

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[TAOMEE HOLDINGS LIMITED INDEX TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014](#)

[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

- ☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014.
OR
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.
OR
☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report: _____.

Commission file number: 001-35190

TAOMEE HOLDINGS LIMITED

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

16/F, Building No. A-2, No. 1528 Gumei Road, Xuhui District
Shanghai 200233, People's Republic of China
(Address of principal executive offices)

Sam Lawn, Chief Financial Officer

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16/F, Building No. A-2, No. 1528 Gumei Road, Xuhui District
Shanghai 200233, People's Republic of China
(86-21) 6128-0056

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

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

Title of Each Class

American Depositary Shares, each representing 20 ordinary shares of par value
US\$0.00002 per share

Name of Each Exchange on Which Registered

New York Stock Exchange

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

NONE

(Title of Class)

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

NONE

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

757,684,760 ordinary shares of par value US\$0.00002 per share, as of December 31, 2014.

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

☐ Large accelerated filer

☐ Accelerated filer

☒ Non-accelerated filer

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

☒ U.S. GAAP

☐ International Financial Reporting Standards as issued

☐ Other by the International Accounting Standards Board

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

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

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

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

TABLE OF CONTENTS

CONVENTIONS USED IN THIS ANNUAL REPORT	2
PART I	3
ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS	3
ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE	3
ITEM 3. KEY INFORMATION	3
ITEM 4. INFORMATION ON THE COMPANY	45
ITEM 4A. UNRESOLVED STAFF COMMENTS	77
ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS	77
ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES	114
ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS	127
ITEM 8. FINANCIAL INFORMATION	129
ITEM 9. THE OFFER AND LISTING	130
ITEM 10. ADDITIONAL INFORMATION	132
ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	139
ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES	140
PART II	143
ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES	143
ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS	143
ITEM 15. CONTROLS AND PROCEDURES	143
ITEM 16. AUDIT COMMITTEE FINANCIAL EXPERT	144
ITEM 16B. CODE OF ETHICS	145
ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES	145
ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES	145
ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS	145
ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT	146
ITEM 16G. CORPORATE GOVERNANCE	146
ITEM 16H. MINE SAFETY DISCLOSURE	146
PART III	147
ITEM 17. FINANCIAL STATEMENTS	147
ITEM 18. FINANCIAL STATEMENTS	147
ITEM 19. EXHIBITS	147

CONVENTIONS USED IN THIS ANNUAL REPORT

In this annual report, unless otherwise indicated, references in this annual report to:

- "ADRs" are to the American depositary receipts, which, if issued, evidence our ADSs;
- "ADSs" are to our American depositary shares, each of which represents 20 ordinary shares;
- "China" and the "PRC" are to the People's Republic of China, excluding, for the purpose of this annual report only, Taiwan and the special administrative regions of Hong Kong and Macau;
- "shares" or "ordinary shares" are to our ordinary shares, par value US\$0.00002 per share;
- "RMB" and "Renminbi" are to the legal currency of China;
- "US\$" and "U.S. dollars" are to the legal currency of the United States;
- "we," "us," "our company," "our" or "Taomee" are to Taomee Holdings Limited, a Cayman Islands company, its predecessor entities, subsidiaries, consolidated variable interest entities ("VIEs") and VIEs' subsidiaries controlled by us.

References to share information and per share data reflect the 50-for-1 share split effected on February 14, 2011, in which every ordinary share and Series A preferred share was subdivided into 50 ordinary shares and 50 Series A preferred shares, respectively, and the par value of the shares was changed from US\$0.001 per share to US\$0.00002 per share for each ordinary share and Series A preferred share.

This annual report contains translations of certain Renminbi amounts into U.S. dollars at specified rates. For amounts not recorded in our consolidated financial statements included elsewhere in this annual report, unless otherwise stated, all translation of financial data from Renminbi into U.S. dollars has been made at RMB6.2046 to US\$1.00, the noon buying rate in effect on December 31, 2014 as set forth in the H.10 Statistical Release of the Federal Reserve Board. We make no representation that the Renminbi or U.S. dollar amounts referred to in this annual report could have been or could be converted into U.S. dollars or Renminbi, as the case may be, at any particular rate or at all. See "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Fluctuation in the value of the RMB may have a material adverse effect on the value of your investment." On April 10, 2015, the noon buying rate was RMB6.2082 to US\$1.00.

This annual report on Form 20-F includes our audited consolidated statements of operations for the fiscal years ended December 31, 2012, 2013 and 2014, and consolidated balance sheet data as of December 31, 2013 and 2014.

We completed the initial public offering of 7,187,500 ADSs, each representing 20 ordinary shares of par value US\$0.00002 per share, on June 10, 2011. On June 8, 2011, we listed our ADSs on the New York Stock Exchange, or NYSE, under the ticker symbol "TAOM".

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

ITEM 3. KEY INFORMATION

A. *Selected Financial Data*

The following selected consolidated statements of operations data for the years ended December 31, 2012, 2013 and 2014 and the selected consolidated balance sheet data as of December 31, 2013 and 2014 have been derived from our audited consolidated financial statements, which are included elsewhere in this annual report. Our selected consolidated combined balance sheet data as of December 31, 2010 and the selected consolidated balance sheet data as of December 31, 2011 and 2012, and selected consolidated combined statements of operations data for the year ended December 31, 2010 and selected consolidated statements of operations data for the years ended December 31, 2011 have been derived from our audited consolidated combined financial statements or audited consolidated financial statements that are not included in this annual report.

	For Years Ended December 31,				
	2010	2011	2012	2013	2014
	(US\$ in thousands, except share and per share data)				
Consolidated and Combined Statements of Operations Data:					
Net revenues:					
Online business	33,683	40,331	32,169	35,330	33,292
Offline business	2,290	5,066	8,039	13,024	8,897
Total net revenues	35,973	45,397	40,208	48,354	42,189
Cost of revenues(1):					
Online business	(5,166)	(6,035)	(6,950)	(7,644)	(6,535)
Offline business	(686)	(1,653)	(3,048)	(5,621)	(5,182)
Gross profit	30,122	37,709	30,210	35,089	30,472
Operating income (expenses):					
Product development expenses(1)	(4,649)	(10,304)	(12,318)	(13,886)	(14,446)
Sales and marketing expenses(1)	(1,570)	(6,255)	(9,966)	(9,446)	(9,304)
General and administrative expenses(1)	(5,729)	(7,965)	(10,078)	(13,095)	(13,506)
Impairment loss on acquired intangible assets	—	—	—	(1,046)	(116)
Other operating income	278	1,734	5,512	5,708	5,020
Total operating expenses	(11,670)	(22,790)	(26,850)	(31,765)	(32,352)
Income (loss) from operations	18,452	14,919	3,360	3,324	(1,880)
Interest income	240	1,410	2,647	2,932	2,914
Other income (expenses), net	(115)	667	859	771	(453)
Impairment loss on investment in equity investees	—	—	—	(370)	(1,400)

[Table of Contents](#)

	For Years Ended December 31,				
	2010	2011	2012	2013	2014
	(US\$ in thousands, except share and per share data)				
Income before income taxes and share of profit (loss) in equity method investments, net of gain (loss) on disposals	18,577	16,996	6,866	6,657	(819)
Income tax (expense) benefit:					
Current	(7)	(2,539)	1,279	(789)	(600)
Deferred	2,511	812	(424)	(630)	2,763
Total income tax (expense) benefit	2,504	(1,727)	855	(1,419)	2,163
Net income before share of profit (loss) in equity method investments, net of gain (loss) on disposals	21,081	15,269	7,721	5,238	1,344
Share of profit (loss) in equity method investments, net of gain (loss) on disposals	494	4,224	1,140	207	(433)
Net income	21,574	19,493	8,861	5,445	911
Net income (loss) attributable to non-controlling interest	—	—	(1)	4	(95)
Net income attributable to Taomee Holdings Limited	21,574	19,493	8,862	5,441	1,006
Deemed dividend on Series A convertible redeemable preferred shares	(469)	(200)	—	—	—
Net income attributable to holders of ordinary shares	21,105	19,293	8,862	5,441	1,006
Earnings per ordinary share:					
Basic	\$ 0.0367	\$ 0.0292	\$ 0.0121	\$ 0.0074	\$ 0.0014
Diluted	\$ 0.0360	\$ 0.0278	\$ 0.0118	\$ 0.0073	\$ 0.0014

Weighted
average
number of
ordinary
shares used
in
calculating
earnings per
share:

Basic	450,000,000	606,648,098	731,303,362	733,333,891	712,973,565
Diluted	458,482,370	640,377,175	753,533,499	746,532,112	719,852,640

(1) Includes share-based compensation expenses as follows:

	For Years Ended December 31,				
	2010	2011	2012	2013	2014
	(US\$ in thousands)				
Share-based compensation expenses:					
Cost of revenues	14.8	203.6	255.3	289.9	294.1
Product development expenses	80.9	814.2	498.5	360.9	448.2
Sales and marketing expenses	69.1	63.4	69.0	31.9	16.4
General and administrative expenses	5.6	915.6	1,383.7	1,459.7	1,469.7
Total	170.4	1,996.8	2,206.5	2,142.4	2,228.4

	As of December 31,				
	2010	2011	2012	2013	2014
	(US\$ in thousands)				
Consolidated and Combined Balance Sheets Data:					
Cash and cash equivalents	43,087	120,679	118,571	114,251	103,174
Accounts receivable, net	438	1,423	2,371	2,388	2,499
Total current assets	47,684	127,066	126,967	129,543	119,302
Total assets	53,032	134,454	139,758	151,189	141,862
Advances from customers	8,684	10,223	8,142	6,961	8,236
Deferred revenue	10,783	12,913	12,062	12,341	11,769
Dividends payable	8,950	—	—	—	—
Total current liabilities	34,297	31,303	26,007	29,260	26,727
Series A convertible redeemable preferred shares	5,628	—	—	—	—
Ordinary shares	9	15	15	15	15
Treasury stock	—	(563)	(747)	(1,199)	(11,521)
Additional paid-in capital	1,158	70,782	72,437	73,757	76,308
Retained earnings	11,258	30,551	39,413	44,854	45,860
Noncontrolling interests	—	—	78	159	284
Total equity	13,107	103,151	113,751	121,929	115,135
Total liabilities, mezzanine equity and equity	53,032	134,454	139,758	151,189	141,862

Exchange Rate Information

Our business is primarily conducted in China and substantially all of our revenues are denominated in RMB. This annual report contains translations of RMB amounts into U.S. dollars at specified rates solely for the convenience of the reader. The exchange rate refers to the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board. Unless otherwise noted, all translations from RMB to U.S. dollars were made at a rate of RMB6.2046 to US\$1.00, the noon buying rate set forth as of December 31, 2014. No representation is made that the RMB amounts referred to in this annual report could have been or could be converted into U.S. dollars at any particular rate or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign exchange and through restrictions on foreign trade. On April 10, 2015, the exchange rate was RMB6.2082 to US\$1.00.

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

Period	Noon Buying Rate			
	Period End	Average(1)	Low	High
	(RMB per US\$1.00)			
2010	6.6000	6.7603	6.8330	6.6000
2011	6.2939	6.4475	6.6017	6.2939
2012	6.2301	6.3088	6.3879	6.2221
2013	6.0537	6.1412	6.2438	6.0537
2014	6.2046	6.1704	6.2591	6.0590

Period	Noon Buying Rate			
	Period End	Average(1)	Low	High
	(RMB per US\$1.00)			
2014				
October	6.1124	6.1251	6.1385	6.1107
November	6.1429	6.1249	6.1429	6.1117
December	6.2046	6.1886	6.2256	6.1490
2015				
January	6.2495	6.2181	6.2535	6.1870
February	6.2695	6.2518	6.2399	6.2695
March	6.1990	6.2386	6.2741	6.1955
April (through April 10, 2015)	6.2082	6.1989	6.2082	6.1930

Source: Federal Reserve Statistical Release

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

B. *Capitalization and Indebtedness*

Not Applicable.

