in-game performance-enhancing items, mechanised vehicles, clothing, accessories and pets. Our Internet games licensing revenues decreased by 66.8% from US$2.4 million in 2012 to US$0.8 million in 2013. Revenues generated within the PRC increased to US$96.0 million in 2013 from US$82.2 million in 2012, representing approximately 97.5% and 94.0% of our total Internet games revenues in 2013 and 2012, respectively. This increase was primarily attributable to increases in transaction volumes from sales of in-game items of the World of Tanks game. The portion of our Internet games revenues derived outside the PRC includes both license fees and revenue share generated from the operation of our self-developed games by third party publishing partners. Revenues generated outside the PRC decreased by 52.5% to US$2.5 million in 2013 from US$5.2 million in 2012, representing approximately 2.5% and 6.0% of our Internet games revenues in 2013 and 2012, respectively.

Sales Tax. Our total sales tax decreased by 0.1% to US$5.787 million in 2013 from US$5.794 million in 2012.

Our WVAS sales tax decreased by 8.0% to US$1.0 million in 2013 from US$1.1 million in 2012, mainly due to a decrease in the volume of our WVAS business.

Our mobile games sales tax decreased by 26.7% to US$0.161 million in 2013 from US$0.219million in 2012, principally due to a decrease in the volume of our mobile games business.

Our Internet games sales tax increased by 3.0% to US$4.7 million in 2013 from US$4.5 million in 2012, primarily due to an increase in the volume of our Internet games business, which was partially offset as we began to pay value-added taxes instead of business taxes on our Internet games revenues pursuant to the change of tax policies by the PRC tax authority.

Cost of Revenues. Our total cost of revenues decreased by 6.5% to US$96.4 million in 2013 from US$103.1 million in 2012, representing 53.7% and 55.3% of our total revenues in 2013 and 2012, respectively. This decrease was largely due to a decrease in the volume of our WVAS businessand mobile games business and associated service fees we paid to our content providers, media partners and telecommunications operators, which was partially offset by an increase in the Internet games cost of revenues.

Our WVAS cost of revenues decreased by 18.2% to US$43.1 million in 2013 from US$52.7 million in 2012, representing 67.4% and 67.7% of our WVAS revenues in 2013 and 2012, respectively.

Our mobile games cost of revenues decreased by 28.8% to US$7.8 million in 2013 from US$10.9 million in 2012, representing 45.6% and 51.6% of our mobile games revenues in 2013 and 2012, respectively. The decrease in our mobile games cost of revenues was primarily due to decreases in service fees and net transmission charges paid to the telecommunications operators, as a result of decreases in our overall mobile games business. To a lesser extent, the decrease in our mobile games cost of revenues was also due to increasing contribution of our lower cost self-developed smartphone games, which we launch on iOS and Android platforms. Smartphone games, unlike feature phone games, incur service fees on iOS and Android distribution platforms which are generally less than those charges paid to the telecommunications operators as a percentage of revenues.

Our Internet games cost of revenues increased by 15.2% to US$45.5 million in 2013 from US$39.5 million in 2012, representing 46.3% and 45.2% of our Internet games revenues in 2013 and 2012, respectively. The increase in our Internet games revenues was primarily due to the increase in shared revenues paid to third party Internet games licensors, largely as a result of increases in the volume of our Internet games business. In particular, the increase in shared revenues paid to third party Internet games licensors was primarily due to increases in shared revenues relating to the World of Tanks game.

Gross Profit and Gross Margin. Our total gross profit decreased by 0.3% to US$77.3 million in 2013 from US$77.5 million in 2012, mainly due to the decrease in the volume of our WVAS and mobile games businesses, which was partially offset by the increases in the volume of our Internet games business. Our gross margin increased to 43.1% in 2013 from 41.6% in 2012.

Our WVAS gross profit decreased by 17.4% to US$20.0 million in 2013 from US$24.1 million in 2012, primarily due to the decrease in our WVAS revenues relative to the decrease in our WVAS cost of revenues. Our WVAS gross profit margin increased to 31.1% in 2013 from 30.9% in 2012.

Our mobile games gross profit decreased by 9.0% to US$9.1 million in 2013 from US$10.0 million in 2012, largely due to decreases in the volume of our mobile games business, as a result of the adoption by China Mobile of measures similar to those that have affected our WVAS business, as described above, and China Mobile's decision to de-emphasize its subscription-based mobile games download services. Our mobile games gross margin increased to 53.5% in 2013 from 47.4% in 2012, primarily due to the growth of our self-developed smartphone games.

Our Internet games gross profit increased by 11.3% to US$48.3 million in 2013 from US$43.4 million in 2012, largely due to increases in the volume of our Internet games business, driven by increases in sales from in-game item purchases made by the World of Tanks game players and our successful operation of the World of Tanks game. Our Internet games gross margin decreased to 49.0% in 2013 from 49.6% in 2012, principally as a result of increases in shared revenues relating to the World of Tanks game, and decreases in the revenues of our self-developed Internet games.

Operating Expenses. Our operating expenses increased by 16.5% to US$63.6 million in 2013 from US$54.6 million in 2012, representing 35.5% and 29.3% of our total revenues in 2013 and 2012, respectively.

Our product development expenses increased by 43.6% to US$26.4 million in 2013 from US$18.4 million in 2012, representing 14.7% and 9.9% of our total revenues in 2013 and 2012, respectively. The increase in our product and development expenses was primarily due to increased software development expense and increases in the number of our product development employees, which increased to 747 as of December 31, 2013 from 698 as of December 31, 2012.

Our sales and marketing expenses increased by 8.5% to US$26.7 million in 2013 from US$24.6 million in 2012, representing 14.9% and 13.2% of our total revenues in 2013 and 2012, respectively. The increase in our sales and marketing expenses was mainly due to increased sales and marketing activity associated with our Internet games and mobile games operated on smartphones.

Our general and administrative expenses decreased by 22.8% to US$9.0 million in 2013 from US$11.7 million in 2012, representing 5.0% and 6.2% of our total revenues in 2013 and 2012, respectively. The decrease in our general and administrative expenses was primarily due to our share options granted to general and administrative employees being mostly vested in 2012, leading to a decrease in our share based compensation expenses in 2013.

Income Tax. Our income tax decreased to US$0.7 million in 2013 from US$3.5 million in 2012, primarily reflecting the decrease in our taxable income.

Net income. As a result of the foregoing, we had net income of US$20.7 million in 2013 compared to a net income of US$25.7 million in 2012.

Liquidity and Capital Resources

Cash Flows and Working Capital

The following table sets forth our cash flows with respect to operating, investing and financing activities for the periods indicated.

	For the year ended December 31,		
	2011	2012	2013
	(in thousands of U.S. dollars)		
Net cash provided by operating activities	US$33,433.8	US$46,655.9	US$35,729.5
Net cash used in investing activities	40,284.8	41,206.8	43,944.6
Net cash used in financing activities	26,335.0	14,313.0	(8,956.8)
Effect of exchange rate changes	5,526.7	47.1	1,991.3
Net (decrease) increase in cash and cash equivalents	(27,659.3)	(8,816.8)	2,733.0
Cash and cash equivalents, beginning of year	157,170.8	129,511.5	120,694.7
Cash and cash equivalents, end of year	US$129,511.5	US$120,694.7	US$123,427.7

Our primary source of liquidity is cash flow from operating activities. As of December 31, 2012 and December 31, 2013, our cash and cash equivalents were US$120.7 million and US$123.4 million, respectively.

We do not bill or collect payment from users of our WVAS and mobile games directly, but instead depend on the billing systems and records of China Mobile and other PRC telecommunications operators to record the volume of such services provided, charge our customers, collect payments and remit payments to us less transmission fees and service fees. If China Mobile or any other PRC telecommunications operator ceases to continue cooperating with us, we would have to explore further cooperation with other telecommunications service providers and/or explore alternative billing systems to collect payments from customers.

Net cash provided by operating activities decreased to US$35.7 million in 2013 from US$46.7 million in 2012. This decrease was primarily due to a decrease in cash provided by our WVAS and mobile games business. Net cash provided by operating activities increased to US$46.7 million in 2012 from US$33.4 million in 2011. This increase was primarily due to an increase in cash provided by our Internet games business.

Net cash used in investing activities increased to US$43.9 million in 2013 from US$41.2 million in 2012. This increase was primarily due to an increase of US$33.0 million in the purchase of held-to-maturities securities and an increase of US$4.1 million in term deposits, which was offset by a deposit of RMB225 million, or US$35.5 million, that we made with the Bank of Communications to guarantee a standby letter of credit in connction with our licensing of Guild Wars2 from ArenaNet in 2012. Net cash used in investing activities increased to US$41.2 million in 2012 from US$40.3 million in 2011. This increase was mainly due to a deposit of RMB225 million, or US$35.5 million, that we made with the Bank of Communications to guarantee a standby letter of credit in connection with our licensing of Guild Wars 2 from ArenaNet, which is offset by the repaymentin 2012 of a loan of RMB139.8 million, or US$22.2 million, at an interest rate of 6.39% per annum, that we made to Chengdu Jinhua Tianchuang Investment Co., Ltd in 2011.

Net cash provided by financing activities was US$9.0 million in 2013, compared to net cash of US$14.3 million used in financing activities in 2012. The increase of net cash provided by financing activities was primarily due to proceeds of US$27.8 million from exercise of warrants by NGP, FitRun and Wargaming, respectively. In September 2013, each of NGP and FitRun exercised a warrant to purchase 40 million of our ordinary shares at a purchase price of US$0.125 per share. In May 2013, Wargaming exercised a warrant to purchase 120 million of our ordinary shares at a purchase price of US$0.1485 per share. Net cash used in financing activities was US$14.3 million in 2012, compared to US$26.3 million used in financing activities in 2011. The decrease was primarily due to the payment of the deferred consideration of US$14.6 million for the acquisition of Dacheng in March 2011, and prepayment of the convertible senior note of US$9.3 million held by NGP in February 2011, which was partially offset by an increase of US$11.9 million for our share repurchase program in 2012 as compared to 2011.

We believe that our current cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated cash needs, including for working capital purposes, capital expenditures and various contractual obligations, for at least the next 12 months. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these sources are insufficient to satisfy our cash requirements, we may seek to sell additional debt securities or equity or to obtain a credit facility. The sale of additional convertible debt securities or equity securities could result in additional dilution to holders of our ordinary shares and ADSs. The incurrence of indebtedness would result in incurring debt service obligations, which could result in operating and financial covenants that would restrict our operations. We currently do not have any lines of credit or loans with any commercial banks. As a result, we are unlikely to rely on any bank loans to meet our liquidity needs. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

We are a holding company with no operations of our own. Our operations are conducted through Beijing AirInbox, Beijing WINT, BJXR, Beijing Chengxitong, Mailifang, Xinreli and Dacheng and their subsidiaries in the PRC. In 2013, our consolidated variable interest entities accounted for an aggregate of 97.4% of our total revenue. As of December 31, 2013, our consolidated variable interest entities accounted for an aggregate of 62.0% of our total assets and 88.6% of our total liabilities. The assets not associated with our consolidated variable interest entities primarily consist of cash and cash equivalents, goodwill, intangible assets and loans to third parties.

Capital Expenditures

Our total capital expenditures in 2011, 2012 and 2013 were US$1.9 million, US$14.6 million and US$13.1 million, respectively. The decrease in capital expenditure in 2013 from 2012 was primarily due to a decrease in the purchase of intangible assets in 2013. The increase in capital expenditure in 2012 from 2011 was primarily due to our payment of license fees to ArenaNet. We did not have any material commitment for capital expenditures as of December 31, 2013. We currently do not have any material capital expenditures in progress.

Our capital expenditures are spent primarily on license fees, servers, computers, office equipment, leasehold improvement and vehicles. In general, there is a positive correlation between our revenues and the amount of traffic that passes through our servers and transmission equipment. From time to time we need to purchase additional servers and transmission equipment as a result of increased business traffic. Our purchase of personal computers is primarily driven by headcount increases.

As the telecommunications operators do not provide us with detailed revenue breakdown on a service-by-service basis, we depend on our internal database system to monitor revenues derived from each of our services that are delivered through the telecommunications operators. We make our business decisions based on our internal data, taking into account other factors, including strategic considerations.

Management Team

Directors and Senior Officers

Leilei Wang, 41, has served as the Chairman of the Board of Directors of our company and our Chief Executive Officer since October 2008. His current term expires in 2013. Mr. Wang was the chief executive officer of TOM Online from September 2003 to September 2008. Between 1999, when Mr. Wang joined TOM Group Limited, or TOM Group, TOM Online's parent company, and 2003, Mr. Wang held various management positions within TOM Group. Mr. Wang graduated in 1996 from the Electronic Engineering Department of Tsinghua University with a bachelor's degree in Electronic Technology and Information.

Jay Chang, 42, has served as the Chief Financial Officer of our company since February 2009 and has been a Director of our company since July 2010. His current term expires in 2014. Before joining our company, Mr. Chang was the president and chief financial officer of 56.com, a leading online video provider in the PRC. Before that, he was the chief financial officer of TOM Online for over two years. Prior to TOM Online, for nearly six years, Mr. Chang was the director of equity research at Credit Suisse, responsible for covering the Internet and telecommunications sectors in the PRC. Mr. Chang graduated in 1994 from the University of Washington with a bachelor's degree in Electrical Engineering.

Xiaoxin Chen, 41, has been an Independent Director of our company since September 2008. His current term expires in 2015. Mr. Chen has been a managing partner of Zeniphs China Capital, a private equity fund, since late 2007. Before joining the fund, Mr. Chen was the chief financial officer of Oak Pacific Interactive, later renamed Renren Inc., a leading social networking service provider in China. Before joining Renren Inc., Mr. Chen was an investment banker at Citigroup Hong Kong. Mr. Chen was an independent director of Abax Global Capital (Hong Kong) Ltd. until June 2011. Mr. Chen was also an independent director of Prosten Technology Holdings Ltd., a Hong Kong Stock Exchange Growth Enterprise Market-listed company, until December 2013. Mr. Chen graduated at the top of his class and received his bachelor's degree in Operations Research and Industrial Engineering (summa cum laude) from Cornell University. He received his MBA degree from Stanford Graduate School of Business and was a recipient of the 2000 Arjay Miller Scholar Award upon graduation.

Hope Ni, 41, has been an Independent Director of our company since January 2007. Her current term expires in 2015. Ms. Ni has been the chairman of the board of directors of Inspire Capital, an investment and consulting company, since May 2008. Until January 2008, Ms. Ni served as the chief financial officer and director for Cogo Group, Inc., a NASDAQ-listed company and a technology service provider in the PRC, which she joined in August 2004. Prior to joining Cogo, Ms. Ni spent six years as a practicing attorney at Skadden, Arps, Slate, Meagher & Flom LLP in New York and Hong Kong, specializing in corporate finance, during which she was actively involved in the initial public offerings and New York Stock Exchange/ NASDAQ listings of a number of major global PRC-based companies. Prior to that, Ms. Ni worked at Merrill Lynch's investment banking division in New York. Ms. Ni is also an independent director at Digital China Holdings Ltd., a Hong Kong-listed company; JA Solar Holdings Co., Ltd., a NASDAQ-listed company; and ATA Inc., a NASDAQ-listed company. Ms. Ni received her J.D. degree from the University of Pennsylvania Law School and her bachelor's degree in Applied Economics and Business Management from Cornell University.

Xiaolong Li, 48, has been an Independent Director of our company since December 2013. His current term expires in 2014. Mr. Li currently serves as a director of several companies, some of them in the United States. Mr. Li serves as an independent director of E-Commerce China Dangdang Inc, a company listed on the New York Stock Exchange. Mr. Li has more than 20 years of experience in the industry of information technology and telecommunications. He founded 263 Network Communication Company Limited, a company currently listed on the Shenzhen Stock Exchange, in 1999 and has been its chairman since then. Prior to that, he founded Beijing Jingxun Public Information Technology Company Limited in 1997 and served as its executive director until 1999. In 1992, he founded Beijing Haicheng Telecommunication Technology Company Limited and served as its chairman until 1997. Mr. Li attended the undergraduate program in software engineering in Beijing University of Technology.

Tai Fan, 42, has served as the Chief Investment Officer of our company since March 2009. Since August 2002, Mr. Fan has served as the vice president of the department of finance at Beijing Super Channel, a subsidiary of TOM Online, and as an executive vice president of TOM Online. Prior to joining TOM Online, Mr. Fan served as the financial controller of Xin De Telecom and was an auditor at KPMG. Mr. Fan graduated in 2003 from the State University of New Jersey, Rutgers with an EMBA and in 1994 from Beijing College of Economics with a bachelor's degree in Accounting.

Report of Independent Registered Public Accounting Firm

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF
KONGZHONG CORPORATION

We have audited the accompanying consolidated balance sheets of KongZhong Corporation, its subsidiaries and variable interest entities (collectively, the "Company") as of December 31, 2012 and 2013 and the related consolidated statements of comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of KongZhong Corporation, its subsidiaries and variable interest entities as of December 31, 2012 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 16, 2014 expressed an unqualified opinion on the Company's internal control over financial reporting.

Deloitte Touche Tohmatsu Certified Public Accountants LLP

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP
Beijing, the People's Republic of China
April 16, 2014

Deloitte.
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REPORT OF INDEPENDENCE REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF
KONGZHONG CORPORATION

We have audited the internal control over financial reporting of KongZhong Corporation, its subsidiaries and variable interest entities (collectively, the "Company") as of December 31, 2013, based on the criteria established in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2013 of the Company, and our report dated April 16, 2014, expressed an unqualified opinion on those financial statements.

Deloitte Touche Tohmatsu Certified Public Accountants LLP

Deloitte Touche Tohmatsu Certified Public Accountants LLP
Beijing, the People's Republic of China
April 16, 2014

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (In US dollars)

	For the years ended December 31,		
	2011	2012	2013
Revenues	$160,008,435	$186,379,708	$179,440,410
Sales tax	(3,827,823)	(5,793,557)	(5,786,615)
Net revenues	156,180,612	180,586,151	173,653,795
Cost of revenues (including impairment on intangible assets of $nil, $nil and $250,553 for 2011, 2012 and 2013, respectively)	(91,930,241)	(103,130,272)	(96,399,886)
Gross profit	64,250,371	77,455,879	77,253,909
Operating expenses			
Product development (including share-based compensation expense of $614,780, $468,232 and $305,385 for 2011, 2012 and 2013, respectively)	(15,416,944)	(18,382,383)	(26,401,720)
Selling and marketing (including share-based compensation expense of $121,623, $227,804 and $111,198 for 2011, 2012 and 2013, respectively)	(20,891,615)	(24,586,039)	(26,674,024)
General and administrative (including share-based compensation expense of $3,843,119, $3,768,461 and $1,157,146 for 2011, 2012 and 2013, respectively)	(11,582,200)	(11,629,273)	(8,976,176)
Impairment loss on goodwill	(20,255,242)	-	-
Impairment loss on intangible assets	(3,927)	-	(1,562,386)
Total operating expenses	(68,149,928)	(54,597,695)	(63,614,306)
Change in fair value of contingent consideration for business acquisition	(3,729,513)	-	-
Government subsidies	319,319	301,359	2,176,449
(Loss) income from operations	(7,309,751)	23,159,543	15,816,052
Interest income	3,569,175	5,231,308	6,763,938
Interest income from loans to third party	1,193,226	453,602	-
Interest expense	(487,763)	(262,758)	(693,282)
Impairment loss on cost method investment	-	-	(2,000,000)
Loss on extinguishment of debt upon prepayment of convertible senior note	(1,567,472)	-	-
Exchange gain	-	387,642	1,487,343
Investment income	85,561	261,473	-
Net (loss) income before income taxes	(4,517,024)	29,230,810	21,374,051
Income taxes expense	(3,137,838)	(3,490,842)	(712,402)
Net (loss) income	$(7,654,862)	$25,739,968	$20,661,649
Net (loss) income per share, basic	$(0.00)	$0.02	$0.01
Net income (loss) per share, diluted	$(0.00)	$0.01	$0.01
Weighted average shares used in calculating basic net (loss) income per share	1,607,110,119	1,661,864,846	1,714,924,612
Weighted average shares used in calculating diluted net (loss) income per share	1,607,110,119	1,721,622,756	1,751,621,340
Net (loss) income	$ (7,654,862)	$25,739,968	$20,661,649
Other comprehensive income			
Foreign currency translation adjustments	13,871,922	431,986	8,944,839
Comprehensive income	$6,217,060	$26,171,954	$29,606,488

CONSOLIDATED BALANCE SHEETS
(In US dollars)

	As of December 31	
	2012	2013
ASSETS		
Current assets		
Cash and cash equivalents	$120,694,716	$123,427,729
Term deposits	-	4,448,839
Held-to-maturity securities	17,465,340	51,866,479
Accounts receivables, net of allowance of $5,626 and $342,442 as of December 31, 2012 and 2013	23,699,745	17,230,844
Prepaid expenses and other current assets	4,717,674	7,762,570
Total current assets	166,577,475	204,736,461
Rental deposits	747,491	797,372
Property and equipment, net	3,065,486	5,842,522
Long-term investments	3,999,999	1,999,999
Goodwill	87,551,023	90,266,629
Acquired intangible assets, net	75,069,314	78,726,587
Restricted cash	35,773,340	36,870,739
Total assets	$372,784,128	$419,240,309
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable (including accounts payable of the consolidated variable interest entities ("VIEs") without recourse to the Company of $42,326,895 and $39,488,204 as of December 31, 2012 and 2013, respectively)	$42,612,324	$39,514,379
Accrued expenses and other current liabilities (including accrued expenses and other current liabilities of the consolidated VIEs without recourse to the Company of $9,435,188 and $15,437,141 as of December 31, 2012 and 2013, respectively)	18,276,365	19,224,723
Deferred revenue (including deferred revenue of the consolidated VIEs without recourse to the Company of $3,585,350 and $2,262,223 as of December 31, 2012 and 2013, respectively)	3,784,866	2,262,223
Income tax payable (including income tax payable of the consolidated VIEs without recourse to the Company of $143,740 and $322,714 as of December 31, 2012 and 2013, respectively)	6,556,007	6,369,482
Total current liabilities	$71,229,562	$67,370,807
Commitments and contingencies (Note 28)		
Non-current deferred tax liability (including non-current deferred tax liability of the consolidated VIEs without recourse to the Company of $10,498 and $nil as of December 31, 2012 and 2013, respectively)	10,498	-
Long-term liabilities (including long-term liabilities of the consolidated VIEs without recourse to the Company of $18,660,000 and $19,260,000 as of December 31, 2012 and 2013, respectively)	18,660,000	19,260,000
Total liabilities	$89,900,060	$86,630,807
Ordinary shares ($0.0000005 par value; 1,000,000,000,000 shares authorized, 1,678,097,663 and 1,834,883,063 shares issued and outstanding as of December 31, 2012 and 2013, respectively)	832	918
Additional paid-in capital	126,786,049	152,052,241
Warrants	15,566,332	10,419,000
Accumulated other comprehensive income	46,618,263	55,563,102
Statutory reserve	10,572,330	10,723,748
Retained earnings	83,340,262	103,850,493
Total shareholders' equity	282,884,068	332,609,502
Total liabilities and shareholders' equity	$372,784,128	$419,240,309

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In US dollars)

For the years ended December 31,			
	2011	2012	2013
Operating activities:			
Net (loss) income	$(7,654,862)	$25,739,968	$20,661,649
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	4,443,449	7,628,005	4,988,007
Loss (gain) on disposal of property and equipment	(37,099)	(6,694)	30,714
Provision of bad debt	222,007	5,626	342,442
Impairment loss on cost method investment	-	-	2,000,000
Impairment loss on goodwill	20,255,242	-	-
Impairment loss on intangible assets	3,927	-	1,812,939
Change in fair value of contingent consideration for business acquisition	3,729,513	-	-
Share-based compensation	4,579,522	4,464,497	1,573,729
Loss on extinguishment of debt upon prepayment of convertible senior note	1,567,472	-	-
Amortization of the debt discount	294,543	36,297	-
Imputed interest on long-term liabilities	-	-	600,000
Changes in operating assets and liabilities:			
Accounts receivable	2,902,691	(3,757,638)	6,723,022
Prepaid expenses and other current assets	3,748,469	(387,517)	(3,037,894)
Rental deposits	98,928	(233,859)	(29,697)
Trading securities	(8,339,291)	7,602,189	-
Accounts payable	4,780,428	(167,693)	(2,757,184)
Deferred revenue	1,347,963	(266,818)	(1,621,249)
Accrued expenses and other liabilities	760,161	2,551,298	4,513,352
Income tax payable	730,690	3,448,253	(70,320)
Net cash provided by operating activities	33,433,753	46,655,914	35,729,510
Investing activities:			
Acquisition of businesses (net of cash acquired $ nil, $586,701 and $nil for 2011, 2012, and 2013, respectively)	-	(8,413,299)	-
Purchase of intangible assets	-	(13,666,768)	(1,565,294)
Long-term investments	-	(3,999,999)	-
Loans to third party	(21,227,812)	-	-
Loan repayment from third party	-	22,190,124	-
Purchase of term deposits	-	-	(20,824,178)
Proceeds from disposal of term deposits	-	-	16,710,813
Purchase of held-to-maturity securities	(17,203,826)	(319,589,646)	(259,536,862)
Proceeds from disposal of held-to-maturity securities	-	319,293,275	226,240,067
Purchase of property and equipment	(1,890,271)	(1,516,362)	(4,969,144)
Proceeds from disposal of property and equipment	37,099	6,694	-
Restricted cash	-	(35,510,803)	-
Net cash used in investing activities	(40,284,810)	(41,206,784)	(43,944,598)
Financing activities:			
Deferred payment for acquisition of business	(14,578,427)	-	(3,000,000)
Repurchase of ordinary shares	(2,748,579)	(14,590,355)	(10,123,821)
Proceeds from exercise of employee stock options	302,075	277,309	849,038
Deferred payments for intangible assets	-	-	(6,588,420)
Proceeds from bank borrowing	-	-	9,000,000
Repayment of bank borrowing	-	-	(9,000,000)
Proceeds from exercise of warrants	-	-	27,820,000
Prepayment of convertible senior note	(9,310,000)	-	-
Net cash (used in) provided by financing activities	(26,334,931)	(14,313,046)	8,956,797
Effect of foreign exchange rate changes	5,526,757	47,102	1,991,304
Net (decrease) increase in cash and cash equivalents	(27,659,231)	(8,816,814)	2,733,013
Cash and cash equivalents, beginning of year	157,170,761	129,511,530	120,694,716
Cash and cash equivalents, end of year	$129,511,530	$120,694,716	$123,427,729
Supplemental disclosures of cash flow information			
Income taxes paid	$2,561,368	$647,839	$909,496
Interest paid	$358,632	$26,730	$93,282
Non-cash investing and financing activities:			
Warrants issued in acquisition of game licenses	-	$14,889,000	-
Consideration payable in connection with business acquisition	-	$5,880,600	-
Ordinary shares issued for business acquisitions	$29,220,543	$4,230,000	-
Consideration payable in connection with purchase of intangible assets	-	$47,172,547	$4,784,675

Note to the Consolidated Financial Statements

1.ORGANIZATION AND PRINCIPAL ACTIVITIES

KongZhong Corporation ("KongZhong") was incorporated under the laws of the Cayman Islands on May 6, 2002. KongZhong and its consolidated entities (collectively, the "Company") provide wireless interactive entertainment, media and community value-added services to customers of the telecommunications operators, mobile games services and internet games services.