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

Not Applicable.

D. *Risk Factors*

Risks Related to Our Business

We may experience net losses or earnings declines in the future and we may not sustain our historical revenue growth rate or profitability.

It is difficult to evaluate our prospective business, because we may not be able to address the risks frequently encountered by companies operating in a new and rapidly evolving industry, which may adversely affect our business and results of operations. These risks may include our potential failure to:

- retain existing users and attract new users;
- develop, license, or acquire additional virtual worlds and mobile games that are appealing to users;
- anticipate and adapt to changing user preferences;
- adapt to competitive market conditions;
- timely respond to technological changes or resolve unexpected network interruptions;
- adequately and efficiently operate, upgrade and develop our online entertainment community;
- maintain adequate control of our expenses; and
- attract and retain qualified personnel.

Our net revenues amounted to US\$40.2 million in 2012, increased to US\$48.4 million in 2013 and decreased to 42.2 million in 2014. Our average active playing users were 44.4 million in 2012, increased to 46.0 million in 2013 and then decreased to 45.8 million in 2014, while our active paying users have been decreasing from 1.7 million in 2012, to 1.4 million in 2013 and to 1.1 million in 2014. We may not

[Table of Contents](#)

be able to achieve revenue or user growth in future periods and we cannot assure you that we will not incur net losses in the future due to a number of factors, including, among others, economic factors out of our control, competition in the children's entertainment industry in China, in which market share can be quickly acquired or lost, the greater difficulty of growing at sustained rates from a larger net revenue base, and adjustment to our strategic decision in response to changing circumstances that emphasize long-term influence over short-term growth. We also expect that our total operating expenses will increase in absolute amount as we further grow our business. We may incur substantial costs and expenses to develop, market or operate a virtual world, mobile game or franchise content and may not collect revenues in connection with the virtual world, the mobile game or franchise content for some time after its commercial launch or at all. We may not succeed in our expansion in the offline business. Any failure or delay in generating revenues could result in material operating losses and harm our financial condition. Accordingly, you should not rely on the results of any prior period as an indication of our future operating performance.

As we currently depend on a limited number of virtual worlds and mobile games for the majority of our revenues, if any of these virtual worlds or mobile games incur any adverse developments or if we are unable to develop, purchase or license additional virtual worlds or mobile games that are attractive to users or players and result in overall revenue growth, our business, financial condition and results of operations may be materially and adversely affected.

Our virtual worlds, Seer Series, Gong Fu Pai, Flower Angel and The Monsters, as well as our mobile game, Reverse World contributed to the majority of our online revenues in 2014. We anticipate that these and other existing virtual worlds and mobile games of ours will continue to account for a substantial portion of our online revenues in the near term. Accordingly, any of the following could materially and adversely affect our business, financial condition and results of operations:

- failure by us to make quality upgrades, enhancements or improvements to the existing virtual worlds and mobile games in a timely manner;
- delay in or discontinuation of regular content updates;
- any reduction in or failure to grow the user base of these existing virtual worlds and mobile games, any decrease in their popularity in the market due to intensifying competition or other factors;
- any decrease in or failure to grow the amount of revenues generated from the existing virtual worlds and mobile games; or
- any breach of virtual world and mobile game related software security, prolonged server interruption due to network failures, hacking activities or other factors or any other adverse developments relating to our existing virtual worlds and mobile games.

In order to achieve our long-term profitability and financial and operational success, we must continually develop, purchase or license new virtual worlds and mobile games that are attractive to users or players. Although we currently have new virtual worlds and mobile games in development, they may not be released on time, may not be profitable or popular among users or players.

The success of our internally developed virtual worlds and mobile games will require additional investment prior to commercial launch. Furthermore, our ability to purchase or license successful virtual worlds and mobile games will depend on their availability on acceptable terms, including price, our ability to compete effectively against other potential purchasers or licensees to attract the developers of these virtual worlds and mobile games, and our ability to obtain government approvals required for the purchase or licensing and operation of these virtual worlds and mobile games.

[Table of Contents](#)

The virtual worlds and mobile games that we develop, purchase or license may not be attractive to users and players, may be viewed by the regulatory authorities as not complying with content restrictions, may not be launched as scheduled or may not compete effectively with our competitors' products. For example, we incurred impairment for intangible assets of US\$1.0 million and US\$0.1 million in 2013 and 2014, respectively, related to the write-off of the remaining term of three underperforming games, namely, Wizard 101 and Speed Hunter for 2013 and Magic Haqi II for 2014. Magic Haqi II is a game for which we obtained a three-year exclusive license in 2012 and commercially launched in the fourth quarter of 2012. Due to its poor performance in the China market, we officially stopped operating Magic Haqi II on April 30, 2014. If we are not able to successfully develop, purchase or license virtual worlds and mobile games appealing to users and players, our future profitability and growth prospects could decline.

In addition, we entered into revenue sharing agreements with third-party web game developers, and primarily collect payments from game players in connection with the sale of virtual currencies and remit certain agreed-upon percentages of the proceeds to the game developers and record revenue net of remittances. Purchases of virtual currencies are not refundable after they have been sold unless there are unused virtual currencies at the time a game is discontinued. Typically, a game will be discontinued when the monthly revenue generated by a game is insignificant. We make our effort to help the game players eliminate their loss before a game is discontinued to avoid paying cash refunds to game players or game developers as a result of discontinuation of a game, or for any other reason. However, we cannot guarantee that we will not be required to pay such cash refunds in the future, which may have adverse effect on our revenues.

We may not be able to maintain our revenues and profitability as we operate in a competitive industry and compete against many companies.

We believe that there are a number of competing developers and operators in China providing online and offline entertainment to children. Given the relatively low capital requirements and entry barriers, we expect more companies to enter the children's entertainment industry in China. For example, our competitors could introduce a wide range of virtual worlds targeting children to the China market in a relatively short period of time. We believe our principal competitors in online children's entertainment in China include Tencent Holdings Limited, or Tencent, the developer of Roco Kingdom, and BAOO Family Interactive Limited (2100 HK), the developer of Aola Star and Aobi Island. Potential competitors also include major Internet portal operators, other domestic and foreign virtual world developers and operators, media companies focused on children's entertainment and alliances between our existing and new competitors. Some of our competitors, especially major foreign and China-based publicly listed media and virtual world operators, have significantly greater financial and marketing resources and name recognition than we have. As we expand into the mobile game market, we also compete with other mobile game developers and operators. The mobile game market is evolving and highly competitive. Unforeseen changes in this market may prove to be more advantageous to certain competitors than they will be to us. We also face these and other competitors in our offline business, including Guangdong Alpha Animation and Culture Co., Ltd, a company listed in Shenzhen Stock Exchange which primarily engages in toy and animation industry (Ticker: 002292). Competition in China animation industry is intensifying as there are an increasing number of companies in China entering into this market. Our competitors may adopt loss-leading pricing or other tactics or business models, and if these prove to be more attractive to children on a temporary or permanent basis, our users may switch to our competitors' services and products at our expense. We cannot assure you that we will be able to compete successfully against any new or existing competitors, or maintain our user base and number of active paying accounts when competitors launch promotional campaigns targeting our user base, which could have a material adverse effect on our revenues and profitability.

We face risks and uncertainties regarding the growth of the online entertainment industry for children and market acceptance of our online products and services.

The online entertainment industry for children in China, from which we currently derive most of our revenues, is a relatively new and evolving industry and concept. The growth of the online entertainment industry for children and the level of demand and market acceptance of our virtual worlds, mobile games and other online products and services are subject to a high degree of uncertainty. Our future operating results will depend on numerous factors, some of which are beyond our control. These factors include:

- the direct growth and growth rate of personal computer, mobile devices, Internet and broadband users as well as penetration in China and other markets in which we offer our virtual worlds, and mobile games;
- whether the online entertainment market in China, and in particular the online entertainment market for children, continues to grow and the rate of any such growth;
- general economic conditions, particularly economic conditions adversely affecting discretionary spending on children's entertainment;
- the availability and popularity of other forms of entertainment, particularly console system games; and
- our ability to create new digital entertainment products appealing to our users, including the ability to timely update our existing virtual worlds, mobile games and other services while introduce new virtual worlds, mobile games and other services that attract existing and new users.
- the general acceptance by parents to accept mobile games as a form of entertainment for their children, as typically children's entertainment options in terms of time and spending are regulated by parents.

If we fail to anticipate and effectively manage these risks and uncertainties, our market share may decrease, our business, financial condition and results of operations may be materially and adversely affected.

Our digital entertainment products and services including new virtual worlds and mobile games may attract our users away from our established virtual worlds and mobile games, and enhancements and updates to our established virtual worlds and mobile games may result in certain users deciding not to participate in them, which could materially and adversely affect our business, results of operations and financial condition.

Our digital entertainment products and service including new virtual worlds and mobile games may attract our users away from our established virtual worlds and mobile games, particularly with respect to virtual worlds with similar story lines or mobile games with the same style. Although we intend to target different types of users with new virtual worlds and mobile games and therefore minimize users of our existing virtual worlds and mobile games migrating to later launched virtual worlds and mobile games, such movement may nevertheless occur and may lead to fewer active users, reduced network effect and lower spending on subscriptions and virtual items.

In addition, in order to retain our existing users and to attract new users, we periodically introduce new features and make changes to our established virtual worlds based on feedback gathered from our users, or offer upgraded versions with new avatars and new story lines to our existing mobile games. However, these changes or updates may result in some of our existing users deciding not to participate in our virtual worlds and mobile games, either temporarily or permanently. Our users may not respond well to enhancements to our virtual worlds and mobile games, or policy changes in our online

entertainment community, which could materially and adversely affect our business, results of operations and financial condition.

We may not be successful in effectively promoting our brand or enhancing our brand recognition, and any negative publicity, regardless of its veracity, may harm our brand.

Promoting the "Taomee" and "Glove Game" brands and enhancing their recognition is an integral part of our growth strategy. There is no assurance that we will be able to effectively promote or develop our brands and if we fail to do so, our growth may be adversely affected. In addition, negative publicity or disputes regarding our brands, products and services, company or management could materially and adversely affect public perception of our brand and the virtual worlds, mobile games and other products and services we offer. Any negative publicity in relation to our services or products, regardless of its veracity, could harm our brand image and, in turn, result in decreases in the number of users and average net revenues per paying account from the operation of our online business. Any impact on our ability to effectively promote our brand and any significant damage to the public perception of the "Taomee" and "Glove" brands or our virtual worlds and mobile games could materially and adversely affect our prospects and results of operations.

Unauthorized use of our intellectual property by our distributors, licensees or third parties, and the expenses incurred in protecting our intellectual property rights, may harm our brands and reputation and adversely affect our business.

We regard our copyrights, trademarks and other intellectual property as important to our success. Unauthorized use of our intellectual properties may harm our brands and reputation and adversely affect our business.

We have historically relied on a combination of trademark and copyright law, trade secret protection, restrictions on disclosure and other agreements that restrict the use of our intellectual properties to protect our intellectual property rights. Although our contracts with distributors and licensees prohibit the unauthorized use of our franchises, brands and other intellectual property rights, we cannot assure you that they will always comply with these terms. Although we presently enter into confidentiality agreements with most of our employees, we cannot assure you that these confidentiality agreements will not be breached, that we will have adequate remedies for any breach, or that our proprietary technology, know-how or other intellectual property will not otherwise become known to, or be independently developed by, third parties.