As of December 31, 2013, details of the Company's significant majority-owned subsidiaries and VIEs are as follows:

Name	Incorporation or acquisition date/place	Shareholder/ nominee owner	Legal ownership %	Principal activities
Subsidiaries:				
KongZhong Information Technologies (Beijing) Co., Ltd. ("KongZhong Beijing")	July 2002 People's Republic of China ("PRC")	KongZhong	100	Providing consulting and technology services
KongZhong China Co., Ltd. ("KongZhong China")	June 2005 the PRC	KongZhong	100	Providing consulting and technology services
Simlife (Beijing) Science Co., Ltd. ("Simlife Beijing ")	June 2009 the PRC	Simlife International Inc.	100	Providing consulting and technology services
Success Blueprint Limited ("Success Blueprint")	October 2009 British Virgin Islands	KongZhong	100	Providing novel license to overseas
Dacheng Holdings Limited ("Dacheng Holdings")	January 2010 Cayman Islands	KongZhong	100	Providing internet games services
Dacheng Investment (Hong Kong) Limited ("Dacheng Hong Kong")	January 2010 Hong Kong	KongZhong	100	Providing internet games services
Noumena Innovation (BVI) Ltd. ("Noumena")	March 2012 British Virgin Islands	KongZhong	100	Providing smart mobile games services
Noumena Productions limited	March 2012 Hong Kong	Noumena	100	Providing smart mobile games services
VIEs:				
Beijing AirInbox Information Technologies Co., Ltd. ("Beijing AirInbox")	April 2002 the PRC	Linguang Wu SonglinYang Guijun Wang Zhen Huang	45 42 10 3	Providing wireless value-added services to mobile phone users
Beijing Wireless Interactive Network Technologies Co., Ltd. ("Beijing WINT")	Feburary, 2005 the PRC	Yang Yang Jingye Sun Li Ai	40 30 30	Providing wireless value-added services to mobile phone users
Beijing Chengxitong Information Technology Co., Ltd. ("Beijing Chengxitong")	November, 2005 the PRC	Yang Li Xuelei Wu	90 10	Providing wireless value-added services to mobile phone users
Beijing Xinrui Network Technology Co., Ltd. ("Beijing Xinrui")	January, 2006 the PRC	Guijun Wang Yang Li	51 49	Providing wireless value-added services to mobile phone users
Shanghai Mailifang Communication Co., Ltd. ("Shanghai Mailifang")	March, 2009 the PRC	Xu Guo Yang Yang	90 10	Providing wireless value-added services to mobile phone users
Xiamen Xinreli Technology Co., Ltd. ("Xiamen Simlife")	June 2009 the PRC	Tao Jia Junhong Chen	80 20	Providing wireless value-added services to mobile phone users
Shanghai Dacheng Network Technology Co., Ltd. ("Shanghai Dacheng")	January 2010 the PRC	Leilei Wang Zhen Yang	59 41	Providing internet games services
Subsidiaries of VIE:				
Beijing Boya Wuji Technologies Co., Ltd.	March 2004 the PRC	Beijing AirInbox	100	Providing internet games services
Tianjin Mammoth Technologies Co., Ltd. ("Tianjin Mammoth")	May, 2005 the PRC	Beijing AirInbox Beijing WINT	95 5	Mobile games developing services
Beijing Shiyuan Leya Culture Communication Co., Ltd.	July 2008 the PRC	Beijing Xinrui	100	Providing wireless value-added services to mobile phone users
Nanjing Net Book Culture Co., Ltd.,	October 2009 the PRC	Beijing Chengxitong	100	Providing internet novel services
Beijing Yin'ao Fulai Culture Development Co., Ltd.,	May 2012 the PRC	Beijing Xinrui	100	Providing wireless value-added services to mobile phone users
Beijing Shangshu Boer Culture Communication Co., Ltd.,	July 2012 the PRC	Beijing Xinrui	100	Providing wireless value-added services to mobile phone users
Shanghai KongZhong Brilliant Game Co., Ltd.	July 2012 the PRC	Beijing AirInbox	100	Providing internet games services

The VIE arrangements

PRC regulations prohibit direct foreign ownership of business entities providing value-added telecommunications services in the PRC where certain licenses are required for the provision of such services. To comply with these regulations, the Company conducts the majority of its activities through its VIEs and their subsidiaries.

The VIEs hold the requisite licenses and permits necessary to conduct the Company's value-added telecommunications business. KongZhong Beijing, KongZhong China, or Simlife Beijing (collectively, the "Foreign Owned Subsidiaries") have entered into the following contractual arrangements with Beijing AirInbox, Beijing WINT, Beijing Chengxitong, Shanghai Mailifang, Xiamen Simlife, Beijing Xinrui and Shanghai Dacheng (collectively the "VIE Companies"), that enable the Company to (1) have power to direct the activities that most significantly affects the economic performance of the VIEs, and (2) receive the economic benefits of the VIEs that could be significant to the VIEs. Accordingly, the Company is considered the primary beneficiary of the VIEs and has consolidated the VIEs' financial results of operations, assets and liabilities in the Company's consolidated financial statements.

Name of Foreign Owned Subsidiaries	Name of VIE Companies
KongZhong Beijing	Beijing AirInbox
KongZhong Beijing	Beijing WINT
KongZhong Beijing	Beijing Chengxitong
KongZhong Beijing	Shanghai Mailifang
Simlife Beijing	Xiamen Simlife
KongZhong China	Beijing Xinrui
KongZhong China	Shanghai Dacheng

In making the conclusion that the Company is the primary beneficiary of the VIE Companies, the Company believes the Company's rights under the terms of the exclusive option agreements provide it with a substantive kick out right. More specifically, the Company believes the terms of the exclusive option agreements are valid, binding and enforceable under PRC laws and regulations currently in effect. A simple majority vote of the Company's board of directors is required to pass a resolution to exercise the Company's rights under the exclusive option agreements, for which consent of the shareholders of VIE Companies is not required. The Company's rights under the exclusive option agreements give the Company the power to control the shareholders of VIE Companies and thus the power to direct the activities that most significantly impact the VIE Companies' economic performance. In addition, the Company's rights under the powers of attorney also reinforce the Company's abilities to direct the activities that most significantly impact the VIE Companies' economic performance. The Company also believes that this ability to exercise control ensures that the VIE Companies will continue to execute and renew services agreements and pay service fees to the Company. The technical and consulting services agreements are automatically renewed and may only be terminated at the Company's sole discretion. The Company has the sole discretion to determine the amounts of the technical and consulting service fees. As a result, the Company believes that it has the rights to receive substantially all of the economic benefits from the VIE Companies.

•Agreements that provide the Foreign Owned Subsidiaries effective control over the VIE Companies

Business operation agreement The Foreign Owned Subsidiaries have entered into business operation agreements with the VIE Companies and their respective shareholders, respectively. Pursuant to these agreements, the VIE companies and their respective shareholders agreed to appoint individuals designated by the Foreign Owned Subsidiaries to the management team of the VIE Companies and to refrain from taking certain actions that may materially affect these VIE Companies' operations.

The business operation agreements of Beijing AirInbox and Xiamen Simlife will expire in 2016 and 2019, respectively. The business operation agreement of Beijing AirInbox will be automatically extended for another ten years unless KongZhong Beijing writes to terminate the agreement three months before the expiration of the agreement. The business operation agreement of Xiamen Simlife could be extended upon the requirements of Simlife Beijing. The business operation agreements of the remaining VIEs do not contain any expiration date. The termination of the agreements requires thirty day written notice from the Foreign Owned Subsidiaries. The VIEs have no authority to terminate the business operation agreements.

Power of attorney. Each of the shareholders of the VIE Companies has also executed an irrevocable power of attorney in favor of individuals designated by the Foreign Owned Subsidiaries. Pursuant to these powers of attorney, those designated individuals have full power and authority to exercise all of such shareholders' rights with respect to their equity interests in the VIE Companies. The power of attorney has no expiration date.

Exclusive option agreement Each of the VIE Companies and their respective shareholders have also entered into an exclusive share option agreement with the respective Foreign Owned Subsidiaries. Pursuant to these agreements, each of the shareholders of the VIE Companies has granted an exclusive option to the Foreign Owned Subsidiaries or their designees to purchase all or part of such shareholder's equity interest in the VIE Companies, at a purchase price equal to the respective capital of the VIE companies or a price required under PRC laws at the time of such purchase.

Equity pledge agreement Each of the shareholders of the VIE Companies has also entered into an equity pledge agreement with the respective Foreign Owned Subsidiaries, pursuant to which these shareholders pledged their respective interests in the VIE Companies to guarantee the performance of such VIE Companies' payment obligations under the respective exclusive technical and consulting services agreements.

•Agreements that transfer economic benefits to the Foreign Owned Subsidiaries

Exclusive technical and consulting services agreement The Foreign Owned Subsidiaries have entered into exclusive technical and consulting services agreements with the VIE Companies, respectively. Pursuant to these technical and consulting services agreements, the Foreign Owned Subsidiaries provide certain technical and consulting services to the VIE Companies in exchange for service fees. The Foreign Owned Subsidiaries have the sole discretion to determine the amounts of the technical and consulting services fee.

The exclusive technical and consulting services agreements of Beijing AirInbox, Shanghai Mailifang, Beijing Xinrui and Shanghai Dacheng will expire in 2014, 2019, 2019 and 2020, respectively. The exclusive technical and consulting services agreements of these VIEs will be automatically extended for another ten years unless the relevant Foreign Owned Subsidiaries write to terminate the agreements three months before the expiration of the agreements. The technical and consulting services agreements of the remaining VIEs do not contain any expiration provision.

The agreements may be terminated only at the option of the Foreign Owned Subsidiaries and the VIEs have no authority to terminate the exclusive technical and consulting services agreements.

Risks in relation to the VIE structure

The Company believes that the contractual arrangements with VIE Companies and their subsidiaries and their current shareholders are in compliance with PRC laws and regulations and are legally enforceable. However, uncertainties in the PRC legal system could limit the Company’s ability to enforce the contractual arrangements. If the legal structure and contractual arrangements were found to be in violation of PRC laws and regulations, the PRC government could:

•Revoke the business and operating licenses of the Foreign Owned Subsidiaries, VIE Companies and their subsidiaries;
•Discontinue or restrict the operations of any related-party transactions among the Foreign Owned Subsidiaries, VIE Companies and their subsidiaries;
•Impose fines or other requirements on the Foreign Owned Subsidiaries, VIE Companies and their subsidiaries;
•Require the Company or Foreign Owned Subsidiaries, VIE Companies and their subsidiaries to revise the relevant ownership structure or restructure operations; and/or
•Restrict or prohibit the Company’s use of the proceeds of the additional public offering to finance the Company’s business and operations in China.

The Company’s ability to conduct its business may be negatively affected if the PRC government were to carry out of any of the aforementioned actions. As a result, the Company may not be able to consolidate VIE Companies and their subsidiaries in its consolidated financial statements as it may lose the ability to exert effective control over VIE Companies and their subsidiaries and their shareholder, and it may lose the ability to receive economic benefits from VIE Companies and their subsidiaries.

The interests of the shareholders of the VIE Companies may diverge from that of the Company and that may potentially increase the risk that they would seek to act contrary to the contractual terms, for example by influencing the VIE Companies not to pay the service fees when required to do so. The Company cannot assure that when conflicts of interest arise, shareholders of the VIE Companies will act in the best interests of the Company or that conflicts of interests will be resolved in the Company’s favor. Currently, the Company does not have existing arrangements to address potential conflicts of interest the shareholders of VIE Companies may encounter in their capacity as beneficial owners and directors of VIE Companies, on the one hand, and as beneficial owners and directors of the Company, on the other hand. The Company believes the shareholders of VIE Companies will not act contrary to any of the contractual arrangements and the exclusive option agreements provide the Company with a mechanism to remove the current shareholders of VIE Companies should they act to the detriment of the Company. The Company relies on certain current shareholders of VIE Companies, as directors and executive officers of the Company, to fulfill their fiduciary duties and abide by laws of the PRC and Cayman Islands and act in the best interest of the Company. If the Company cannot resolve any conflicts of interest or disputes between the Company and the shareholders of VIE Companies, the Company would have to rely on legal proceedings, which could result in disruption of its business, and there is substantial uncertainty as to the outcome of any such legal proceedings.

The Company's ability to control the VIE Companies also depends on the powers of attorney the Foreign Owned Subsidiaries have to vote on all matters requiring shareholder approvals in the VIE Companies. As noted above, the Company believes the powers of attorney are legally enforceable but may not be as effective as direct equity ownership.

The following financial statement amounts and balances of KongZhong's VIEs were included in the accompanying consolidated financial statements:

As of December 31,		
	2012	2013
Total current assets	$123,346,361	$140,476,592
Total assets	$217,772,519	$259,746,443
Total current liabilities	$55,491,173	$57,510,282
Total liabilities	$74,161,671	$76,770,282

For the years ended December 31,			
	2011	2012	2013
Gross revenues	$154,828,573	$177,868,368	$174,775,692
Net income	$22,628,312	$28,331,383	$16,439,680

For the years ended December 31,			
	2011	2012	2013
Net cash provided by operating activities	$29,159,789	$43,021,136	$28,830,017
Net cash (used in) investing activities	$(16,777,374)	$(53,172,297)	$(38,188,141)
Net cash (used in) financing activities	$-	$-	$(6,588,420)

The VIEs contributed an aggregate of 96.8%, 95.4% and 97.4% of the consolidated gross revenues for the year ended December 31, 2011, 2012 and 2013, respectively. The Company's operations not conducted through contractual arrangements with the VIEs primarily consist of its smartphone business. As of December 31, 2012 and 2013, the VIEs accounted for an aggregate of 58.4% and 62.0%, respectively, of the consolidated total assets, and 82.5% and 88.6%, respectively, of the consolidated total liabilities. The assets not associated with the VIEs primarily consist of cash and cash equivalents, goodwill and intangible assets.