As of December 31, 2014, we had received approval for 376 and 7 trademark registrations in China and Taiwan, respectively, and are in the process of applying for registration of an additional 70 trademarks in China. In addition, we have obtained 105 copyright registrations for software we developed, 177 copyright registrations for Mole's World, Seer and Flower Angel animation series and 416 copyright registrations for artworks owned by us. We also registered 38 domain names, including www.61.com, our primary operation website. While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. For example, in 2014, our Mole's World cartoon animations were broadcast by a third party website without our authorization. In addition, we cannot assure you that any of the above trademark applications will ultimately proceed to registration or will result in registration with adequate scope for our business. Some of our pending applications or registrations may be successfully challenged or invalidated by others. If our trademark applications are not successful, we may have to use different marks for affected products or services, or seek to enter into arrangements with any third parties who may have prior registrations, applications or rights, which might not be available on commercially reasonable terms, if at all.

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

We have no control over our prepaid card distributors, mobile game publishers or franchise licensees except through agreements we entered into with them. Our brands and reputation could be harmed and our results of operations could suffer if our distributors or licensees fail to comply with our agreements with them.

We rely on our distributors to distribute our prepaid cards, through which our users pay subscription fees and purchase online virtual items, and mobile game publishers to operate our mobile games. We also rely on our licensees to manufacture and distribute products, including toys, of our licensed franchises. We have limited ability to manage the activities of our distributors, publishers and licensees, who are independent from us, except through the enforcement of agreements with them. If a significant number of our distributors or licensees fail to comply with our agreements with them, such as distribution targets, brand and service promotion arrangements, quality control standards, or protocols on approving the presentation or portrayal of our franchises, our brands and reputation could be harmed and our results of operations could suffer as a result.

We rely on our nationwide prepaid card distribution network, mobile game publishers and distribution channels, merchandise licensees, toy distributors and film distributors for a significant portion of our net revenues. If we fail to effectively manage our distributor, publisher and licensee relationships or our distributors, publishers and licensees fail to adhere to our agreements with them, our results of operations could suffer as a result.

We rely on a number of provincial and regional distributors to sell our prepaid cards. Online payment systems in China are still in a relatively early stage of development and are not as widely acceptable to users in China as compared to the United States. Also, compared to adult online users, children have fewer means to make payment through online payment channels. As a result, although we make our prepaid cards available for purchase online using an online payment system, our business is dependent on the performance of our regional distributors. In 2012, 2013 and 2014, 73.9%, 71.9% and 65.4%, respectively, of our net sales proceeds collected were from the sales of prepaid cards to our distributors, respectively. Our largest distributor accounted for 9.8%, 7.4% and 6.9% of our net sales proceeds generated from prepaid card sales in 2012, 2013 and 2014, respectively. Although we typically enter into semi-annual contracts with and provide performance based incentives to our distributors, our distribution agreements are not exclusive and do not prohibit our distributors from selling our competitors' game cards. Maintaining relationships with a significant number of distributors may be difficult and time-consuming. If we fail to maintain good relationships with, or to effectively manage, our distributors, if these new distributors may not strictly adhere to our agreements with them or provide targeted distribution in locations frequented by target users, or if the distributors promote our competitors' service and products at our expense, our results of operations could suffer as a result.

We license our self-developed mobile games, which are played on iOS or Android based smartphones and tablets, to certain publishers including Chukong, IGG, True Digital Plus and Netmarble. Those publishers publish such games to end players through distribution channels, primarily comprise online application stores and mobile app portals, such as Apple App Store for iOS; Google Play Store for international Android distribution and 360 Mobile Assistant, UC Web, 91 Wireless and SnapPea for domestic Android distribution. We are subject to the standard service terms and conditions of these publishers and distribution channels with regard to the promotion, distribution, operation and

payment methods for our mobile games. If any of these publishers and distribution channels (i) fails to provide high levels of service to enable our end users to access our mobile games, (ii) experiences issues with in-app purchasing functionality, (iii) goes out of business, (iv) discontinues its relationship with us due to any reason, such as our failure to comply with any laws or regulations in any jurisdiction where our mobile games are offered, (v) limits our access to its channels, (vi) modifies its terms of services or other policies, (vii) changes its fee structure, such as the change on revenue sharing strategy, (viii) provides more favorable terms to our competitors or develops its own games, or (ix) is forced to cease the business relationship with us due to its lack of required licenses or permits or other regulatory compliance issues, our business could be adversely affected. Furthermore, under the agreements we entered into with our publishers and distribution channels, we will be held liable for the losses incurred by them as a result of the violation of any applicable laws and regulations or the infringement upon third parties' intellectual property rights by our mobile games, in which case the affected publishers and distribution channels may terminate the agreement. If any of the above happens and the relevant agreement is terminated, our business may be adversely affected. In addition, we have benefited from these publishers and distribution channels' widely recognized brand names and large player bases. If any of these publishers and distribution channels loses its market position or otherwise falls out of favor among players or other factors cause its player base to stop growing or shrink, or if any of them fails to perform its contractual obligations to us, we would need to identify alternative distributors and channels for promoting and distributing our mobile games, which would consume substantial resources and may not be effective, or available at all.

We also rely on our licensees and distributors to distribute our merchandises and toys. We sell a vast majority of our products in China through our licensees and distributors, who in turn sell our products to consumers through retail stores directly operated by them or by their sub-distributors. Our distributors are not contractually obligated to work with us on an exclusive basis. In addition, some of our distributors may sell products that compete with our products. Our dependence on distributors increases their bargaining power with us and the need for us to maintain good relationships with them. To the extent that any material distributor ceases to cooperate with us for any reason and we are not able to find a suitable replacement in a timely manner, we may lose significant business. In addition, we may have to offer volume-based discounts or more favorable credit terms to our distributors in the future, which may lower our operating profit. As we rely to a large extent on our distributors for the sale of our products, our future growth will also depend on the performance of our distributors and their ability to expand their business and sales networks. There is no assurance that we will be able to renew our distribution agreements or renew such agreements on terms that are favorable to us. In addition, there is no assurance that one or more of our major distributors will not breach their distribution agreements or fail to comply with their obligations thereunder. In such event or events, our results of operations may be materially and adversely affected.

We also rely on our film distributors to release our featured films. Film distributors act as intermediaries between film producers and movie theater operators. As a result, the releases of our films depend on maintaining relationships with these film distributors. There can be no assurance that we will be able to maintain these relationships and that film distributors will continue to enter into arrangements with us on favorable terms or at all. In addition, any deterioration in our relationships with the film distributors could require us to enter into arrangements with alternative film distributors. If alternative film distributors do not provide us with comparable services at favorable terms or at all, we may not be able to release our films, which in turn could materially and adversely affect our business, financial condition and results of operations. In addition, if any film distributor breaches the contracts with us and fails to pay us the film box office sharing, our results of operations may be materially and adversely affected.

The operators of major online application stores on which we distribute our mobile games in many cases have the unilateral ability to change and interpret the terms of our contract with them.

We distribute our games through online application stores, such as Apple App Store. The distribution terms and conditions of those online application stores are often "click through" agreements that we are not able to negotiate. For example, we are subject to Apple's standard click-through terms and conditions for application developers, which govern the promotion, distribution and operation of applications, including our games, on their storefronts. Apple can unilaterally change their standard terms and conditions without prior notice to us. In addition, the agreement terms can be vague and subject to changing interpretations by the operators. For example, in the second quarter of 2011, Apple began prohibiting certain types of virtual currency-incented advertising offers in games sold on the Apple App Store. Any similar changes in the future could materially harm our business, and we may not receive any advance warning of such change. In addition, Apple has the right to prohibit a developer from distributing its applications on its storefront if the developer violates its standard terms and conditions. If we violate the standard terms and conditions of Apple or any other online application stores and are prohibited from distributing our games on its storefront, our business, financial condition and prospects could be materially and adversely affected.

Unauthorized character enhancements, other hacking or cheating activities, and undetected programming errors or defects in our virtual worlds could harm our online business and reputation and materially and adversely affect our results of operations.

With the increase in the number of virtual world users in China, virtual world operators have increasingly encountered problems arising from the use of unauthorized character enhancements, theft of user account passwords and other hacking or cheating activities. We have from time to time detected a number of users who have gained an unfair advantage by installing hacking or cheating tools to facilitate character progression. In response to these activities, we have installed detection mechanisms in our virtual worlds to identify various hacking and cheating activities, and have expanded our technical team dedicated to detecting unauthorized character enhancements and resolving other hacking issues.

In addition, our virtual worlds may contain undetected programming errors or other defects. Continued occurrences of unauthorized character enhancements, other hacking or cheating activities, and undetected errors or defects in our virtual worlds may negatively impact the image of our virtual worlds and users' perception of their reliability, decrease the number of users, reduce the users' interest in purchasing virtual items, shorten the life span of the virtual worlds and adversely affect our results of operations. A constant recurrence of these activities may require us to shift our management's and personnel's attention from research and development and other operations to focus instead primarily on anti-hacking programs and activities, which could hurt our ability to develop and launch new virtual worlds and could materially and adversely affect our business, financial condition and results of operations.

If we fail to successfully execute our growth strategies, including our current expansion into film and merchandise sales, our future results of operations and growth prospects may be materially and adversely affected.

As part of our growth strategy, we have expanded from the online business to the offline business, such as film, toys and other licensed products. Expansion into these or other new businesses or adoption of other new business models present operating and marketing challenges that are different from those that we encounter in our online business. We face competition from existing players within these markets who may have more experience and resources. We may need to satisfy different regulatory requirements and obtain additional licenses or permits from relevant regulatory authorities. If we cannot successfully address these new challenges and compete effectively in these markets or

under these business models, we may not be able to operate these offline businesses, attract a sufficiently large number of audience or customers, or recover costs incurred for developing and marketing these products or services, and our future results of operations and growth strategies could be materially and adversely affected as a result. Pursuing these and other growth strategies in our offline business may also require us to expand our operations through internal development efforts and through partnerships, joint ventures, investments and acquisitions. If we are unable to successfully implement our growth strategies, our revenue and profitability may not grow as we expect, and our competitiveness may be materially and adversely affected.

We may undertake acquisitions, investments, joint ventures or other strategic alliances, which could have a material adverse effect on our ability to manage our business. In addition, such undertakings may not be successful.

Our strategy includes plans to grow both organically and through acquisitions, joint ventures or other strategic alliances. Joint ventures and strategic alliances may expose us to new operational, regulatory and market risks, as well as risks associated with additional capital requirements. We may not be able to identify suitable future acquisition candidates or alliance partners. Even if we identify suitable candidates or partners, we may be unable to complete an acquisition or alliance on terms commercially acceptable to us. If we fail to identify appropriate candidates or partners, or complete desired acquisitions, we may not be able to implement our strategies effectively or efficiently.

In addition, our ability to successfully integrate acquired companies may be adversely affected by a number of factors. These factors include diversion of management's attention, difficulties in retaining personnel of the acquired companies, unanticipated legal liabilities, and tax and accounting issues in association with the acquisition and business combination. If we fail to integrate acquired companies efficiently, our earnings, revenues growth and business could be negatively affected.

Furthermore, the acquired companies may not perform to our expectations for various reasons, including legislative or regulatory changes that affect the acquired companies' operations, and the loss of personnel. If we are not able to realize the benefits envisioned for such acquisitions, our business and results of operations could be materially and adversely affected. For example, in 2013 and 2014, we made an impairment of US\$0.4 million in our investment in Chuangyou and US\$1.4 million in our investment in Voozclub Co., Ltd., or Voozclub, respectively, due to deteriorating financial position and performance of Chuangyou and Voozclub.

We may not be able to obtain the land use rights in Songjiang, Shanghai in a timely manner and we may not successfully recover our prepayment for building ownership thereunder, which may have a material adverse effect on our results of operations and financial condition.

In May 2013, we entered into a land pre-development cooperation agreement with respect to our intention to purchase the land use rights of two parcels with an aggregated area of approximately 23,300 square meters in Songjiang District, Shanghai for a total consideration of RMB8.9 million (US\$1.4 million), which has been paid in full as of December 31, 2014.

In December 2014, we entered into a land use right transfer agreement with Songjiang Planning and Land Administration Bureau of Shanghai Municipality to purchase the land use right of the above mentioned two parcels for considerations of RMB11.0 million (US\$1.8 million) (the "First Parcel") and RMB10.4 million (US\$1.7 million) (the "Second Parcel"), respectively, which have been paid in full as of January 31, 2015.

Under the land use right transfer agreement in connection with the First Parcel, we agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach annual sales revenues of RMB259.2 million (US\$41.8 million), (ii) the relevant annual tax expenses will be no less than RMB14.6 million (US\$2.4 million) and (iii) the annual tax expenses per

square meter will be no less than RMB1,200 (US\$193.4) by January 26, 2020. In addition, we also committed to pay a project completion security deposit of RMB2.2 million (US\$0.4 million), adhering us to certain project commencement, completion and operation milestones on specific dates. Should we fail to meet these requirements and depending on the severity of breach, we may be subject to liabilities for breach including forfeiture of a portion or all of our deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Under the land use right transfer agreement in connection with the Second Parcel, we agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach annual revenues of RMB244.3 million (US\$39.4 million), (ii) the relevant annual tax expenses will be no less than RMB13.8 million (US\$2.2 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by February 11, 2020. In addition, we also committed to pay a project completion security deposit of RMB2.1 million (US\$0.3 million), adhering us to certain project commencement, completion and operation milestones on specific dates. Should we fail to meet these requirements and depending on the severity of breach, we may be subject to liabilities for breach including forfeiture of a portion or all of our deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Separate from the project completion security deposits, if we fail to comply with the terms of the land use right transfer agreements (and depending on the severity of breach), we may be subject to liabilities for the breach including the forfeiture of land use rights by the PRC government. If our land use rights are forfeited, we will not be able to recover the costs incurred for the initial acquisition and will only be refunded the consideration paid for the remaining term of the land use rights, which relies on the government credit for the payment.

In August 2013, we entered into a letter of intent with respect to our intention to purchase a building with an aggregated construction area of approximately 4,860 square meters in Songjiang District, Shanghai for a total consideration of RMB46.6 million (US\$7.5 million) and made a prepayment of RMB14.0 million (US\$2.3 million) in 2013. Given the current business landscape, we decided to terminate the purchase and are in the process of taking back the prepayment. Pursuant to the agreements we have entered into with the parties thereto, we will be fully refunded of the prepayments of if we fail to obtain the land use rights, or if we decide to terminate our intent under no cause. We rely on the other party's credit for the refund of our prepayment. If we have difficulty recovering the balance of the deposits we have paid, we may be obliged to record provisions for impairment loss for all or part of our prepayments, which could have a material adverse effect on our results of operations and financial condition. We believe the risk of the other party to breach its covenants is remote. However, the other party may fail to refund our deposits in a timely manner.

Our Songjiang land development relies heavily on the cooperation by the government and also requires a substantial amount of investment to complete, of which if we do not manage effectively due to our limited knowledge of land development, could adversely affect our cash balance.

We are currently discussing with the Songjiang District government on the plan to develop our future office buildings on the parcels of land acquired in 2014. Our options include, but not limited to, developing the two parcels entirely on our own, co-developing with a third-party partner approved by the Songjiang District government, or cooperating directly with the Songjiang District government in co-development. Should we develop the project entirely on our own, we anticipate a minimum of 30% of the entire project cost to be funded by our cash balance, with the remaining in debt under limited liability entities to minimize our exposure. Given our limited knowledge in office building development, we may incur risks, such as poor construction management, inadequate quality assurance, over budgeting and delays on the project completion. While we aim to possibly co-develop with potential partners to minimize our risks, we rely heavily on the Songjiang District's governments' cooperation

and willingness to approve third-party partners or their interest to co-develop with us. If we have difficulty in receiving the support of the Songjiang District government, our investment and estimated development costs may be adversely affected.

Our limited resources may affect our ability to manage our growth.

Our growth to date has placed, and our anticipated further expansion will continue to place, a strain on our management, systems and resources. To accommodate our growth pursuant to our strategies, we implemented and maintained and will continue to accommodate a variety of new and upgraded operational and financial systems, procedures and controls, as well as our accounting and other internal management systems, all of which require substantial management efforts. We also will need to continue to expand, train, manage and motivate our workforce, and manage our relationships with our users, our distributors and third-party product and service providers. All of these endeavors will require substantial management effort and skill and the incurrence of additional expenditures. We cannot assure you that we will be able to efficiently or effectively implement our growth strategies and manage the growth of our operations, and any failure to do so may limit our future growth and hamper our business strategy.

Our failure to anticipate or successfully implement new technologies could render our game engines, development platforms or virtual worlds and mobile games unattractive or obsolete, and reduce our revenues and market share.

Our proprietary engines for powering our virtual worlds and mobile games, make our flexible and secure software framework and anti-cheating expertise critical to our success. Our industry is subject to rapid technological changes. We need to anticipate the emergence of new technologies and assess their market acceptance. We also need to invest significant resources, including financial resources, in research and development to keep pace with technological advances in order to make our development capabilities and our virtual worlds and mobile games competitive in the market. However, development activities are inherently uncertain, and we might encounter practical difficulties in commercializing our development results. Our significant expenditures on research and development may not generate corresponding benefits. Given the fast pace with which virtual world and mobile game technology has been and will continue to be developed, we may not be able to timely upgrade our engines or the software framework for our virtual world development in an efficient and cost-effective manner, or at all. New technologies in virtual world and mobile game programming or operations could render our technologies, our existing virtual worlds and mobile games, or the virtual worlds and mobile games that we are developing or expect to develop in the future obsolete or unattractive, thereby limiting our ability to recover related product development costs, purchase costs and/or licensing fees, which could result in a decline in our revenues and market share.

We may be subject to intellectual property infringement claims, which could be time-consuming and costly to defend and may result in diversion of our financial and management resources and our inability to continue providing some of our existing virtual worlds.

We cannot assure you that our franchise characters, our plots, or other content posted on our websites or made available through our video site or our partners' site, has not infringed or will not infringe upon patents, valid copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business within the relevant statute of limitation. For instance, in 2014, we were accused by Shanghai Animation Film Studio for Shanghai Taomee's unauthorized broadcast of 11 pieces of cartoons on v.61.com. We reached a settlement to pay the plaintiff a compensation of RMB44,000 (US\$7,092). In late 2014, we are accused by Xi'an Jiayunsheng Digital Entertainment Distribution Ltd. for Shanghai Taomee's unauthorized broadcast of four series of TV

[Table of Contents](#)

cartoons on v.61.com, and the accused compensation amount was RMB200,000 (US\$32,234) with all litigation expenses. We are still in the process of evidence exchanging. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, be forced to pay fines and damages, and we may incur licensing fees or be forced to develop alternatives. In addition, we may incur substantial expenses and diversion of our financial and management resources in defending against these third-party infringement claims, regardless of their merit. Successful infringement or other intellectual property rights claims against us may result in substantial monetary liabilities, which may disrupt our operations and materially adversely affect our business, results of operations and prospects.

Some of our employees were previously employed at other companies, including our current and potential competitors. We also intend to hire additional personnel to expand our development team and technical support team. To the extent these employees are involved in the development of content or technology similar to ours at their former employers, we may become subject to claims that such employees or we may have appropriated proprietary information or intellectual properties of the former employers of our employees. If we fail to successfully defend such claims against us, our results of operations could be materially and adversely affected.

We could be liable for our users' privacy being compromised, which may have a material adverse effect on our reputation and business.

Although we seek to provide a safe playing environment for our users by implementing a sophisticated security mechanism, our virtual worlds and mobile games are subject to infiltrating behaviors from predators who hack the accounts of our users to gain progression advantages, access these users' accounts, or for other purposes. Despite our efforts to employ security features to filter offensive content and monitor users' interactions, there is no guarantee that we can successfully keep our users free from predatory behavior, offensive contact or other acts that violate the privacy of our users. A significant number of failures to prevent our users' exposure to such infiltration would severely harm our reputation and business.

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

In 2012, 2013 and 2014, 26.1%, 28.1% and 34.6%, respectively, of our net sales proceeds collected were generated from sales of our virtual currency through third-party payment systems. In such transactions, secure transmission of confidential information, such as users' debit and credit card numbers and expiration dates, personal information and billing addresses, over public networks, including our official website, is essential for maintaining user confidence. We currently provide password protection for a majority of our users' accounts, and we were taking measures to encourage users to set password. In addition, we are developing new tools to better ensure the security of our users' accounts in the future. While we have not experienced any material breach of our security to date, we still must prevent future breaches and current security measures may be inadequate. In addition, we expect that an increasing number of our sales will be conducted over the Internet as a result of the expanded user base and the growing use of online payment systems. We also expect that associated online crime will likely increase accordingly. We must therefore be prepared to increase our security measures and efforts so that our users have confidence in the reliability of the online payment systems that we use. We do not have directly control over the security measures of our third-party payment operators, and their security measures may not be adequate at present or may not be adequate with the expected increased usage of online payment systems. We could be exposed to litigation and possible liability if we fail to safeguard confidential user information, which could harm our reputation and our ability to attract users and may have a material adverse effect on our business.

The successful operation of our online business depends on the performance and reliability of the Internet infrastructure and fixed telecommunications networks in China.

Our online business depends on the performance and reliability of the Internet infrastructure in China. Almost all access to the Internet is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or the MIIT. In addition, the national networks in China are connected to the Internet through international gateways controlled by the PRC government. These international gateways are the only channels through which a domestic user can connect to the Internet. Although the PRC government has pledged to improve the Internet infrastructure in China as part of its stimulus packaged introduced in the first quarter of 2009, a more sophisticated Internet infrastructure may not be developed in China. We or the users of our virtual worlds and mobile games may not have access to alternative networks in the event of disruptions, failures or other problems with China's Internet infrastructure.

Unexpected network interruptions, network security breaches or computer virus attacks could have a material adverse effect on our business, financial condition and results of operations.

Any failure to maintain the satisfactory performance, reliability, security and availability of our network infrastructure may cause significant harm to our reputation and our ability to attract and maintain users. All of the servers operating our virtual worlds and mobile games, all of the servers handling log-in, billing and data back-up matters for us, and all of our backup servers are owned by our company, and are maintained by our internal personnel. Major risks involved in such network infrastructure include any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures that may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware.

In the past, our server network has experienced unexpected outages for several hours and occasional slower performance in a number of locations in China as a result of failures by third-party service providers. Our network systems are also vulnerable to damage from fire, flood, power loss, telecommunications failures, computer viruses, hacking and similar events. Any network interruption, virus or other inadequacy that causes interruptions in the availability of our virtual worlds and mobile games or deterioration in the quality of access to our virtual worlds could reduce our users' satisfaction and ultimately harm our business and results of operations.