There are no consolidated VIEs' assets that are collateral for the VIEs' obligations and can only be used to settle the VIEs' obligations. There are no creditors (or beneficial interest holders) of the VIEs that have recourse to the general credit of the Company or any of its consolidated subsidiaries. There are no terms in any arrangements, considering both explicit arrangements and implicit variable interests, that require the Company or its subsidiaries to provide financial support to the VIEs. However, if the VIEs ever needs financial support, the Company or each of its subsidiaries may, at its option and subject to statutory limits and restrictions, provide financial support to its VIEs through loans to the shareholders of the VIEs or entrustment loans to the VIEs.

Relevant PRC laws and regulations restrict the VIEs from transferring a portion of their net assets, equivalent to the balance of their statutory reserve and their share capital, to the Company in the form of loans and advances or cash dividends. Please refer to Note 29 for disclosure of restricted net assets.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

Basis of consolidation

The consolidated financial statements include the financial statements of the Company, its wholly-owned subsidiaries, and its VIEs. All inter-company transactions and balances have been eliminated upon consolidation.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty

Term deposits

The balance represents the Company's investments in time deposits with financial institutions with remaining maturities of greater than three months when purchased.

Restricted cash

Restricted cash is related to deposits with financial institutions as guarantees to issue standby letters of credit and is restricted as to withdrawal or usage.

Fair value

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

Authoritative literature provides a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement as follows:

Level 1

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The Company measures certain assets, including the cost method investments, at fair value on a nonrecurring basis when they are deemed to be other-than-temporarily impaired. The fair values of these investments are determined based on valuation techniques using the best information available, and may include management judgments, future performance projections, etc. An impairment charge is recorded when the cost of the investment exceeds its fair value and this condition is determined to be other-than-temporary.

Fair value of acquired assets is discussed in Note 3.

Short-term investments

Short-term investments comprise debt and equity securities, which are classified as held-to-maturity securities. Short-term investments are classified as held-to-maturity securities when the Company has the positive intent and ability to hold the securities to maturity. All of the Company's held-to-maturity securities are classified as current assets on the consolidated balance sheets based on their contractual maturity dates which are less than one year and are stated at their amortized costs.

The Company reviews its short-term investments for other-than-temporary impairment based on the specific identification method. The Company considers available quantitative and qualitative evidence in evaluating potential impairment of its short-term investments. If the cost of an investment exceeds the investment's fair value, the Company considers, among other factors, general market conditions, government economic plans, the duration and the extent to which the fair value of the investment is less than the cost, and the Company's intent and ability to hold the investment, in determining if impairment is needed.

Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses in the financial statements and accompanying notes. Significant accounting estimates reflected in the Company's financial statements include impairment of goodwill and other intangible assets, purchase price allocation in business combinations, accruals for revenues, valuation of warrants, valuation allowance for deferred tax assets, and share-based compensation expense. Actual results could differ from those estimates.

Property and equipment, net

Property and equipment are carried at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

Computer and transmission equipment	3 years
Furniture and office equipment	3 years
Motor vehicles	3 years
Leasehold improvements	Over the shorter of the lease term or useful lives
Communication equipment	1 year
Office building	20 years

Acquired intangible assets (other than indefinite lived intangible assets), net

Acquired intangible assets, other than indefinite lived intangible assets, are carried at cost less accumulated amortization and impairment. The amortization of such acquired intangible assets is recognized over the expected useful lives of the assets.

Impairment of long-lived assets

Long-lived assets and certain identifiable intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Company measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets, the Company would recognize an impairment loss based on the fair value of the assets.

Business Combinations

Business combinations are recorded using the acquisition method of accounting. The assets acquired, the liabilities assumed, and any noncontrolling interest of the acquiree at the acquisition date, if any, are measured at their fair values as of that date. Goodwill is recognized and measured as the excess of the total consideration transferred plus the fair value of any noncontrolling interest of the acquiree, if any, at the acquisition date over the fair values of the identifiable net assets acquired. Common forms of the consideration made in acquisitions include cash and common equity instruments. Consideration transferred in a business acquisition is measured at the fair value as at the date of acquisition. For shares issued in a business combination, the Company has estimated the fair value as of the date of acquisition.

Where the consideration in an acquisition the payment of which depends on the achievement of certain specified conditions post-acquisition is recognized and measured at its fair value at the acquisition date and if recorded as a liability it is subsequently carried at fair value with changes in fair value reflected in earnings.

Goodwill and indefinite-lived intangible assets

The excess of the purchase price over the fair value of net assets acquired is recorded on the consolidated balance sheets as goodwill. Goodwill is not amortized but is evaluated by the Company at least annually (at December 31) for impairment following a two-step process.

The first step compares the fair value of each reporting unit (operating segment or one level below an operating segment) to its carrying amount, including goodwill. As of December 31, 2012 and 2013, there were three reporting units, wireless value-added services ("WVAS"), mobile games and internet games. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of the affected reporting unit's goodwill to the carrying value of that goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. The impairment losses of $20.3 million, $nil and $nil were recorded for the years ended December 31, 2011, 2012 and 2013, respectively (see Note 11).

The Company has determined that the Company's trademarks do not have determinable useful lives. Consequently, the carrying amount of trademarks are not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the assets might be impaired. Such impairment test consists of a comparison of the fair value of the trademarks with their carrying amount and an impairment loss is recognized if and when the carrying amounts of the trademarks exceed their fair values. The estimates of fair values of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. Significant assumptions are inherent in this process, including estimates of discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. No impairment of intangible assets with indefinite life was recorded during the years ended December 31, 2011 and 2012 and 2013.

Long-term investments

For investments in investees over which the Company does not have significant influence, the Company carries the investments at cost. The Company reviews the long-term investments for impairment whenever events or circumstances indicate that an other-than-temporary decline has occurred. An impairment loss is recognized in earnings equal to the amount of the investment's carrying amount in excess of its fair value at the assessment date. The fair value of the investment would then become the new cost basis of the investment. Impairment losses of $nil, $nil and $2 million were recorded for the years ended December 31, 2011, 2012 and 2013, respectively (see Note 10).

Revenue recognition and cost of revenues

The Company's revenues are derived from WVAS, mobile games service and internet games services.

(i) WVAS

WVAS revenues are derived from providing personalized interactive entertainment, media and community services primarily to mobile phone customers of China Mobile Communication Corporation ("China Mobile"), China United Telecommunications Corporation ("China Unicom"), and China Telecommunications Corporation ("China Telecom") (collectively, the "Mobile Operator").

The Company contracts with the Mobile Operator for the transmission of WVAS as well as for billing and collection services. The Mobile Operator provides the Company with monthly statements that represent the principal evidence that service has been delivered and triggers revenue recognition for a substantial portion of the Company's revenues. In certain instances, when a statement is not received within a reasonable period of time, the Company makes an estimate of the revenues and cost of revenues for the period covered by the statement based on internally generated information, historical experience, verbal communication with Mobile Operator, and/or other assumptions that are believed to be reasonable under the circumstances.

The Mobile Operator remits to the Company only amounts net of the following items: (1) allowance that Mobile Operator has made for the doubtful debts in respect of the amounts due to the Company from its customers, (2) the Mobile Operator's fees for the services provided to the Company, including billing and collection services, and (3) the Mobile Operator's transmission charges. China Unicom and China Telecom do not provide an itemized analysis of their remittances and the Company is therefore unable to determine what allowance, if any, for doubtful or bad debts should be recorded with respect to services delivered through them. China Mobile occasionally specifies the allowance it makes for doubtful debts. As a result, the Company's revenue recognition is based upon the amounts reported on the Mobile Operator's monthly statements, which are net of doubtful debts and represent the amounts the Company reasonably believes will be collected.

The Company records the following fees paid to the Mobile Operator as cost of revenues:

- Service fees paid to the Mobile Operator which are charged to the Company as a percentage, ranging from 15% to 70%,of gross revenues less bad debts.

- Fixed transmission fees that are charged on a basis of each transmission (regardless whether the customers can be billed or pay the Mobile Operator).

In addition, cost of revenues includes amounts paid to content providers and certain payments to handset manufacturers with whom the Company has cooperation agreements.

(ii) Mobile games

The mobile games revenues are derived from feature phone revenues and smart phone revenues.

<u>Feature phone revenues</u>

The Company recognizes feature phone revenues from providing mobile games services on the platforms of Mobile Operator. Mobile phone users download the mobile games in the same manner as the WVAS and the Company recognizes revenues from such feature phone mobile games services in the same way as the WVAS revenues are recognized.

<u>Smart phone revenues</u>

The Company recognizes smart phone revenues from providing mobile games services on platforms such as global iOS and Android platforms. Smart phone users download the mobile games on iOS and Android platform. The Company adopts the item-based revenue model. The basic game play functions are free of charge, and players are charged for purchases of in-game items. Revenues from the sales of in-game items are recognized when the items are consumed by the customers.

(iii) Internet games

The internet games revenues are primarily derived from internet games operation revenues and licensing revenues.

<u>Online game operation revenues</u>

The Company adopts the item-based revenue model. The basic game play functions are free of charge, and players are charged for purchases of in-game items. Revenues from the sales of in-game items are recognized when the items are consumed by the customers or over the estimated lives of the items.

Cash received but not converted into in-game money is initially recorded as advances from customers, which are transferred as deferred revenue upon conversion into in-game money.

Revenues from licensing arrangement

The Company enters into licensing arrangements with various licensees who provide the internet games services in PRC and overseas. A licensing arrangement usually includes license of the games and support and maintenance services after the commercial launch of the games, which include bug fixes, technical support via telephone and site visit, and unspecified upgrades on a when-and-if-available basis for certain period. The licensees pay non-refundable upfront fee for the license and support and maintenance services.

For the licensing arrangements, the vendor specific objective evidence ("VSOE") of fair value of the support and maintenance services, which is the last element to be delivered, has been established based on renewal prices. Therefore, under the residual method, the amount of consideration allocated to the license of games equals the total arrangement consideration less the fair value of the support and maintenance services, which is fully recognized as revenue from license of games upon the commercial launch of the games by the licensee. The arrangement consideration allocated to the support and maintenance services is recognized as revenue from support and maintenance services ratably over the service period, which is usually one year.

For the licensing arrangements entered prior to the establishment of the VSOE of fair value of the support and maintenance services, the entire licensing arrangement is accounted for as one accounting unit resulting in the upfront fee being recognized on a straight line basis over the support and maintenance services period beginning the commercial launch of the games by the licensee.

According to certain licensing arrangements, the Group is also entitled to ongoing usage-based royalties determined based on the amount charged to the players' accounts or services payable by players in a given country or region. The usage-based royalties are recognized when they are earned, provided that the collection is probable.

Allowance for credit losses

The allowance for credit losses related to accounts receivable is maintained at a level considered by management to be adequate to absorb an estimate of probable future losses existing at the balance sheet date. In estimating probable losses, the Company reviews accounts that are past due or in bankruptcy and accounts that may have higher credit risk using information available about the customer. The Company arrives at an estimated loss for specific doubtful accounts. This process is based on estimates, and ultimate losses may differ from those estimates. Receivable balance is written off when the Company determines that the balance is uncollectible. Subsequent recoveries, if any, are credited to the allowance when received. The Company considers an accounts receivable balance past due when payment has not been received within the stated terms. The charges related to allowance for credit losses for the years ended December 31, 2011, 2012 and 2013 were $222,007, $5,626 and $342,442, respectively.

Movement of allowance for credit losses is as follows:

	Balance at beginning of the year	Charged to expense	Written-off	Balance at end of the year
2011	$-	$222,007	$-	$222,007
2012	$222,007	$5,626	$(222,007)	$5,626
2013	$5,626	$342,442	$(5,626)	$342,442

The allowance for credit losses arising from end users in WVAS and mobile games services has been net off with account receivables in the monthly statements provided by the Mobile Operator. The Company has not experienced any significant credit losses related to the net receivables in monthly statements provided by Mobile Operator.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the lease period.

Government subsidies

The Company receives subsidies from the local government authorities as incentives for local area development and technology development. The Company records the government subsidies that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Company with no future related costs, as income in the period in which such subsidies are received. The Company received total government subsidies of $319,319, $301,359 and $2,176,449 and recognized such amounts as income for the years ended December 31, 2011, 2012 and 2013, respectively.

Foreign currency translation

The functional and reporting currency of KongZhong is US dollar. The functional currency of the Company's subsidiaries and VIEs in the PRC is Renminbi ("RMB").

Assets and liabilities are translated from each entity's functional currency to the reporting currency at the exchange rate on the balance sheet date. Equity amounts are translated at historical exchange rates, and revenues, expenses, gains and losses are translated using the average rate for the year. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of other comprehensive income.

Monetary assets and liabilities denominated in currencies other than the applicable functional currencies are translated into the functional currencies at the prevailing rates of exchange at the balance sheet date. Nonmonetary assets and liabilities are remeasured into the applicable functional currencies at historical exchange rates. Transactions in currencies other than the applicable functional currencies during the year are converted into the functional currencies at the applicable rates of exchange prevailing at the transaction dates. Transaction gains and losses are recognized in the consolidated statements of comprehensive income.

Product development expenses

Product development expenses which consist primarily of the compensation and related costs for employees associated with the development and programming of mobile data content and internet games content are expensed as incurred.

Income taxes

Current income taxes are provided for in accordance with the laws of the relevant tax authorities.

Deferred income taxes are recognized when temporary differences exist between the tax bases of assets and liabilities and their reported amounts in the financial statements. Net operating loss carry forwards and credits are applied using enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more-likely-than-not that a portion of or all of the deferred tax assets will not be realized. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics.