We face risks associated with the licensing of our virtual worlds, mobile games, film or cartoon animations overseas, and if we are unable to effectively manage these risks, they could impair our ability to expand our business internationally.

In order to expand into overseas markets, we have licensed our virtual worlds and mobile games to overseas operators or distributors. As of the date of this annual report, our virtual worlds have been licensed in Taiwan and our mobile game, Reverse World, has been licensed in countries and regions including North America, Europe, Korea, Thailand, Taiwan, Hong Kong, Macau and Singapore. We may license our existing and new products in other countries and regions in the future. The offering of our products in the international markets could expose us to a number of risks, including:

- difficulties in identifying and maintaining good relationships with licensees who are knowledgeable about, and can effectively distribute and operate our products in, international markets;
- difficulties in maintaining the reputation of our company and our products, given that our virtual worlds are operated by licensees in the international markets pursuant to their own standards;

[Table of Contents](#)

- difficulties in protecting our intellectual property rights internationally and the associated costs;
- difficulties and costs relating to compliance with the different commercial, legal and tax requirements of the international markets in which we offer our products, such as foreign ownership restrictions, game import regulatory procedures, taxes and other restrictions;
- difficulties and uncertainties in obtaining software export contract registration license from the relevant PRC authorities;
- fluctuations in currency exchange rates; and
- interruptions in cross-border Internet connections or other system failures.

If we are unable to effectively manage such risks, they could impair our ability to expand our business internationally. We have ceased our cooperation with some of the third-party operators because the operation results did not meet our expectation.

Our business depends substantially on the continuing efforts of our management and other key personnel. If we lose their services, we could incur significant costs in finding suitable replacements and our business may be severely disrupted.

Our future success heavily depends upon the continued services of our management and other key personnel. In particular, we rely on the expertise and experience of Mr. Benson Haibing Wang, our chief executive officer, and Mr. Roc Yunpeng Cheng, our president. In 2014, certain of our executive officers resigned from their positions. For example, in February 2014, Mr. Crow Zhen Wei stepped down from his position as our chief technology officer for personal reasons. In April 2014, Mr. Paul Keung stepped down from his position as our chief financial officer for personal reasons, and we appointed Mr. Sam Lawn as replacement and ensured a seamless transition. In December 2014, Mr. Owen Quan Zhou stepped down from his position of human resources vice president for personal reasons. Although we believe that these changes of our management team did not materially affect our business operations, if one or more of our senior management or key personnel are unable or unwilling to continue in their present positions in the future, we may not be able to replace them easily or at all, and our business may be severely disrupted, our financial condition and results of operations may be materially and adversely affected, and we may incur additional expenses to recruit, train and retain key personnel.

If any of our management or key personnel joins a competitor or forms a competing company, we may lose users, distributors, know-how and key professionals and staff members. Each of our executive officers has entered into employment agreements and confidentiality agreements and the majority of them have entered into non-competition agreements with us. However, if any dispute arises between our officers and us, the non-competition provisions contained in their non-competition agreements may not be enforceable, especially in China, where most of these executive officers and key employees reside, on the ground that we have not provided adequate compensation to these executive officers for their non-competition obligations, which is required under the relevant PRC regulations.

We may not be successful in attracting and retaining qualified personnel and our business and results of operations could be negatively impacted.

We will need to hire and retain additional qualified employees to support our existing operations and planned expansion. Our ability to anticipate and effectively respond to changing user needs depends in part on our ability to attract and retain experienced personnel for our online and offline businesses in technology, graphic design, operation and other functions. The effective operation of our information technology system, call center, logistics and other back office functions also depends in part on our professional employees. Since our industry is characterized by high demand and intense competition for talent, we may need to offer higher compensation and other benefits in order to retain

key personnel in the future. We cannot assure you that we will be able to attract or retain the qualified key personnel that we will need to achieve our business objectives. In addition, as our business has grown rapidly, our ability to train and integrate new employees into our operations may not meet the increasing demands of our business.

Our principal shareholders have substantial influence over our company and their interests may not be aligned with the interests of our other holders of our ordinary shares and ADSs.

As of December 31, 2014, our founders, Mr. Jason Liqing Zeng, Mr. Benson Haibing Wang, Mr. Crow Zhen Wei and Mr. Roc Yunpeng Cheng, who beneficially own our shares through a number of holding entities, and the Qiming Funds together hold 67.9% of our outstanding share capital. Accordingly, our founders and the Qiming Funds have substantial influence over our business, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election and change of directors and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our ADSs. Alternatively, these principal shareholders may cause a merger, consolidation or change of control transaction even if it is opposed by our other shareholders.

Our operating results fluctuate from period to period, making them difficult to predict and may not be indicative of future performance.

Our operating results from period to period are highly dependent upon, and will fluctuate as a result of a variety of factors, including:

- seasonal trends in revenue generation as a result of seasonal fluctuations of active users and online play time, which peaks during summer and winter school vacation periods, which usually occur in the first and third quarters of each year when children have more online playtime, and falls during second and fourth quarters of each year, and generally increases during the Chinese New Year holidays, which occurs in the first quarter of each year, when children are given extra pocket money;
- the introduction of virtual worlds, mobile games and other online and offline services and products;
- the quality, variety, popularity and mix of virtual items and online and offline services and products available for purchase and related promotional efforts;
- the period of time over which we recognize revenue for some of our virtual items in our virtual worlds, which in certain cases is based on the estimated lifespan of our virtual items, which may be adjusted from time to time;
- the period of time which we launch our films and recognize the films related revenue;
- content development costs and licensing or royalty payments; and
- the expansion of our distribution network and the related discounts and rebates.

Additionally, because most of our operating expenses are expected to remain stable in absolute amount in the future, our net income during any given quarter may be adversely affected by any decrease in revenue due to the competition and seasonality effect.

Due to these and other factors, our operating results will vary from period to period, will be difficult to predict for any given period, may be adversely affected from period to period and may not be indicative of our future performance.

If we fail to establish or maintain an effective system of internal controls over financial reporting, we may be unable to accurately report our financial results or prevent fraud, and investor confidence and the market price of our shares may, therefore, be adversely impacted.

As a U.S. public company, we are subject to reporting obligations under the U.S. securities laws. Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future. We are required to prepare a management report on our internal controls over financial reporting containing our management's assessment of the effectiveness of our internal controls over financial reporting. In addition, depending on our market capitalization, our independent registered public accounting firm may be required to attest to and report on our management's assessment of the effectiveness of our internal controls over financial reporting. Our management may conclude that our internal controls over our financial reporting are not effective. Moreover, even if our management concludes that our internal controls over financial reporting are effective, our independent registered public accounting firm may still decline to attest to our management's assessment or may issue a report that is qualified if it is not satisfied with our controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us.

Prior to our initial public offering, we had been a private company with a short operating history and limited numbers of accounting personnel and other resources with which to address our internal controls and procedures. In connection with the audit of our consolidated financial statements for 2012, 2013 and 2014, we and our auditors, an independent registered public accounting firm, identified certain deficiencies in our internal control over financial reporting as defined in the standards established by the U.S. Public Company Accounting Oversight Board, or PCAOB. In connection with our management's assessment of the effectiveness of our internal controls over financial reporting as of December 31, 2014, we have not noted any material weakness, as defined in the standards established by the PCAOB, in our internal controls over financial reporting.

We will continue to implement measures to remedy any deficiencies to meet the deadline imposed by Section 404 of the Sarbanes-Oxley Act. If we fail to timely achieve and maintain the adequacy of our internal controls, we may not be able to conclude that we have effective internal controls over financial reporting in the future. Moreover, effective internal controls over financial reporting are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, our failure to achieve and maintain effective internal controls over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the market price of our ordinary shares. Furthermore, we anticipate that we will continue to incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 of the Sarbanes-Oxley Act.

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

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

Inspections of other firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as

part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

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

We may be unable to secure additional funding in the future or to obtain such funding on favorable terms.

We believe that our current cash and cash equivalents and the anticipated cash flow from operations will be sufficient to meet our anticipated cash needs for the next 12 months. We may, however, require additional cash resources to finance our continued growth or other future developments, including any investments or acquisitions we may decide to pursue. The amount and timing of such additional financing needs will vary principally depending on the timing of new product launches, investments and/or acquisitions, our Songjiang land development projects, as well as the amount of cash flow from our operations. If our resources are insufficient to satisfy our cash requirements, we may seek to issue additional equity or debt securities or obtain a credit facility. The issuance of additional equity securities or securities convertible into our ordinary shares could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties. Financing may not be available in amounts or on terms acceptable to us, if at all, especially if there is a recession or other events causing volatilities in the capital markets worldwide.

We have limited insurance coverage which could expose us to significant costs and business disruption.

Other than insurance for some of the vehicles used in our business, we have not purchased any insurance to cover our assets, property and business. If we were to incur substantial losses or liabilities due to fire, explosions, floods, a wide range of other natural disasters or accidents or business interruption, our results of operations could be materially and adversely affected.

Risks Related to Our Corporate Structure

If the PRC government determines that the contractual arrangements that establish the structure for operating our business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties.

We are a Cayman Islands company and, as such, we are classified as a foreign enterprise under Chinese laws, and our PRC subsidiary, Shanghai Shengran Information Technology Co., Ltd., or Shanghai Shengran, is a foreign-invested enterprise. Various regulations in China currently restrict or prevent foreign-invested entities from holding certain licenses required to operate online virtual worlds, including Internet content provision, Internet culture operation and Internet publishing licenses. In light of these restrictions, we rely on our VIE, Shanghai Taomee, to hold and maintain the licenses necessary to operate our virtual worlds in China. We do not have any equity interest in Shanghai Taomee but receive its economic benefits through various contractual arrangements and certain corporate governance and shareholder rights arrangements. In addition, we have entered into agreements with Shanghai Taomee and its shareholders which provide us with a substantial ability to control Shanghai Taomee. For a description of these contractual arrangements with Shanghai Taomee, see "Item 4. Information on the Company—C. Organizational Structure—Contractual Arrangements with Shanghai Taomee and its Shareholders."

The Circular on Strengthening the Administration of Foreign Investment in and Operation of Value-added Telecommunications Business, or the MII Circular, issued by the MII, in July 2006,

reiterated the regulations on foreign investment in telecommunications businesses, which require foreign investors to set up foreign-invested enterprises and obtain a business operating license for Internet content provision to conduct any value-added telecommunications business in China. Under the MII Circular, a domestic company that holds an Internet content provision license is prohibited from leasing, transferring or selling the license to foreign investors in any form, and from providing any assistance, including providing resources, sites or facilities, to foreign investors that conduct value-added telecommunications business illegally in China. Furthermore, the relevant trademarks and domain names that are used in the value-added telecommunications business must be owned by the local Internet content provision license holder. The MII Circular further requires each Internet content provision license holder to have the necessary facilities for its approved business operations and to maintain such facilities in the regions covered by its license. In addition, all value-added telecommunications service providers are required to maintain network and information security in accordance with the standards set forth under relevant PRC regulations. Due to a lack of interpretative materials from the regulator, it is unclear what impact the MII Circular will have on us or the other Chinese Internet companies that have adopted the same or similar corporate and contractual structures as ours.

In the opinion of Allbright Law Offices, our PRC counsel, (i) the ownership structure and the business and operation model of Shanghai Shengran and Shanghai Taomee are not in violation of any provisions of applicable PRC laws and regulations, and (ii) each contract under Shanghai Shengran's contractual arrangements with Shanghai Taomee and its shareholders is valid and legally binding. However, Allbright Law Offices also advised us that there are uncertainties regarding the interpretation and application of PRC laws and regulations, including the MII Circular. Accordingly, we cannot assure you that the PRC regulatory authorities will ultimately take a view that is consistent with the opinion of our PRC counsel.