The impact of an uncertain income tax position on the income tax return is recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Interest and penalties on income taxes will be classified as a component of the provisions for income taxes.

Comprehensive income

Comprehensive income includes net income and foreign currency translation adjustments. Comprehensive income is reported in the statements of comprehensive income.

Advertising costs

The Company expenses advertising costs as incurred. Total advertising expenses were $1,465,272, $5,802,006 and $8,412,925 for the years ended December 31, 2011, 2012 and 2013, respectively, and have been included as part of selling and marketing expenses.

Share-based compensation

Share-based compensation with employees is measured based on the grant date fair value of the equity instrument. The

Company recognizes the compensation costs net of a forfeiture rate on a straight-line basis over the requisite service period of the award, with the amount of compensation expenses recognized in any period not less than the portion of the grant date fair value of the options vested during that period, which is generally the vesting period of the award. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change.

Net income (loss) per share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of ordinary shares outstanding during the year. Diluted net income (loss) per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares. The dilutive effect of the stock options, nonvested shares and warrants is computed using treasury stock method. The dilutive effect of the convertible senior notes is computed using as-if converted method.

Warrants

Warrants which give the holder the right to exercise the warrant for a share instrument which is not redeemable by the Company are classified as a financial instrument in the consolidated balance sheets. Warrants are measured at fair value at the date of issuance and are not remeasured at subsequent reporting dates.

Recently issued accounting standards adopted

In December 2011, the Financial Accounting Standards Board (" FASB") has issued an authoritative pronouncement related to Disclosures about Offsetting Assets and Liabilities. The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

In February 2013, the FASB has issued an authoritative pronouncement related to Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting these reclassifications. Other comprehensive income includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this pronouncement do not change the current requirements for reporting net income or other comprehensive income in financial statements. The amendments apply to all public and private companies that report items of other comprehensive income. Public companies are required to comply with these amendments for all reporting periods (interim and annual). The amendments are effective for reporting periods beginning after December 15, 2012, for public companies. Early adoption is permitted. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

Recent accounting pronouncements not yet adopted

In March 2013, the FASB has issued an authoritative pronouncement related to parent’s accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. When a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity, the parent is required to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. For an equity method investment that is a foreign entity, the partial sale guidance still applies. As such, a pro rata portion of the cumulative translation adjustment should be released into net income upon a partial sale of such an equity method investment. However, this treatment does not apply to an equity method investment that is not a foreign entity. In those instances, the cumulative translation adjustment is released into net income only if the partial sale represents a complete or substantially complete liquidation of the foreign entity that contains the equity method investment. Additionally, the amendments in this pronouncement clarify that the sale of an investment in a foreign entity includes both: (1) events that result in the loss of a controlling financial interest in a foreign entity (i.e., irrespective of any retained investment); and

(2) events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes also referred to as a step acquisition). Accordingly, the cumulative translation adjustment should be released into net income upon the occurrence of those events. The amendments in this pronouncement are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments, it should apply them as of the beginning of the entity's fiscal year of adoption. The Company does not expect the adoption of this guidance will have a significant effect on its consolidated financial statements.

In July 2013, the FASB issued an Accounting Standard Update ("ASU") which provides guidance on financial statement presentation of an unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The FASB's objective in issuing this ASU is to eliminate diversity in practice resulting from a lack of guidance on this topic in current U.S. GAAP.

The amendments in this ASU state that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows.

To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets.

This ASU applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The Company does not expect the adoption of this guidance will have a material effect on its consolidated financial statements.

3.ACQUISITION OF NOUMENA

On March 20, 2012, the Company obtained the control over Noumena and certain assets from a related party of Noumena, a developer of cross-platform smart phone mobile game engines. The total consideration was $19.11 million, consisting of cash consideration of $14.88 million and share consideration of $4.23 million. $9 million out of $14.88 million cash consideration was paid and $4.23 million share consideration was settled by issuance of 40 million ordinary shares of KongZhong, equivalent to 1 million American Depositary Shares ("ADSs", each representing 40 ordinary shares) in 2012. $3 million out of $14.88 million cash consideration was paid in 2013. This acquisition was recorded using the acquisition method of accounting and, accordingly, the acquired assets and liabilities were recorded at fair value at the date of acquisition. The acquisition-related cost of $77,783 was recorded as general and administrative expenses as incurred in 2012. The revenues and net income of Noumena in the amounts of $2,946,157 and $2,074,536 respectively were included in the Company's consolidated statement of comprehensive income for the year ended December 31, 2012.

Total consideration estimated at acquisition date:

Cash consideration	$14,880,600
Fair value of ordinary shares issued (determined based on the market closing price of the Company's ADSs at the acquisition date after lock up discount)	4,230,000
Total	$19,110,600

The purchase price was allocated based on the estimated total consideration at the acquisition date as follows:

Tangible assets acquired (including cash of $586,701)	$669,600
Acquired intangible assets	
Product technologies	3,487,524
Goodwill	14,953,476
Total	$19,110,600

The goodwill arising from the acquisition of Noumena was allocated to and included in the mobile games segment as of December 31, 2012 and 2013. The useful life of product technologies is 3 years.

Fair value of acquired assets

The Company measured the fair value of the purchased intangible assets using the "cost," "income approach-excess earnings" and "with & without" valuation method. These purchased intangible assets are considered Level 3 assets and liabilities because the Company used unobservable inputs, reflecting the Company's assessment of the assumptions market participants would use in valuing these assets and liabilities.

Pro forma

The following summarized unaudited pro forma results of operations for the year ended December 31, 2011 and 2012 assuming that the acquisition during the period ended December 31, 2012 occurred as of January 1, 2011. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the significant acquisitions occurred as of January 1, 2011, nor is it indicative of future operating results.

For the years ended December 31,		
	2011 (unaudited)	2012 (unaudited)
Revenues	$160,723,554	$186,949,412
Net (loss) income	$(8,227,818)	$26,161,809
(Loss) income per share - basic	$(0.01)	$0.02
(Loss) income per share - diluted	$(0.01)	$0.02

4.HELD-TO-MATURITY SECURITIES

The balance represents the Company's investments in debt securities with original maturities within one year that the Company has positive intent and ability to hold to maturity.

5.TRADING SECURITIES

The Company from time to time invests in publicly traded equity and debt securities in China's stock market, and accounts for such investments as trading securities. The Company recognized gain related to trading securities of $85,561, $261,473 and $nil in the statements of comprehensive income for the years ended December 31, 2011, 2012 and 2013, respectively.

6.LOANS TO THIRD PARTY

The Company entered into three loan agreements with Chengdu JinhuaTianchuang Investment Co., Ltd. ("Chengdu Jinhua"), a third party, and China Mingsheng Banking Co., Ltd. whereby the Company loaned RMB99 million, RMB25.8 million and RMB15 million (a total of RMB139.8 million or $22.2 million) to Chengdu Jinhua for one year commencing January 24, January 24 and February 18, 2011, respectively, at an interest rate of 6.39% per annum. For the year ended December 31, 2011 and 2012, the Company recorded interest income of $1,193,226 and $453,602, respectively. The terms of the loans were subsequently extended to March 31, 2012 at an interest rate of 7.93% per annum for the extended period. These loans were fully settled at the end of March 2012.

7.PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

As of December 31,		
	2012	2013
Prepayment to service providers	$1,990,015	$2,553,524
Employee advances	685,134	1,000,762
Other deposits	1,225,431	1,110,945
Interest receivables	771,849	2,880,612
Other current assets	45,245	216,727
	$4,717,674	$7,762,570

8.PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following:

	As of December 31,	
	2012	2013
Computer and transmission equipment	$11,277,560	$15,312,698
Furniture and office equipment	824,806	1,162,452
Motor vehicles	783,060	807,082
Leasehold improvements	2,606,638	2,917,621
Communication equipment	292,188	543,308
Office building	684,305	705,297
	16,468,557	21,448,458
Less: accumulated depreciation	(13,403,071)	(15,605,936)
	$3,065,486	$5,842,522

Depreciation expenses for the years ended December 31, 2011, 2012 and 2013 are $2,165,883, $2,175,564 and $2,202,865 respectively.

9.ACQUIRED INTANGIBLE ASSETS, NET

Acquired intangible assets, net consist of the following:

	As of December 31, 2012					As of December 31, 2013					Amortization period
	Gross carrying amount	Accumulated amortization	Exchange difference	Impairment	Net carrying amount	Gross carrying amount	Accumulated amortization	Exchange difference	Impairment	Net carrying amount	
Intangible assets not subject to amortization											
Trademarks with indefinite life	$282,182	$-	$507	$-	$282,689	$282,182	$-	$9,179	$-	$291,361	N/A
Intangible assets subject to amortization											
Agreements with Mobile Operator	3,113,746	(3,113,701)	(45)	-	-	3,113,746	(3,113,746)	-	-	-	3 years
Operating platforms	243,974	(215,682)	7	-	28,299	243,974	(240,527)	650	-	4,097	5 years
Service licenses	57,071	(57,071)	-	-	-	57,071	(57,071)	-	-	-	3 years
Contracts with content providers	120,999	(120,999)	-	-	-	120,999	(120,999)	-	-	-	1 year
Non-complete agreement	388,516	(388,516)	-	-	-	388,516	(388,516)	-	-	-	2 years
Self-developed contents	379,089	(379,089)	-	-	-	379,089	(379,089)	-	-	-	2 years
Product technologies	4,966,102	(4,963,168)	(918)	-	2,016	4,966,102	(4,966,102)	-	-	-	3 years
Contracts with service providers	5,713	(5,713)	-	-	-	5,713	(5,713)	-	-	-	1 year
Subscriber list	16,710	(16,710)	-	-	-	16,710	(16,710)	-	-	-	1 year
Trademarks	36,874	(36,874)		-	-	36,874	(36,874)	-	-	-	1 year
Core technologies	8,281,231	(5,210,512)	(1,224)	-	3,069,495	8,281,231	(6,022,186)	84,060	-	2,343,105	5 years
Software	115,150	(8,321)	603	-	107,432	115,150	(40,730)	3,156	-	77,576	5 years
Game licenses	73,952,927	(2,882,332)	498,188	-	71,568,783	80,094,217	(4,206,258)	1,161,598	(1,812,939)	75,236,618	3 years
Employment contract	380,898	(370,030)	(268)	-	10,600	380,898	(380,898)	-	-	-	3 years
Copyright	-	-	-	-	-	813,074	(45,518)	6,274	-	773,830	6 years
Total	$92,341,182	$(17,768,718)	$496,850	$-	$75,069,314	$99,295,546	$(20,020,937)	$1,264,917	(1,812,939)	78,726,587	

The weighted average amortization period of the intangible assets subject to amortization was three years as of December 31, 2012 and 2013, respectively.

For purposes of recognition and measurement of an impairment loss, each intangible asset is considered the lowest level asset group that generates identifiable independent cash flows. As a result of the unsatisfactory performance for one game and expected cessation for another game in 2013, the carrying amount of these game licenses exceeded the sum of undiscounted future cash flows expected to generate from the use and eventual disposition of such licenses, which were insignificant Accordingly, the Company recognized an impairment loss of $250,553 and $1,562,386 respectively in 2013, which were reported in cost of revenues and impairment loss of intangible assets, respectively. The licenses were included in the internet game segment.

During 2012 and 2013, the Company obtained certain new game licenses from third party game developers. The intangible assets recognized comprise the relevant initial license fee payments, minimum royalty fee payments and value of warrants issued in connection with obtaining these licenses.

The Company recorded intangible assets relating to the game licenses by reference to the fair value of cash installment payments and warrants because the fair value of the game licenses were not readily determinable at the transaction dates. The Company estimated the useful lives of the game licenses to be three years and amortizes such intangible assets from commercial launches of the games over the useful lives. As of December 31, 2013, only certain games had been launched and relevant intangible assets started amortization.

The Company recorded amortization expenses of $2,277,566, $5,452,441, and $2,785,142 for the years ended December 31, 2011, 2012, and 2013, respectively. The amortization expenses for the years ending December 31, 2014, 2015, 2016, 2017, 2018 and thereafter are expected to be $15,527,480, $24,441,349, $25,793,029, $10,771,530, and $1,901,838.

10.LONG-TERM INVESTMENTS

(a)In February 2012, the Company acquired certain preferred shares in U4iA Games Incorporated ("U4iA"), a developer and publisher of a free-to-play, console-quality, browser-based first person shooter game for $2 million in cash. The holder of such preferred shares is entitled to the number of votes equal to the number of share of common stock into which the preferred shares could be converted. The acquired preferred shares would entitle the Company approximately 2.4% of the total voting rights as of the acquisition date if all related shares were converted. As the Company had no significant influence over U4iA, this investment was accounted for using the cost method.

Since the completion of this investment, U4iA has been in a continuous loss-making position and failed to create the type of profit-generating business that was contemplated at the time of the Company's investment. As a result, the Company recorded a full impairment loss of $2 million in the year ended December 31, 2013 since it does not expect any positive cash flows from the investment in U4iA in the future and has no intention to hold this investment for recovery.

(b)In October 2012, the Company acquired certain preferred shares in Meteor Entertainment Inc., ("Meteor"), a developer and publisher of a free-to-play first person shooter game for $2 million in cash. The holder of such preferred shares is entitled to the number of share of common stock into which the preferred shares could be converted. The acquired preferred shares would entitle the Company approximately 2.5% and 1.2% of the total voting rights as of the acquisition date and as of the end of 2013 after further issuance of shares to other holders, respectively, if all related shares were converted. As the Company had no significant influence over Meteor, this investment was accounted for using the cost method.

11.GOODWILL

The change in the carrying amounts of goodwill by reporting unit which is the same as reportable segment is as follows:

	2012				2013			
	WVAS	Mobile Games	Internet Games	Total	WVAS	Mobile Games	Internet Games	Total
Gross amount:								
Beginning balance	$43,923,184	$5,267,663	$68,831,261	$118,022,108	$43,929,382	$20,274,048	$68,408,299	$132,611,729
Goodwill recognized in acquisition	-	14,953,476	-	14,953,476	-	-	-	-
Exchange differences	6,198	52,909	(422,962)	(363,855)	106,018	608,682	2,098,524	2,813,224
Ending balance	43,929,382	20,274,048	68,408,299	132,611,729	44,035,400	20,882,730	70,506,823	135,424,953
Accumulated impairment loss:								
Beginning balance	(41,878,521)	-	(3,176,478)	(45,054,999)	(41,878,521)	-	(3,182,185)	(45,060,706)
Exchange differences	-	-	(5,707)	(5,707)	-	-	(97,618)	(97,618)
Ending balance	(41,878,521)	-	(3,182,185)	(45,060,706)	(41,878,521)	-	(3,279,803)	(45,158,324)
Goodwill, net	$2,050,861	$20,274,048	$65,226,114	$87,551,023	$2,156,879	$20,882,730	$67,227,020	$90,266,629

During 2011, the Company determined that due to the significant decline in its stock price for a sustained period, there was an impairment indicator related to goodwill, and hence, the Company performed an impairment test on goodwill as of September 30, 2011. The Company estimated the fair values of the reporting units using the income approach valuation methodology.

The income approach valuations included cash flow discount rates of 22.0%, 22.5% and 25.0%, and terminal value growth rates of 3%, 3% and 3% for WVAS, mobile games and internet games reporting units, respectively. Since the fair value of WVAS reporting unit is lower than its carrying value as a result of a decline of expected business performance, WVAS reporting unit failed in the first step of the impairment test and the Company determined that there is an impairment loss of $20,255,242 relating to the unit as of September 30, 2011 based on result of the second step of the impairment test. For the purpose of its annual goodwill impairment test, the Company performed another test as of December 31, 2011 using the same valuation methodology and assumptions on relevant discount rates and growth rates described above and concluded that no further impairment loss needs to be recognized as of December 31, 2011.

As of December 31, 2012, the Company performed an annual impairment test on goodwill. The Company estimated the fair values of the reporting units using the income approach valuation methodology. The income approach valuations included cash flow discount rates of 25.0%, 24.0% and 26.0%, and terminal value growth rates of 1%, 1% and 3% for WVAS, mobile games and internet games reporting units, respectively. Based on the results of the goodwill impairment test, the fair value of each reporting unit was more than the respective carrying value. Accordingly, there was no goodwill impairment needed to be recognized for the fiscal year 2012.

As of December 31, 2013, the Company performed an annual impairment test on goodwill. The Company estimated the fair values of the reporting units using the income approach valuation methodology The income approach valuations included cash flow discount rates of 26.0%, 25.0% and 27.0%, and terminal value growth rates of 1%, 3% and 3% for WVAS, mobile games and internet games reporting units, respectively. Based on the results of the goodwill impairment test, the fair value of each reporting unit was more than the respective carrying value. Accordingly, there was no goodwill impairment needed to be recognized for the fiscal year 2013.

During the years ended December 31, 2011, 2012 and 2013, the Company recognized goodwill impairment losses of $20,255,242, $nil and $nil, respectively.

12.RESTRICTED CASH

In connection with the requirements of a game license agreement entered into during 2012, a deposit with a carrying amount of $35.8 million and of $36.9 million was placed with a bank as a pledged asset for the issuance of a standby letter of credit in favor of the licensor as of December 31, 2012 and December 31, 2013, respectively. The deposit is restricted as to withdrawal or usage for five years since the issuance of the standby letter of credit in 2012.

13.ACCOUNTS PAYABLE

Accounts payable consisted of the following:

	As of December 31,	
	2012	2013
Game license fees payable	$27,172,547	$26,280,480
Fees payable to content and channel providers	9,048,431	6,589,293
Royalty fees payable	4,938,395	5,448,409
Others	1,452,951	1,196,197
	$42,612,324	$39,514,379

14.SHORT-TERM BANK LOAN

In February 2013, the Company entered into a financing agreement with a bank and obtained US dollars loans totaling $9,000,000 for the purpose of share repurchase. The loans were repayable on various dates up to February 2014 and secured by a pledge of RMB deposits equivalent to approximately of $9,900,000. In May 2013, the Company fully settled such US dollars loans. In November 2013, the pledge of RMB deposits was released.

15.ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	As of December 31,	
	2012	2013
Accrued welfare benefits	$680,994	$167,290
Accrued payroll and bonus	2,233,130	4,126,279
Advance from customers	1,881,043	1,149,073
Accrued professional service fees	2,500,505	2,351,363
Accrued marketing expense	1,658,828	6,393,334
Other tax payables	3,245,845	2,148,117
Acquisition payable	5,880,600	2,880,600
Others	195,420	8,667
	$18,276,365	$19,224,723

The balance of acquisition payable as of December 31, 2012 and 2013 represented the outstanding consideration in relation to the acquisition of Noumena (see Note 3)

16.INCOME TAXES

KongZhong and Dacheng Holdings are companies incorporated in the Cayman Islands. Under the current laws of the Cayman Islands, they are not subject to tax on either income or capital gain.

Success Blueprint is a company incorporated in the British Virgin Islands. Under the current laws of the British Virgin Islands, it is not subject to tax on either income or capital gain.

Under the current Hong Kong Inland Revenue Ordinance, Dacheng Hong Kong is subject to 16.5% income tax on its taxable income generated from operations in Hong Kong.

The Company's subsidiaries, VIEs and VIEs' subsidiaries established in the PRC are subject to income tax rate of 25%, except for the following, according to the PRC Enterprise Income Tax (the "EIT Law"), which adopted a unified income tax rate of 25% for both domestic and foreign enterprises.

In 2011, KongZhong Beijing, Beijing AirInbox, Beijing Xinrui, Tianjin Mammoth renewed their "high and new technology enterprise" ("HNTE") status for additional three years through a simplified application process since their operations continue to qualify for HNTE status after they first obtained such status in 2008. KongZhong China, Beijing Chengxitong and Beijing WINT also renewed their HNTE status in 2012 for additional three years after they first obtained such status in 2009. The HNTE status allows qualifying China-based enterprises to use a 15% tax rate for three years. After the first six years, enterprises will go through a new application process in order to renew their HNTE status. The Company believes it is highly likely that its qualifying entities will continue to obtain the renewal of the HNTE status in the future and has assumed so in calculating deferred tax assets and liabilities.

Xiamen Simlife, Shanghai Dacheng qualified for software enterprise for tax purposes. They were entitled to an exemption from income tax for two years commencing from the first year that presents accumulated earnings under the PRC tax law and entitled to a 50% relief from income tax for the following three years. The preferential tax treatment of Xiamen Simlife started in 2010 and Shanghai Dacheng started in 2011.

	As of December 31,	
	2012	2013
Current deferred tax assets		
Accrued expenses	$166,357	$298,992
Less: valuation allowance	(166,357)	(298,992)
Current deferred tax assets, net	$-	$-
Non-current deferred tax assets		
Net operating loss carry forwards	65,738	116,765
Less: valuation allowance	(65,738)	(116,765)
Non-current deferred tax assets, net	$-	$-
Deferred tax liabilities		
Amortization of intangible assets	$10,498	$-

The Company operates through multiple subsidiaries and VIEs and the valuation allowance is considered on each individual entity basis. A full valuation allowance has been established because the Company believes that either it is more likely than not that its deferred tax assets will not be realized as it does not expect to generate sufficient taxable income in the future. The tax losses carried forward as of December 31, 2013 amounted to $4,635,501 and will expire by 2018.

The income taxes expense consists of:

	For the years ended December 31,		
	2011	2012	2013
Current	$3,326,277	$3,558,263	$722,971
Deferred	(188,439)	(67,421)	(10,569)
Total	$3,137,838	$3,490,842	$712,402

A reconciliation between the statutory PRC enterprise income tax rate and the Company's effective tax rate is as follows:

	For the years ended December 31,		
	2011 %	2012 %	2013 %
Applicable rate for reconciliation purpose (note)	(25)	25	25
Effect of tax holiday granted to PRC entities	(50.7)	(7.6)	(6.5)
Effect on tax rates in different tax jurisdiction	(23.7)	12.5	(2.3)
Tax effect of expenses that are not deductible in determining taxable profit (note)	(6.7)	3.1	1.1
Tax effect of allowable special deduction in determining taxable profit (note)	36.1	(20.5)	(14.9)
Change in valuation allowance	0.5	(0.6)	0.9
Effective tax rate for the year	(69.5)	11.9	3.3

Note: The domestic tax rate in the jurisdiction where the operation of the Company is substantially based is used. Expenses that are not deductible included accrued salary and accrued bonus which exceeded the upper limit of deduction under the EIT Law. Special deduction is an extra 50% deduction allowable under the EIT Law in respect of qualifying product development expense incurred.

If the tax holidays granted to the relevant subsidiaries and VIEs were not available, the impact on income tax provision and earnings per share amounts would be as follows:

	For the years ended December 31,		
	2011	2012	2013
Increase in income tax expense	$2,290,131	$2,207,096	$1,399,105
Impact on net income (loss) per ordinary share-basic	$0.00	$0.00	$0.00
Impact on net income (loss) per ordinary share-diluted	$0.00	$0.00	$0.00

The Company did not identify any significant unrecognized tax benefits or incur any interest or penalties related to potential underpaid income tax expenses for each of the three years ended December 31, 2013. The Company does not expect to have a significant increase or decrease on unrecognized tax benefits within 12 months from December 31, 2013.

Under EIT Law, a "resident enterprise" which may include an enterprise established outside of the PRC with management located in the PRC, will be subject to the PRC income tax. If the PRC tax authorities subsequently determine that the Company and its subsidiaries registered outside the PRC should be deemed a resident enterprise, the Company and its subsidiaries registered outside the PRC will be subject to the PRC income tax at a rate of 25%.

Aggregate undistributed earnings of the Company's VIEs and its VIEs' subsidiaries located in the PRC that are available for distribution to the Company of approximately $171,394,598 at December 31, 2013 are considered to be indefinitely reinvested and accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon the distribution of those amounts to the Company. The Chinese tax authorities have also clarified that distribution made out of pre January 1, 2008 retained earnings will not be subject to the withholding tax.

Under applicable accounting principles, a deferred tax liability should be recorded for taxable temporary differences attributable to the excess of financial reporting over tax basis, including those differences attributable to a more than 50% interest in a domestic subsidiary. However, recognition is not required in situations where the tax law provides a means by which the reported amount of that investment can be recovered tax-free and the enterprise expects that it will ultimately use that means. The Company has not recorded any such deferred tax liability attributable to the undistributed earnings of its financial interest in VIE affiliates because the Company believes such excess earnings can be distributed in a manner that would not be subject to tax.

17.LONG-TERM LIABILITIES

In connection with the acquisition of the intangible assets relating to a game license in 2012, the Company was required to make certain cash payments by installment. The total cash installment payments amounted to $55,000,000 with a present value of $53,460,269 on the acquisition date. The Company has recorded the outstanding current and noncurrent payment liabilities of $20,000,000 and $19,260,000 under accounts payable and long-term liabilities, respectively as of December 31, 2013.

18.CONVERTIBLE SENIOR NOTE

On March 18, 2009, the Company issued a convertible senior note to Nokia Growth Partners ("NGP"), which is due in 2014. This note in an aggregate principal amount of $6,775,400 is convertible to ordinary shares of the Company at the conversion price of $0.08915 per share. The conversion price is adjustable subject to standard anti-dilution provision i.e. stock splits, subdivisions, reclassifications or combinations, etc. The initial interest rate was 8% per annum for the period commencing and including March 18, 2009 and ending and including December 31, 2009, compounded annually on the outstanding portion of the principal amount and any accrued and unpaid interest that is overdue. The applicable interest rate was changed from 8% to 7% in 2010 according to certain earning/debt ratio. For the fiscal year commencing January 1, 2011 and each fiscal year thereafter, the applicable interest rate will be adjustable in a range of 6% to 8% according to certain earning/debt ratio. The interest was payable on July 15, 2009 and semi-annually on January 15 and July 15 afterwards. The Company was also entitled to a purchased call option to redeem the convertible senior note plus any accrued but unpaid interest following the third anniversary of the closing date. Furthermore, a share purchase warrant was issued to NGP to purchase 80,000,000 ordinary shares of KongZhong with a purchase price of $0.125 per share, which is to be expired in five years after the issuance.

The conversion feature, interest rate reset feature and prepayment feature embedded in the convertible senior note are derivatives but not subject to bifurcation in accordance with the guidance of accounting for derivative instruments. The warrant issued with the convertible senior note was detachable and classified as equity. The total proceeds were allocated between the convertible senior note and the warrant based on their relative fair values. The amount of $677,332 allocated to the warrant was recorded as equity. A beneficial conversion feature of $3,667,931 was resulted as the effective conversion price was lower than the fair value of the ordinary shares on the closing date of March 18, 2009, which was recognized as additional paid in capital with a corresponding increase in debt discount. The debt discount totaling $4,345,263 was amortized into interest expense over the term of convertible senior note using the effective interest rate method. During 2010, 2011 and 2012, the amortized discount of $585,627, $294,543 and $36,297 were recorded as part of the interest expense respectively.

On February 25, 2011, the Company prepaid 70% of the aggregate principal amount of the convertible senior note for $9,310,000 in cash, plus any accrued but unpaid interest. The prepaid portion of the convertible senior note has rights to be converted into 1,330,000 ADSs, equivalent to 53,200,000 ordinary shares.