If we are found to be in violation of any existing or future PRC laws or regulations, including the MII Circular, or fail to obtain or maintain any of the required permits or approvals, the relevant regulatory authorities would have broad discretion in dealing with such violation, including levying fines, confiscating our income, revoking Shanghai Shengran or Shanghai Taomee's business or operating licenses, requiring us to restructure the relevant ownership structure or operations, and requiring us to discontinue or restrict our transaction with our VIEs, VIEs' subsidiaries or PRC subsidiaries, limit our business expansion in China by contractual arrangements, or restrict or prohibit our use of proceeds to finance our business and operation in China. If any of these actions results in our inability to direct the activities of VIEs or VIEs' subsidiaries that affect their economic performance, and/or our failure to receive the economic benefits from VIEs and VIEs' subsidiaries, we may not be able to consolidate the operating results of our VIEs and VIEs' subsidiaries into our consolidated financial statements in accordance with U.S. GAAP. However, we do not believe that such actions would result in the liquidation or dissolution of our company or our wholly owned subsidiaries.

If the PRC government determines that our ownership structure does not comply with the restrictions contained in the GAPP Notice, we could be subject to severe penalties.

Our virtual worlds and mobile games are deemed online games by relevant PRC government authorities and we are subject to relevant PRC regulations on operators of online games. On September 28, 2009, the General Administration of Press and Publication, or the GAPP, together with the National Copyright Administration, and National Office of Combating Pornography and Illegal Publications jointly issued a Notice on Further Strengthening of the Administration of Pre-examination and Approval of Online Game and the Examination and Approval of Imported Online Game, or the GAPP Notice. The GAPP Notice provides, among other things, that foreign investors are not permitted to invest in online game operating businesses in China via wholly-owned, equity joint venture or cooperative joint venture investments, and expressly prohibits foreign investors from gaining control

over or participating in domestic online game operators through indirect ways such as establishing other joint venture companies, or contractual or technical arrangements. We are not aware of any online game companies adopting the same or similar contractual arrangements as ours having been penalized or ordered to be terminated since the GAPP Notice first became effective. As advised by our PRC counsel, Allbright Law Offices, there is uncertainty with respect to the interpretation and implementation of the GAPP Notice; although (i) according to the relevant provisions of the Regulation on the Main Functions, Internal Organization and Staffing of the GAPP issued by the General Office of the State Council on July 11, 2008, or the Regulation on Three Provisions, the GAPP is authorized to approve the publication of online games before their launch on the Internet, while the Ministry of Culture is authorized to administer and regulate the overall online game industry; (ii) a circular on the interpretation of the Regulations on Three Provisions, which was issued by the office of the Central Organization Establishment Commission on September 7, 2009, provides that once an online game is launched on the Internet, it will only be regulated by the Ministry of Culture, and that if an online game is launched on the Internet without prior approval of the GAPP, the Ministry of Culture, instead of the GAPP, is the direct authority to investigate the game; and (iii) the original set of our contractual agreements with our significant VIE took effect in June 2009, which was prior to the effective date of the GAPP Notice. There are, however, uncertainties regarding the interpretation and application of the GAPP Notice. Accordingly, we cannot assure you that the GAPP will not ultimately take a view that is contrary to the opinion of our PRC legal counsel. In the event that we, our PRC subsidiary or VIEs are found to be in violation of the GAPP Notice to operate our online virtual worlds, the GAPP in conjunction with the relevant regulatory authorities would have the power to investigate and deal with such violations, including in the most serious cases where relevant licenses and registrations would be suspended or revoked.

Our contractual arrangements with Shanghai Taomee and its shareholders may not be as effective in providing control over Shanghai Taomee as direct ownership of this company.

We conduct our business in China through Shanghai Taomee. Our contractual arrangements with Shanghai Taomee and its shareholders provide us with effective control over Shanghai Taomee. See "Item 4. Information on the Company—Organizational Structure—Contractual Arrangements with Shanghai Taomee and its Shareholders." As a result of these contractual arrangements, we are considered to be the primary beneficiary of Shanghai Taomee and accordingly, we consolidate the results of operations, assets and liabilities of Shanghai Taomee in our financial statements.

Although we have been advised by Allbright Law Offices, our PRC legal counsel, that each contract under these contractual arrangements is valid and legally binding, these contractual arrangements may not be as effective in providing us with control over Shanghai Taomee as direct ownership of this company. If Shanghai Taomee or its shareholders fail to perform their respective obligations under these contractual arrangements, we may have to incur substantial costs and resources to enforce such arrangements, and rely on legal remedies under PRC law, including seeking specific performance or injunctive relief, and claiming damages, which we cannot assure you that it will be effective. See "—Risks Related to Our Corporate Structure—Our ability to enforce the Equity Interest Pledge Agreements between us and the shareholders of Shanghai Taomee may be subject to limitations based on PRC laws and regulations".

These contractual arrangements are governed by PRC law and provide for the resolution of disputes through arbitration in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. The legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements, which may make it difficult to exert effective control over our VIEs and VIEs' subsidiaries, and our ability to conduct our business may be negatively affected and we may not

be able to consolidate the financial results of our VIEs and VIEs' subsidiaries into our consolidated financial statements in accordance with U.S. GAAP. See "—Risks Related to Doing Business in China—Uncertainties with respect to the PRC legal system could have a material adverse effect on us."

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

Shanghai Taomee is jointly owned by Mr. Jason Liqing Zeng, our chairman and director, Mr. Benson Haibing Wang, our co-founder, director and chief executive officer, Mr. Crow Zhen Wei, our co-founder and director, Mr. Roc Yunpeng Cheng, our co-founder, director and president, Mr. Bin Wang and Mr. Yuliang Feng. In addition, except for Mr. Bin Wang and Mr. Yuliang Feng, the above other individuals are also directors or executive officers of Shanghai Taomee. The PRC Company Law provides that a director or member of management owes a fiduciary duty to the company he directs or manages. The abovementioned individuals, except for Mr. Bin Wang and Mr. Yuliang Feng, must therefore act in good faith and in the best interests of Shanghai Taomee and must not use their respective positions for personal gain. These laws do not require them to consider our best interests when making decisions as a director or member of management of Shanghai Taomee.

Conflicts of interests between these individuals' role as shareholders or directors of Shanghai Taomee and their duties to our company may arise. We cannot assure you that when conflicts of interest arise, these individuals will act in the best interests of our company or that conflicts of interest will be resolved in our favor. In addition, these individuals may breach or cause Shanghai Taomee to breach or refuse to renew the existing contractual arrangements that allow us to effectively control Shanghai Taomee, and receive economic benefits from it. Currently, we do not have arrangements to address potential conflicts of interest between these individuals and our company and a conflict could result in these individuals as officers of our company violating fiduciary duties to us. We believe these individuals will not act contrary to any of the contractual arrangements, and the option agreements entered into by each of these individuals with our company entitled us to remove the shareholders as beneficial shareholders of the VIEs should any of them act in a way that is detrimental to our company. We rely on these individuals as our directors and executive officers to fulfill their fiduciary duties and abide by laws of the PRC and Cayman Islands and act in the best interest of our company. However, if we cannot resolve any conflicts of interest or disputes between us and any of the shareholders of Shanghai Taomee, we would have to rely on legal proceedings, which could result in disruption to our business, and there would be uncertainty as to the outcome of any such legal proceedings.

Our ability to enforce the Equity Interest Pledge Agreements between us and the shareholders of Shanghai Taomee may be subject to limitations based on PRC laws and regulations.

Pursuant to the Equity Interest Pledge Agreements with the shareholders of Shanghai Taomee, such shareholders agreed to pledge their equity interests in Shanghai Taomee to secure their performance under the relevant contractual arrangements. The equity pledges of Shanghai Taomee under these Equity Interest Pledge Agreements have been registered with the local branch of State Administration for Industry and Commerce pursuant to the new PRC Property Rights Law. According to the PRC Property Rights Law and PRC Guarantee Law, the pledgee and the pledgor are prohibited from making an agreement prior to the expiration of the debt performance period to transfer the ownership of the pledged equity to the pledgee when the obligor fails to pay the debt due. However, under the PRC Property Rights Law, when an obligor fails to pay its debt when due, the pledgee may choose to either conclude an agreement with the pledgor to obtain the pledged equity or seek payments from the proceeds of the auction or sell-off of the pledged equity. If Shanghai Taomee or its respective shareholders fail to perform their obligations secured by the pledges under the equity pledge agreements, one remedy in the event of default under the agreements is to require the pledgor to sell

the equity interests of Shanghai Taomee in an auction or private sale and remit the proceeds to our wholly owned subsidiary in China, net of related taxes and expenses. Such an auction or private sale may not result in our receipt of the full value of the equity interests in Shanghai Taomee. We consider it very unlikely that the public auction process would be undertaken since, in an event of default, our preferred approach is to ask Shanghai Shengran, our PRC wholly owned subsidiary and a party to the Option Agreements, to replace or designate another PRC person or entity to replace the existing shareholders of Shanghai Taomee pursuant to the direct transfer option we have under the Option Agreement.

In addition, in the registration forms of the local branch of State Administration for Industry and Commerce for the pledges over the equity interests under the Equity Interest Pledge Agreements, the amount of registered equity interests in Shanghai Taomee pledged to us was stated as RMB10.0 million (US\$1.6 million), which represents 100% of the registered capital of Shanghai Taomee. The Equity Interest Pledge Agreements with the shareholders of Shanghai Taomee provide that the pledged equity interest shall constitute continuing security for any and all of the indebtedness, obligations and liabilities under all of the contractual arrangements. In case of a breach of the contractual arrangement, Shanghai Shengran, as the pledgee, can require the shareholders of Shanghai Taomee to sell the pledged equity interest in a private sale or auction in order to realize Shanghai Shengran's right to the pledged equity interest in Shanghai Taomee. However, if the proceeds obtained by the shareholders of Shanghai Taomee from the foregoing realization process are insufficient to cover the full amount payable to Shanghai Shengran, the uncovered part will be determined as unsecured debt and will rank pari passu with other unsecured debt of the shareholders of Shanghai Taomee. We do not have agreements that pledge the assets of Shanghai Taomee for the benefit of us.

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

As required by applicable PRC laws and regulations, arrangements and transactions among related parties need to be periodically filed with local tax authorities and may be subject to audit or challenge by the PRC tax authorities. We could face adverse tax consequences if the PRC tax authorities determine that the contractual arrangements between Shanghai Shengran and Shanghai Taomee do not represent pricing at arm's length and adjust Shanghai Taomee's income in the form of a transfer pricing adjustment. A transfer pricing adjustment could, among other things, result in a reduction, for PRC tax purposes, of expense deductions recorded by Shanghai Taomee, which could in turn increase its tax liabilities. In addition, the PRC tax authorities may impose late payment fees and other penalties on our affiliated entities for underpaid taxes. Our net income may be adversely affected if our affiliated entities' tax liabilities increase or if they are found to be subject to late payment fees or other penalties.

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

In January 2015, MOFCOM published a draft of the proposed Foreign Investment Law, or Draft FIL, for public review and comments. If enacted, the Draft FIL would replace the existing laws regulating foreign investment in China and harmonize the regulations governing both foreign invested enterprises and PRC domestic entities. Among other things, the Draft FIL expands the definition of foreign investment and introduces the principle of "actual control" in determining whether a company is considered a foreign invested enterprise. Foreign invested enterprises that operate in industries deemed to be either "restricted" or "prohibited" in a "negative list" will be subject to entry clearance and other approvals not required for PRC domestic entities unless such foreign invested enterprises can demonstrate that it is ultimately controlled by a PRC entity. Under the Draft FIL, variable interest

entities would also be deemed as foreign invested enterprises, if they are ultimately "controlled" by foreign investors, and be subject to restrictions on foreign investments. However, the draft law has not taken a position on what actions will be taken with respect to the existing companies with the "variable interest entity" structure. Because the negative list has yet to be published, it is unclear whether it will differ from the current list of industries subject to restrictions or prohibitions on foreign investment. The entry clearance and approvals could prevent certain foreign invested enterprises that operate in industries on the negative list from continuing to conduct their operations through contractual arrangements.

There is substantial uncertainty regarding the Draft FIL, including the content of its final form and the timing of its adoption and implementation. Moreover, it is uncertain whether the Internet content provision service, online gaming, internet publishing and other internet-based industries, in which our subsidiaries and affiliated entities operate, will be subject to the foreign investment restrictions or prohibitions set forth in the "negative list" to be issued. If adopted in its current form and if those industries in which we and our subsidiaries and affiliated entities operate fall in the scope of the negative list, the Draft FIL could have a material and adverse impact on our ability to participate in key sectors of the Chinese economy, including the online game business, as well as the effectiveness or the necessity of our contractual arrangements with our affiliated entities. As of the date of this annual report, the majority of our ultimate controlling persons are all PRC citizens.

Risks Related to Doing Business in China

Changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.

Substantially all of our business operations are conducted in China. Accordingly, our business, results of operations, financial condition and prospects are subject to a significant degree to economic, political and legal developments in China. While China's economy has experienced significant growth over the past decades, growth has been uneven, both geographically and among various sectors of the economy, and may slow down in the future. Any prolonged slowdown in the Chinese economy, in particular the information technology industry, could have a negative impact on our business, operating results and financial condition in a number of ways. For example, our users may decrease spending on our products, while we may have difficulty expanding our user base fast enough, or at all, to offset the impact of decreased spending by our existing users.

Although the Chinese economy is no longer a planned economy, the PRC government continues to exercise significant control over China's economic growth through direct allocation of resources, monetary and tax policies, and a host of other government policies such as those that encourage or restrict investment in certain industries by foreign investors, control the exchange between RMB and foreign currencies, and regulate the growth of the general or specific market. These government involvements have been instrumental in China's significant growth in the past 30 years. If the PRC government's current or future policies fail to help the Chinese economy achieve further growth or otherwise negatively affect our business, our growth rate or strategy, our results of operations could be adversely affected as a result.

Uncertainties in PRC government policies and regulations regarding virtual worlds and online games and children's Internet use in China may adversely affect our business.

In April 2007, the GAPP, the MII, the Ministry of Education, the Ministry of Public Security, and other relevant government authorities jointly issued a circular concerning the mandatory implementation of an addiction prevention program in virtual worlds and online games, which aims to protect the physical and psychological health of minors. This circular requires all virtual worlds to incorporate an addiction prevention program and an identity verification system, both of which limit

the amount of time that a minor or other user may continuously spend participating in a virtual world or playing an online game. Failure to do so may subject us to certain penalties, such as suspension of Internet publishing operation and relevant Internet-access services or revocation of relevant licenses.

On June 3, 2010, the Ministry of Culture, or the MOC, adopted the Provisional Administration Measures of Online Games, or the Online Games Administration Measures, which became effective as of August 1, 2010. The MOC also issued a notice regarding the implementation of the Online Games Administration Measures. We are required to establish the identity verification systems within three months of the effectiveness of the Online Games Administration Measures for online games and virtual worlds which started operation after August 1, 2010, and within six months for those which started operation prior to August 1, 2010. Failing to do so may subject us to an order from relevant authorities to rectify and a fine up to RMB20,000 (US\$3,223).

However, since the users of our virtual worlds and mobile games are principally minors, the implementation of an identity verification system has practical difficulties, mainly because most minors do not have PRC identity cards. We understand that the purpose of identity verification system required under the abovementioned circular issued in 2007 is to facilitate addiction prevention; hence, we have implemented addiction prevention programs for all users of our virtual worlds. We have established the identity verification system in all of our virtual worlds and are currently using it as one of the ways for registration. We plan to use the identity verification system as the only option for registration once required by relevant authorities.

In addition, a notice jointly issued by several central governmental agencies in February 2007 increased the punishment for Internet cafés admitting minors. As Internet cafés provide means for children to access the Internet especially in smaller cities, this restriction may adversely affect our plan for growth in these cities. Further strengthening of these regulations, or enactment by the PRC government of any additional laws to further tighten its administration over the Internet, online games, and, in particular, the Internet use and access to online games and virtual worlds by children, may result in less time spent by users or fewer users, which may materially and adversely affect our business results and prospects for future growth.

The laws and regulations governing virtual worlds and online games in China are developing and are subject to future changes. If we or the third-party publishers we work with fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

The online game industry in China is heavily regulated by the PRC government. Various regulatory authorities of the PRC central government, such as the State Council, the MIIT, the GAPP, the Ministry of Culture and the Ministry of Public Security, have the authority to issue and implement regulations governing various aspects of the online game industries.

We are required to obtain applicable permits or approvals from different regulatory authorities in order to operate our virtual worlds. An Internet content provider, or ICP, such as Shanghai Taomee, must obtain an ICP license in order to engage in any commercial ICP operations in China. Online game operators must also obtain a license from the Ministry of Culture and an Internet publishing license from the GAPP in order to distribute games through the Internet. We hold the Internet culture operation license issued by the Ministry of Culture and the Internet publishing license issued by GAPP. Prior to obtaining the Internet publishing license from GAPP, we worked with third party publishers to publish Mole's World, Seer, Flower Angel, Magic Haqi and Gong Fu Pai. We have obtained 21 approvals from the GAPP in total, covering the Internet publications of all the virtual worlds and mobile games which are developed by us and have been commercially launched, including Mole's World, Seer, Magic Haqi, Flower Angel, Gong Fu Pai, The Monsters and Reverse World. If we cannot obtain the GAPP approval for our virtual worlds to be launched in future or fail to maintain any of our permits or approvals, we may be subject to various penalties, including fines and the discontinuation or

restriction of our operations. Any such disruption in our business operations would materially and adversely affect our business, financial condition and results of operations.

As virtual world and online game industry continues to develop in China, new laws and regulations may be adopted from time to time to require additional licenses and permits other than those we currently have. As a result, uncertainties exist regarding the interpretation and implementation of current and future PRC laws and regulations applicable to virtual worlds and mobile games. We cannot assure you that we will be able to timely obtain required licenses or any other new license required in the future, or at all. We cannot assure you that we will not be found in violation of any current or future PRC laws and regulations.

The laws and regulations governing virtual worlds and online games in China are developing and are subject to future changes. If we, as the developer of our mobile games, are required to obtain applicable permits and licenses before their release online, or if we are required to obtain approval for the release of our e-books on mobile platforms, it may materially and adversely affect our business results and future growth.

According to the Regulation on Three Provisions, the term of online games refers to all the online game works provided to the public through the Internet (including wired Internet and wireless network) for online user interaction or download, which includes but is not limited to MMORPG, web games, casual games, PC game downloading, games with net connection function, online counter strike game platforms and online mobile games. In addition, the distribution of online games to the public through the Internet for online user interaction or download is deemed as publication of such online games and is subject to the approval of the GAPP before such online games are distributed online.

To further build our franchises and animated characters, in October 2011, we expanded into mobile front by releasing the mobile version of Mole's World, which is our first mobile game. Since then, we further expanded our mobile game portfolio, including multiple games based on Seer franchise and Mole's World franchise and a mobile application named "Taomee Mama" as well as a few e-books. In December 2013, we reorganized our wireless division and launched a new studio named "Glove Game" to develop mainstream mobile games like Reverse World, and no longer focus solely on the children entertainment market. Our accumulated mobile downloads on Apple iOS and Android platforms increased to over 36.8 million as of December 31, 2014. All of our mobile games can be downloaded onto iPhones and iPads through Apple's App Store, or downloaded onto Android based mobile devices through Google Play Store or other app portals. We may charge a fee for download or provide free download of our mobile products, depending on the nature of our different types of products and relevant distribution strategies; while we may have an in-application purchase system for virtual items. Currently, there is no official or public interpretation on the distinction between the terms of online games and mobile games, and we understand that the term of online mobile games are covered by the definition of "online games" under the Regulation on Three Provisions, and we have obtained the approvals from the GAPP covering all of our online games, including Mole's World and Seer. However, it still remains uncertain whether we need to obtain approvals for our online mobile games before we distribute such mobile games online. Furthermore, even under the assumption that our mobile games are subject to separate approvals before they are released online, it is still unclear whether we, as the developer of our games, or the third-party operators who manage and operate the platform where our mobile games are offered to the public for download, are required to apply for the approval from GAPP before such online mobile games are distributed online.

As of December 31, 2014, we have released over 12 e-books which featured the Mole's World franchise and Seer animation application on Apple's IOS platform. According to *the Opinions of GAPP on the Development of E-Books Industry*, which was promulgated by GAPP on October 9, 2010 and took effective on the same day, enterprises engaging in e-book industries are subject to approvals and administration from relevant governmental authorities. In addition, enterprises engaging in the creation, editing and publication of e-books or in the operation of platform where the e-book resources are

delivered to users are deemed as e-book publishers and are subject to approvals for the publication of e-books. Since there is no official or public interpretation on the definition of e-book publication, we are not certain whether our release of e-books on mobile platforms will be deemed as publication and therefore be subject to the approval of GAPP.

If relevant governmental authorities retroactively determine that we should obtain separate approvals for our online mobile games before we distribute them online, or that we should apply for approval for the release of our e-books on mobile platforms, we may be subject to penalties or an order to withdraw our mobile games and/or e-books from the Internet, which may adversely affect our business results and prospects for future growth.

The laws and regulations governing animation televisions and films in China are developing and are subject to future changes. If we or the third-parties we work with fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

The film and animation industry of PRC is regulated mainly by the State Administration of Radio, Film and Television, or SARFT. The administration of the foregoing industry is mainly focused on the production and broadcasting of a film and animation television series.

According to the Regulations on the Administration of Movies promulgated by the State Council of PRC on December 25, 2001 which took effective as of February 1, 2002, the film production entity is required to either obtain a Film Production License for engaging in film production activities or a One-Time Film Production License for each single film to be produced. In addition, upon the completion of the film making, the film production entity is required to submit the film to the local branch of SARFT for examination. SARFT will issue a License of Public Screening for each film that passes such examination, allowing the broadcast of such film to the public.

On July 19, 2004, SARFT promulgated the *Administration Rules on the Production and Operation of Broadcasting Television Programs*, pursuant to which an entity that plans to produce and operate television and broadcast programs in China is required to obtain the License for Producing and Operating Television and Broadcast Programs. On July 11, 2006, SARFT issued *Provisional Regulations on Filing and Publicity of Domestic Television Animations*, stipulating that registrations for domestic television animations must be filed with, and be publicly displayed by, SARFT prior to their production. On February 14, 2008, SARFT promulgated the *Notice of the State Administration of Radio, Film and Television on Strengthening the Administration of the Broadcasting of Animation Series* and on May 14, 2010, SARFT further promulgated *Regulations on Content of Television Series*, which stated that for each domestic television animation completed, the animation production entity is required to obtain the Domestic Animation Publication License prior to the broadcast of such domestic television animation to the public.