On March 1, 2012, NGP converted the remaining 30% of the aggregate principal amount of the convertible senior note into 570,000 ADSs, equivalent to 22,800,000 ordinary shares.

Interest expense on the convertible senior note has been recorded at the effective rate of 31.85% after prepayment comparing to previous effective interest rate of 37.01%. Interest expense recognized related to the convertible senior note was as follows:

	For the years ended December 31,	
	2011	2012
Interest expense at coupon rate	$193,220	$26,730
Amortization of debt discount	294,543	36,297
Total interest expense recognized	$487,763	$63,027

19.SHARE REPURCHASE

On September 30, 2011, the Board of Directors authorized to purchase the ADSs on the open market (the "2011 Purchase Plan"). The number of ADSs to be purchased under the 2011 Purchase Plan shall not exceed 5,000,000 ADSs. The aggregate value of ADSs to be purchased under the 2011 Purchase Plan shall not exceed $15,000,000. During 2011, the Company repurchased 607,478 ADSs for a total consideration of $2,748,579. 500,000 ADSs repurchased by the Company were cancelled during 2011, and the remaining ADSs were cancelled in March 2012. During 2012, the Company repurchased 1,746,059 ADSs for a total consideration of $12,518,624. All such ADSs repurchased by the Company were cancelled during 2012.

On October 26, 2012, the Board of Directors authorized to purchase the ADSs on the open market (the "2012 Purchase Plan"). The aggregate value of ADSs to be purchased under the 2012 Purchase Plan shall not exceed $20,000,000, and the number of ADSs to be purchased shall not exceed 5,000,000 ADSs. During 2012, the Company repurchased 362,807 ADSs for a total consideration of $2,071,731. During 2013, the Company repurchased 1,592,558 ADSs for a total consideration of $10,123,821. All such ADSs repurchased by the Company in 2012 and 2013 under the 2012 Purchase Plan were cancelled during 2013.

20.EMPLOYEE EQUITY INCENTIVE PLAN

The Company's 2002 employee equity incentive plan ("2002 Plan") allows the Company to offer a variety of incentive awards to employees, consultants or external service advisors of the Company. Options to purchase 105,000,000 ordinary shares are authorized under the 2002 Plan. In 2005, the shareholders authorized additional 32,000,000 options under the 2002 Plan. Under the terms of the 2002 Plan, options are generally granted at prices equal to the fair market value of the Company's shares listed on the Nasdaq National Market. The majority of the options will vest over four years where 25% of the options will vest at the end of the first year, 6.25% will vest quarterly in the second year through the fourth year. The stock options expire 10 years from the date of grant.

As of December 31, 2013, options to purchase 46,256,457 shares of ordinary shares were outstanding, and options to purchase 4,105,423 ordinary shares were available for future grant.

The Company's 2006 Equity Incentive Plan ("2006 Plan") allows the Company to offer a variety of incentive awards to employees, consultants or advisors of the Company. 40,000,000 nonvested ordinary shares are authorized under the 2006 Plan. In December 2008, the shareholders authorized additional 140,000,000 nonvested ordinary shares under the 2006 Plan.

As of December 31, 2013, 9,670,000 shares were outstanding and 1,857,500 shares were available for future grant. The majority of nonvested shares will vest over four years where 25% of the nonvested shares will vest at the end of the first year, and 6.25% will vest quarterly from the second year through the fourth year.

The Company's 2013 Equity Incentive Plan ("2013 Plan") allows the Company to offer a variety of incentive awards to officers, other employees, prospective employees, directors, consultants and advisors of the Company. The total number of ordinary shares that may be transferred pursuant to the incentive awards granted under the 2013 Plan shall not exceed 80,000,000 ordinary shares. No incentive awards have been granted under the 2013 Plan since its adoption by the Company in 2013.

The Company recognizes the compensation costs net of estimated forfeitures on a straight-line basis over the requisite service period of the award, which is generally the vesting period. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of share-based compensation expense to be recognized in future periods.

Stock options

A summary of the stock option activities is as follows:

	Outstanding options		
	Number of Options	weighted average exercise price	weighted average grant-date fair value
Options outstanding at January 1, 2011	42,486,780	$0.07	$0.05
Granted	19,800,000	$0.10	$0.10
Forfeited	(5,034,283)	$0.09	$0.05
Exercised	(6,566,880)	$0.05	$0.03
Options outstanding at December 31, 2011	50,685,617	$0.10	$0.07
Forfeited	(2,921,040)	$0.11	$0.08
Exercised	(4,710,120)	$0.06	$0.03
Options outstanding at December 31, 2012	43,054,457	$0.10	$0.08
Granted	13,320,000	$0.21	$0.06
Forfeited	(1,515,040)	$0.12	$0.08
Exercised	(8,602,960)	$0.10	$0.06
Options outstanding at December 31, 2013	46,256,457	$0.10	$0.12

There were no options granted during the year ended December 31, 2012.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for each applicable period.

Option grants	2011	2012	2013
Weighted average risk-free interest rate	0.46%	N/A	0.60%
Weighted average expected option life	2.75 years	N/A	2.75 years
Weighted average volatility rate	62%	N/A	54.36%
Weighted average dividend yield	-	-	-

(1)Risk-free interest rate
Risk-free interest rate was estimated based on the yield to maturity of treasury bonds of the United States with a maturity period close to the expected life of the options.

(2)Expected life
The expected life was estimated based on historical and other economic data trended into the future.

(3)Volatility
The volatility of the underlying ordinary shares during the life of the options was estimated based on the historical stock price volatility of KongZhong over a period comparable to the expected life of the options.

(4)Dividend yield
The dividend yield was estimated by the Company based on its expected dividend policy over the expected life of the options.

(5)Exercise price
The exercise price of the options was determined by the Board of Directors.

(6)Fair value of underlying ordinary shares
The closing market price of the ADSs of KongZhong as of the grant date was used to determine the fair value of the ordinary shares on that date.

The weighted average per share fair value of options granted in each year was as follows:

	For the years ended December 31,		
	2011	2012	2013
Stock options	$0.1	N/A	$0.26

The total intrinsic value of options exercised during the years ended December 31, 2011, 2012 and 2013 was $377,622, $212,849 and $31,708 respectively.

The following table summarizes information with respect to stock options outstanding at December 31, 2013:

	Options outstanding				Options exercisable			
	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value	Number exercisable	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value
Average exercise price								
$0.07	7,655,857	-	-	$844,058	7,655,857	-	-	$844,058
$0.09	1,600,000	-	-	149,200	1,600,000	-	-	149,200
$0.10	14,195,560	-	-	1,213,720	6,695,560	-	-	572,470
$0.12	2,000,000	-	-	122,000	1,000,000	-	-	61,000
$0.13	4,352,520	-	-	238,876	4,352,520	-	-	238,876
$0.15	3,132,520	-	-	93,192	2,632,520	-	-	78,317
$0.19	11,320,000	-	-	-	-	-	-	-
$0.32	2,000,000	-	-	-	-	-	-	-
Total	46,256,457	$0.10	6.58year	$2,661,046	23,936,457	$0.10	5.78years	$1,943,921

The number of the options expected to vest was 22,320,000 with a weighted-average exercise price of $0.17 and the weighted-average remaining contractual term of 9.00 years. The aggregate intrinsic value of the option expected to vest was $717,125 as of December 31, 2013.

Nonvested shares

A summary of the nonvested share activities is as follows:

	Number of nonvested shares outstanding	Weight average grant-date fair value
Nonvested shares outstanding at January 1, 2011	77,593,333	$0.13
Granted	16,160,000	$0.10
Forfeited	(1,975,000)	$0.09
Vested	(35,303,333)	$0.12
Nonvested shares outstanding at December 31, 2011	56,475,000	$0.12
Vested	(33,920,000)	$0.12
Nonvested shares outstanding at December 31, 2012	22,555,000	$0.13
Vested	(12,885,000)	$0.15
Nonvested shares outstanding at December 31, 2013	9,670,000	$0.11

There were no nonvested shares granted or forfeited during the years ended December 31, 2012 and 2013.

The total intrinsic value of shares vested in the year of 2011, 2012 and 2013 was $3,653,895, $4,647,040 and $2,325,743, respectively.

The following table summarizes information with respect to nonvested shares outstanding at December 31, 2013:

	Nonvested share outstanding	
	Number outstanding	Aggregate intrinsic value
Grant date		
June 22, 2010	1,750,000	$315,875
October 3, 2011	7,920,000	1,429,560
Total	9,670,000	$1,745,435

The Company recorded share-based compensation expenses of $4,579,522, $4,464,497 and $1,573,729 for the years ended December 31, 2011, 2012 and 2013, respectively. The amount of stock-based compensation currently estimated to be expensed from 2014 through 2016 related to unvested share-based payment awards at December 31, 2013 is $1,861,232. This amount will be recognized as presented in the following table.

Year	
2014	$848,267
2015	436,148
2016	576,817
Total	$1,861,232

That cost is expected to be recognized over a weighted average period of 2.02 years. To the extent the actual forfeiture rate is different from the Company's original estimate, share-based compensation related to these awards may require to be adjusted.

21.WARRANTS

In March 2009, the Company issued to NGP, a warrant to purchase up to 80 million of ordinary shares with a purchase price $0.125 per share, which is to be expired in five years after the issuance. In August 2012, NGP transferred 50% of its original warrant in the form of a warrant to purchase up to 40 million of ordinary shares of the Company, exercisable prior to March 18, 2014, to Fit Run Limited. In exchange for the original warrant, the Company issued a new warrant to NGP to purchase up to 40 million of ordinary shares, exercisable prior to March 18, 2014. During 2013, warrants to purchase 80 million of ordinary shares were exercised by NGP and Fit Run limited and cash proceeds of $10,000,000 was received by the Company. The exercise of the warrants and the corresponding issuance of the ordinary share were recorded in equity.

During 2012, in connection with the acquisition of intangible assets relating to game licenses, the Company issued a number of tranches of warrants as part of the consideration. The warrants are exercisable by the warrant holders starting from the commercial launch dates of respective games. The warrants were not determined as free standing financial instruments required to be measured at fair value at subsequent reporting dates since the underlying warrants were issued as part of settlement consideration for the purchases of game licenses and were not redeemable. The warrants held by the holders are required to be classified as equity and were recognized at the fair value of $14,889,000 and are not remeasured at subsequent reporting dates.

The following table sets forth information regarding the warrants issued during 2012:

	Issue date	No. of underlying shares	Price per share	Fair value per warrant	Exercisable period	Total fair value
Tranch 1	May 11, 2012	120,000,000	$0.1485	$0.0372	One year from May 11, 2012	$4,470,000
Tranch 2	May 11, 2012	40,000,000	0.1485	0.0681	Three years from commercial launch	2,723,000
Tranch 3	May 11, 2012	40,000,000	0.1485	0.0837	Three years from commercial launch	3,346,000
Tranch 4	August 2, 2012	40,000,000	0.1985	0.0537	One year from commercial launch	2,148,000
Tranch 5	August 28, 2012	40,000,000	$0.1750	$0.0550	One year from commercial launch	2,202,000
Total		280,000,000				$14,889,000

The fair value of the warrants issued during 2012 was determined by the Company using Binomial Option Pricing Model with the following assumptions:

	Tranch 1	Tranch 2	Tranch 3	Tranch 4	Tranch 5
Risk-fee rate of return	0.952%	1.674%	1.916%	1.185%	1.186%
Expected remaining contractual lives of the warrants	1 year	4 years	5 years	1.8 years	2.1 years
Volatility	63.2%	58.5%	66.6%	56.6%	54.5%
Expected dividend yield	-	-	-	-	-

Exercisable multiple was not considered by the Company in the valuation since it was assumed that the warrant holders have no incentive to exercise the warrants before maturity as the Company does not pay dividends, and theoretically, holders of call options are better off to hold the warrants until maturity. During 2013, warrants to purchase 120 million of ordinary shares were exercised by the holder and cash proceeds of $17,800,000 was received by the Company. The exercise of the warrants and the corresponding issuance of ordinary shares were recorded in equity. As of December 31, 2013, the warrants for the purchases of up to 160 million ordinary shares of the Company remained outstanding.

22.SEGMENT AND GEOGRAPHIC INFORMATION

Segment reporting

The Company's chief operating decision maker has been identified as the Chief Executive Officer who reviews results of operations by business lines when making decisions about allocating resources and assessing performance of the Company. The Company has therefore determined that each business line represents an operating segment and there are three operating segments presented: WVAS, mobile games and internet games.

The Company does not allocate any assets to its operating segments as management does not believe that allocating these assets is useful in evaluating these segments' performance. Accordingly, the Company has not made disclosure of total assets by reportable segment.

	For the years ended December 31,		
	2011	2012	2013
Revenues			
WVAS	$80,265,942	$77,765,502	$63,922,188
Mobile games	40,850,452	21,190,283	17,069,010
Internet games	38,892,041	87,423,923	98,449,212
	160,008,435	186,379,708	179,440,410
Sales tax			
WVAS	(1,390,901)	(1,053,179)	(968,969)
Mobile games	(621,069)	(219,306)	(160,728)
Internet games	(1,815,853)	(4,521,072)	(4,656,918)
	(3,827,823)	(5,793,557)	(5,786,615)
Cost of revenues			
WVAS	(50,758,629)	(52,655,523)	(43,085,208)
Mobile games	(25,247,963)	(10,934,999)	(7,780,237)
Internet games	(15,923,649)	(39,539,750)	(45,534,441)
	(91,930,241)	(103,130,272)	(96,399,886)
Gross profit			
WVAS	28,116,412	24,056,800	19,868,011
Mobile games	14,981,420	10,035,978	9,128,045
Internet games	21,152,539	43,363,101	48,257,853
	64,250,371	77,455,879	77,253,909
Operating expenses			
Product development	(15,416,944)	(18,382,383)	(26,401,720)
Selling and marketing	(20,891,615)	(24,586,039)	(26,674,024)
General and administrative	(11,582,200)	(11,629,273)	(8,976,176)
Impairment loss on goodwill and intangible assets	(20,259,169)	-	(1,562,386)
Total operating expenses	(68,149,928)	(54,597,695)	(63,614,306)
Changes in fair value of contingent consideration for business acquisition	$ (3,729,513)	$-	$-
Government subsidies	$319,319	$301,359	$2,176,449
(Loss) income from operations	$ (7,309,751)	$23,159,543	$15,816,052

Service lines of WVAS

The WVAS include services delivered through the 2.5G mobile networks, which comprise Wireless Application Protocol ("WAP") services and Multimedia Messaging Services ("MMS"), and services delivered through 2G technology platforms, which comprise Short Messaging Services ("SMS"), Interactive Voice Response services ("IVR"), and Color Ring Back Tones ("CRBT"). Revenues of WVAS by service line for the years ended December 31, 2011, 2012 and 2013 are as follows:

	For the years ended December 31,		
	2011	2012	2013
WVAS			
2.5 Generation			
- WAP	$2,355,376	$2,688,051	$719,897
- MMS	6,573,187	3,392,146	1,113,005
	8,928,563	6,080,197	1,832,902
2 Generation			
- SMS	$37,096,542	$39,178,143	$32,334,591
- IVR	12,661,930	13,437,961	14,884,236
- CRBT and others	21,578,907	19,069,201	14,870,459
	71,337,379	71,685,305	62,089,286
	$80,265,942	$77,765,502	$63,922,188

Service lines of mobile games

The mobile games revenues are derived from feature phone revenues and smart phone revenues. Revenues of mobile games by service line for the years ended December 31, 2011, 2012 and 2013 are as follows:

	For the years ended December 31,		
	2011	2012	2013
Mobile games			
- Feature phone	$40,850,452	$15,613,441	$10,232,105
- Smart phone	-	5,576,842	6,836,905
	$40,850,452	$21,190,283	$17,069,010

Service lines of internet games

The internet games revenues are derived from online game operation revenues and licensing revenues including royalties. Revenues of internet games by service line for the years ended December 31, 2011, 2012 and 2013 are as follows:

	For the years ended December 31,		
	2011	2012	2013
Internet games			
- Online game operation	$33,337,889	$82,197,478	$95,965,162
- Licensing arrangement	5,554,152	5,226,445	2,484,050
	$38,892,041	$87,423,923	$98,449,212

Geographical information

The Company's operations are mainly located in its country of domicile (i.e. the PRC) and to a lesser extent, overseas. The Company's revenues by geographic areas (based on location of the other signing party of the revenue contract) are detailed below:

	For the years ended December 31,		
	2011	2012	2013
PRC	$154,455,308	$176,466,462	$173,539,400
Asia-pacific	4,502,636	3,702,017	913,465
Europe and America	1,050,491	6,211,229	4,987,545
	$160,008,435	$186,379,708	$179,440,410

The Company's long-lived assets as of December 31, 2012 and 2013 were all located in the PRC.

23. FAIR VALUE MEASUREMENTS

Measured on recurring basis

The Company measured its financial assets and liabilities including cash equivalents, and game license payment liabilities at fair value on a recurring basis as of December 31, 2012 and 2013.

Cash equivalents included time deposits that can been withdrawn at any time and are stated at fair value. The Company classified such financial assets as investments with Level 1 of the fair value hierarchy because they are valued based on the quoted market price in an active market.

The Company did not have Level 2 investments as of December 31, 2012 and 2013.

Game license payment liabilities arising from the acquisition of intangible assets relating to a game license in 2012 are classified within Level 3 of the fair value hierarchy because the Company recorded the present value of the installment payment liabilities using discounted cash flow ("DCF") method. The significant unobservable input used in the DCF model was the discount rate of 3.25% which approximated to the Company's expected borrowing rate from banks in the United States. Significant increase (decrease) in the discount rate would result in a significantly lower (higher) fair value.

The following table shows the fair value of the Company's financial assets and liabilities measured at recurring basis as of December 31, 2012 and 2013:

	As of December 31, 2012				As of December 31, 2013			
	Fair Value Measurements at the Reporting Date Using				Fair Value Measurements at the Reporting Date Using			
	Quoted prices in active markets for identical instruments (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)	Total balance	Quoted prices in active markets for identical instruments (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)	Total balance
Time deposits	$47,355,121	$-	$-	$47,355,121	$72,520,957	$-	$-	$72,520,957
Game license payment liabilities	-	-	43,660,000	43,660,000	-	-	39,260,000	39,260,000
Total	$47,355,121	$-	$43,660,000	$91,015,121	$72,520,957	$-	$39,260,000	$111,780,957

Measured on nonrecurring basis

The Company measured the fair value of the purchased intangible using the "cost," "income approach-excess earnings" or "with & without" valuation methods. In addition, the Company measured the fair value of intangible assets using income approach method based on which to recognize the impairment loss in 2013. These intangible assets are considered Level 3 assets because the Company used unobservable inputs, such as forecast financial performance of the acquired businesses or assets and discount rates to determine the fair value of these purchased assets.

Goodwill and cost method investments are measured at fair value on a nonrecurring basis when impairment is recognized. The Company measured the fair value of cost method investment in U4iA using income approach method based on which to recognize the impairment loss in 2013. The cost method investment in U4iA is considered as Level 3 assets because the Company used unobservable inputs, such as forecast financial performance and future cash flow to determine the fair value of the cost method investment.

Warrants and intangible assets purchased with issued warrants as consideration are measured at fair value on a nonrecurring basis on the transaction date (see Note 21).

24.NET (LOSS) INCOME PER SHARE

The following table sets forth the computation of basic and diluted net (loss) income per share:

	For the years ended December 31,		
	2011	2012	2013
Net (loss) income (numerator), basic and diluted	$(7,654,862)	$25,739,968	$20,661,649
Shares (denominator):			
Weighted average ordinary shares outstanding used in computing basic net (loss) income per share	1,607,110,119	1,661,864,846	1,714,924,612
Effect of dilutive securities:			
Plus incremental weighted average ordinary shares from assumed conversions of stock options, nonvested shares and warrants using the treasury stock method	-	59,757,910	36,696,728
Total weighted average shares used in computing diluted net (loss) income per share	1,607,110,119	1,721,622,756	1,751,621,340
Net (loss) income per share, basic	$(0.00)	$0.02	$0.01
Net (loss) income per share, diluted	$(0.00)	$0.01	$0.01

The dilutive effects of the options, nonvested shares and warrants are calculated using the treasury stock method. Under the treasury stock method, the proceeds from the assumed conversion of options, nonvested shares and warrants, which include the benefit of the compensation costs attributable to future services and not yet recognized, are used to repurchase outstanding ordinary shares using average market prices.

The dilutive effect of the convertible senior note in 2011 was calculated using if-converted method. Under the if-convertible method, the interest less income tax effects applicable to the convertible senior note is added back to the numerator. The convertible senior note is assumed to have been converted at the beginning of the period.

For the years ended December 31, 2011, 2012 and 2013, the Company had the following securities outstanding which could potentially dilute basic net (loss) income per share in the future, but were excluded from the computation of diluted net (loss) income per share in 2011, 2012 and 2013 as their effects would have been antidilutive:

	For the years ended December 31,		
	2011	2012	2013
Options, nonvested shares and warrants	187,160,617	285,312,520	11,320,000
Convertible senior note	22,800,000	-	-

25.CONCENTRATIONS

(a)Dependence on Mobile Operator

The revenue of the Company is primarily derived from cooperative arrangements with the Mobile Operator in the PRC. The major operators cooperated with the Company are China Mobile, China Unicom and China Telecom. If the strategic relationship with the Mobile Operator in the PRC is terminated or scaled-back, or if the Mobile Operator alters the revenue sharing arrangements, the Company's WVAS business would be adversely affected.

The following table shows the revenues and percentage of total revenues derived from those operators for the years ended December 31, 2011, 2012 and 2013:

	For the years ended December 31,		
	2011	2012	2013
	Percentage of Total Revenues		
Revenues collected through operators			
China Mobile	62%	36%	30%
China Unicom	7%	7%	5%
China Telecom	5%	6%	6%
WVAS revenues collected through operators			
China Mobile	37%	28%	24%
China Unicom	7%	7%	5%
China Telecom	5%	6%	6%
Mobile games revenues collected through operators			
China Mobile	25%	8%	6%
China Unicom	-	-	-
China Telecom	-	-	-

Net accounts receivable from the operators as of December 31, 2012 and 2013 were as follows:

	Percentage of accounts receivable as of December 31,	
	2012	2013
China Mobile	52%	63%
China Unicom	7%	9%
China Telecom	15%	9%

Other than disclosed above, there was no customer with 10% or more of total accounts receivable.

(b)Internet games revenue

The Company derived the majority of internet game revenue from a game which accounted for approximately 17%, 41% and 52% of total revenues in 2011, 2012 and 2013, respectively.

(c)Credit risk

In WVAS and mobile games services, the Company depends on the billing system of the Mobile Operator to charge the mobile phone users and collect payments from them. The Company generally does not require collateral for its accounts receivable and has not experienced any significant credit losses for any periods presented.

26.PRC CONTRIBUTION PLAN AND PROFIT APPROPRIATION

The employees of the Company in the PRC participate in a government-mandated defined contribution plan pursuant to which pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require the Company accrue these benefits based on certain percentages of the employees' salaries. The total provision for such employee benefit was$3,635,872, $3,480,839 and $5,135,732 for the years ended December 31, 2011, 2012 and 2013, respectively.

Pursuant to the laws applicable to the PRC's Foreign Investment Enterprises and local enterprises, the Company's subsidiaries in the PRC must make appropriations from after-tax profit to non-distributable reserve funds as determined by the boards of directors of the relevant subsidiaries.

For foreign enterprises, these reserve funds include (i) a statutory surplus reserve fund and (ii) a general surplus reserve fund. Subject to certain cumulative limits, the general reserve fund requires annual appropriations of 10% of after-tax profit (as determined under PRC accounting standards and regulation at each year-end); the other fund appropriations are at the Company's discretion. These reserve funds can only be used for specific purposes of enterprise expansion and staff welfare and bonus and are not distributable as cash dividends.

As of December 31, 2012 and 2013, the total statutory reserve amounted to $10,572,330 and $10,723,748, respectively.

27.RELATED PARTY TRANSACTIONS

Leilei Wang indirectly owns more than 10% of Prosten Technology Holdings Limited ("Prosten"). Prosten and its subsidiaries engage in the business of providing solutions to companies that provide mobile and search services. In 2011, 2012 and 2013, Prosten and its subsidiaries provided the Company mobile value-added services valued at $3.8 million, $1.5 million and $1.0 million, respectively. The accounts payable to Prosten and its subsidiaries as of December 31, 2012 and 2013 were $223,713 and $73,216 respectively.

28.COMMITMENT AND CONTINGENCY

(a)Operating lease as lessee

The Company leases certain office premises under non-cancelable leases. Rental expenses under operating leases for the years ended December 31, 2011, 2012 and 2013 were $2,087,203, $2,424,259 and $3,449,577, respectively.

Future minimum lease payments under non-cancelable operating leases agreements are as follows:

Year ending	
2014	$2,834,637
2015	1,264,563
2016	404,864
2017	46,584

(b)Purchase obligations

The Company entered into a series of agreements with content providers to develop WVAS, mobile games and internet games. The future minimum purchase obligations payments under non-cancelable purchase agreements are approximately as follows:

Year ending	
2014	$14,785,011
2015	655,770
2016	78,465
2017	27,924
2018 and thereafter	3,795

(c)Sales tax

The subsidiaries and VIEs incorporated in the PRC are subject to the sales tax at rates of 3% to 5% on PRC taxable revenues, as defined by the related tax rules and regulations. When determining the PRC taxable revenues for sales tax purpose, the subsidiaries and VIEs adopted a "net" basis, i.e. deducting profit sharing with content providers from revenues. However, as the deductible items for sales tax purposes are not clearly defined, the Company would be subject to additional sales tax if the net basis used by the Company was determined inappropriate for the computation of sales tax. Additional business tax amounting to $4,566,562 could arise had the gross revenue been used for sales tax calculations as of December 31, 2013.

29.RESTRICTED NET ASSETS

Relevant PRC laws and regulations restrict the Company's PRC subsidiaries and VIEs from transferring a portion of their net assets, equivalent to the balance of their statutory reserves and their share capital, to KongZhong in the form of loans, advances or cash dividends. The balance of restricted net assets were $76,482,066 and $77,426,504, of which $48,996,677 and $49,357,157 was attributed to the paid in capital, additional paid in capital and statutory reserves of the VIEs and $27,485,389 and $28,069,347 were attributed to the paid in capital, additional paid in capital and statutory reserves of the Company's PRC subsidiaries, as of December 31, 2012 and 2013, respectively. The PRC subsidiaries' accumulated profits may be distributed as dividends to KongZhong without the consent of a third party. The VIEs' revenues and accumulated profits may be transferred to KongZhong through contractual arrangements without the consent of a third party. Under applicable PRC law, loans from PRC companies to their offshore affiliated entities require governmental approval, and advances by PRC companies to their offshore affiliated entities must be supported by bona fide business transactions.

30.SUBSEQUENT EVENT

In January 2014, the Company entered into agreements to acquire a minority interest in Ourgame International Holdings Limited ("Ourgame" also known as "LianZhong") for a total consideration of RMB100 million in cash (equivalent to approximately $16.4 million at the exchange rate on the dates of the agreements). The investment represents 28.6 million series A Preferred Shares which accounts for 10% equity interest in Ourgame. The investment is to enhance the Company's platform offerings to the browser-based and mobile games market. As the Company has no significant influence over Ourgame, this investment will be recorded as a cost method investment.