We cooperate with third parties with the requisite qualifications and licenses in the production and distribution of the animation series and film based on our Mole's World franchise, the animation series and film based on our Seer franchise and the animation series based on our Flower Angel franchise. Shanghai Taomee Animation Co., Ltd. has obtained (i) the license for the production and broadcasting of radio and television program, and the license for the broadcasting of Seer I, Seer II, Seer III, Mole's World III and Flower Angel animation series, (ii) license of public screening for the third and fourth film based on our Seer franchise, and (iii) the license of public screening for the third film based on our Mole's World franchise. If we fail to renew the Broadcasting and Television Program Production License obtained by us or if we or the third parties we worked with cannot obtain the license from SARFT for any of our future animation television series or films, the business of animation and film production will be adversely affected. Any such disruption in our business operations would materially and adversely affect our business, financial condition and results of operations.

The laws and regulations governing broadcasting audio/video programs through the Internet in China are developing and are subject to future changes. If we or the third-parties we work with fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

On July 6, 2004, the SARFT promulgated the Rules for the Administration of Broadcasting of Audio/Video Programs through the Internet and Other Information Networks, or the Audio/Video Broadcasting Rules. The Audio/Video Broadcasting Rules apply to the opening, broadcasting, integration, transmission or download of audio/video programs via the Internet and other information networks. Anyone who wishes to engage in Internet broadcasting activities must first obtain an audio/video program transmission license, with a term of two years, issued by the SARFT and operate pursuant to the scope as provided in such license. Foreign-invested enterprises are not allowed to engage in the above business.

On December 20, 2007, the SARFT and the MIIT jointly issued the Rules for the Administration of Internet Audio and Video Program Services, commonly known as Document 56, which came into effect as of January 31, 2008. Document 56 reiterates the requirement set forth in the Audio/Video Broadcasting Rules that online audio/video service provider must obtain a license from the SARFT. Furthermore, Document 56 requires all online audio/video service providers to be either wholly state-owned or state-controlled. According to relevant official answers to press questions published on the SARFT's website dated February 3, 2008, officials from the SARFT and the MIIT clarified that online audio/video service providers that already had been operating lawfully prior to the issuance of Document 56 may re-register and continue to operate without becoming state-owned or controlled, provided that such providers have not engaged in any unlawful activities. This exemption will not be granted to online audio/video service providers established after Document 56 was issued.

In January 2012, in cooperation with a number of China's leading online video websites who have obtained the audio/video program transmission licenses, we launched v.61.com, a website that offers animation series based on our franchises, such as Seer and Mole's World, as well as other content from these websites. In November 2012, we jointly developed with Turner Broadcasting System Asia Pacific (the parent company of Cartoon Network) ben10.61.com, a dedicated Chinese online zone for Ben 10 fans featuring videos, online games, wallpaper downloads, e-comics and character profiles. If the governmental authorities determine that our website v.61.com and ben10.61.com falls within Document 56, we may not be able to obtain the audio/video program transmission license as required, and we may become subject to penalties, fines or an order to suspend our website v.61.com and ben10.61.com.

Regulation and censorship of information disseminated over the Internet in China may adversely affect our business, and we may be liable for information displayed on, retrieved from, or linked to our Internet websites.

The PRC government has adopted certain regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is obscene, superstitious, fraudulent or defamatory. Failure to comply with these requirements could result in the revocation of ICP and other required licenses and the closure of the concerned websites. The website operator may also be held liable for such prohibited information displayed on, retrieved from or linked to such website.

In addition, the MIIT has published regulations that subject website operators to potential liability for content included on their websites and the actions of users and others using their websites, including liability for violations of PRC laws prohibiting the dissemination of content deemed to be socially destabilizing. The Ministry of Public Security has the authority to order any local Internet

service provider, or ISP, to block any Internet website maintained outside China at its sole discretion. Periodically, the Ministry of Public Security has stopped the dissemination over the Internet of information which it believes to be socially destabilizing. The State Secrecy Bureau, which is directly responsible for the protection of State secrets of the PRC government, is authorized to block any website it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the dissemination of online information.

As these regulations are subject to interpretation by the relevant authorities, it may not be possible for us to determine in all cases the type of content that could result in liability for us as a website operator. In addition, we may not be able to control or restrict the content of other Internet content providers linked to or accessible through our websites, or content generated or placed on our websites by our users, despite our attempt to monitor such content. To the extent that regulatory authorities find any portion of our content objectionable, they may require us to limit or eliminate the dissemination of such information or otherwise curtail the nature of such content on our websites, which may reduce our user traffic and have a material adverse effect on our financial condition and results of operations. In addition, we may be subject to significant penalties for violations of those regulations arising from information displayed on, retrieved from or linked to our websites, including a suspension or shutdown of our operations.

There are currently no laws or regulations in the PRC governing property rights of virtual assets and therefore it is not clear what liabilities, if any, we may have relating to the loss of virtual assets by our users.

Users of our virtual worlds and mobile games acquire and accumulate some virtual assets, such as performance-enhancing items, clothing, accessories and other in-game items. Such virtual assets can be highly valued by users. In practice, virtual assets can be lost for various reasons, such as data loss caused by delay of network service by a network crash, or by hacking activities. There are currently no PRC laws and regulations governing property rights of virtual assets. As a result, it is unclear who the legal owner of virtual assets is and whether the ownership of virtual assets is protected by law. In addition, it is unclear under PRC law whether an operator of virtual worlds such as us would have any liability (whether in contract, tort or otherwise) for loss of such virtual assets by users. Based on several judgments regarding the liabilities of online game operators for loss of virtual assets by users, the courts have generally required the online game operators to provide well-developed security systems to protect such virtual assets owned by users. In the event of a loss of virtual assets, we may be sued by users and may be held liable for damages.

Restrictions on virtual currency may adversely affect our game operations revenues.

A significant part of our virtual world operations revenues are collected through the sale of our prepaid cards. The Notice on the Reinforcement of the Administration of Online Games issued by the Ministry of Culture and other governmental authorities on February 15, 2007, directs the People's Bank of China to strengthen the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. This notice also applies to virtual worlds we operate. This notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency should only be used to purchase in-game items. On June 4, 2009, Ministry of Culture and Ministry of Commerce jointly issued Notice on the Reinforcement of the Administration of Virtual Currency in Online Games, which defines what virtual currency is and requires that entities obtain the approval from the Ministry of Culture before issuing virtual currency and engaging in transactions using virtual currency in connection with online games. We have obtained the approval from the Ministry of Culture for the issuing of our virtual currency. These restrictions on

virtual currency may result in lower sales of our prepaid cards, and could have an adverse effect on our revenues from online business.

Our business benefits from certain government tax incentives. Expiration, reduction or discontinuation of, or changes to, these incentives will increase our tax burden and reduce our net income.

Shanghai Taomee, as a "software enterprise," enjoyed a full exemption from enterprise income tax, or EIT, in 2009 and 2010 and a 50% reduction in the EIT rate from 2011 to 2013. In addition, an enterprise may benefit from a preferential tax rate of 15% under the EIT Law if it qualifies as a "High and New Technology Enterprise", or HNTE. In 2010, Shanghai Taomee obtained "High and New Technology Enterprise" qualification, or HNTE qualification, which is effective for a period of three years and could be renewed thereafter. In 2013, Shanghai Taomee applied for the renewal and received a new HNTE qualification and was approved by local tax authority to enjoy a preferential tax rate of 15% from January 2014 to December 2015. In 2014, Shanghai Taomee applied for preferential tax treatment as a HNTE. Shanghai Shengran was entitled to the full EIT exemption for 2010 and 2011, and 50% reduction in EIT rate from 2012 to 2014. Shanghai Shengran obtained HNTE qualification in 2012 and has not applied to the relevant tax authority for preferential tax treatment as a HNTE. Shanghai Xinsheng also obtained a Software Enterprise Certification in 2013 and has not applied to the relevant tax authority for the two-year EIT exemption and a three-year 50% EIT rate reduction preferential tax treatment as a "software enterprise" due to its accumulated loss position.

Being qualified as a "software enterprise" by the relevant governmental authority is a condition precedent to enterprise's application to the relevant tax authority to apply for preferential tax treatment for the two-year EIT exemption and a three-year 50% EIT rate reduction as a "software enterprise". On February 24, 2015, the State Council issued the *Decision on Cancelling and Adjusting a Batch of Administrative Approval Items and other Matters*, pursuant to which the government approval of qualification of "software enterprise" and registration of software products are released. However, there is no specific regulation or implementation issued by the relevant tax authority on how the software enterprise's preferential tax treatment application may be adapted to such release.

According to the *Notice of the Ministry of Finance and Other Departments regarding Several Opinions on Facilitating the Development of China's Animation Industry* forwarded by the General Office of the State Council on April 25, 2006, an animation enterprise as recognized by the relevant department of the State Council which independently develops or produces animation products can apply for certain tax preferential treatment as applied to the software enterprises. Shanghai Animation was recognized as an "animation enterprise" in November 2013. Currently Shanghai Animation has not applied to the relevant tax authority for the two-year EIT exemption and a three-year 50% EIT rate reduction preferential tax treatment as an "animation enterprise" due to its accumulated loss position.

If Shanghai Taomee, Shanghai Shengran, Shanghai Xinsheng or Shanghai Animation fail to maintain their respective qualification for preferential tax treatments, the effective EIT rate will increase, which could adversely affect our results of operations. In addition, various local governments in China have provided discretionary preferential tax treatments to us. However, these local governments may decide to reduce or eliminate these preferential tax treatments at any time. Furthermore, these local implementations of tax laws may be found to violate national laws or regulations and we may be subject to retroactive imposition of higher taxes as a result. Any expiration, reduction or discontinuation of, or changes to, these tax incentives will increase our tax burden and reduce our net income and thus have a material adverse effect on our operating results.

Further roll-out of the PRC government's plan to replace business tax with value-added tax, or VAT, may subject us to higher tax rate, which could adversely affect our results of operations.

Pursuant to the PRC Provisional Regulations on Business Tax, taxpayers providing taxable services falling under the category of service industry in China are required to pay a business tax at a normal tax rate of 5% of their revenues. In November 2011, the Ministry of Finance and the State Administration of Taxation promulgated the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax, or Circular 111, pursuant to which, from January 1, 2012, VAT has replaced business tax in the transport and shipping industry and some of the modern service industries in Shanghai. In July 2012, the Ministry of Finance and the State Administration of Taxation promulgated the Circular concerning Implementing the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax for Transport and Shipping Industry and Certain Modern Service Industries in Eight Provinces and Municipalities (including Beijing), or Circular 71, which expanded the pilot regions to other eight provinces and municipalities including Beijing, Tianjin, and Shenzhen. In May 2013, the Ministry of Finance and the State Administration of Taxation promulgated the Circular concerning Implementing the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax for Transport and Shipping Industry and Certain Modern Service Industries across the Country, or Circular 37, which expanded the pilot regions to the whole nation and Circular 111 and Circular 71 were annulled accordingly. In December 2013, the Ministry of Finance and the State Administration of Taxation promulgated the Circular on Expanding the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax to Railway Transport and Postal Service, or Circular 106, pursuant to which, from January 1, 2014, VAT would replace business tax in the transport and shipping industry, postal service and some of the modern service industries in PRC and Circular 37 was annulled accordingly. Under Circular 106, a VAT rate of 6% applies to certain modern service industries. In April 2014, the Ministry of Finance and the State Administration of Taxation promulgated the Circular on Expanding the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax to Telecommunication Industry, or Circular 43, pursuant to which, from June 1, 2014, VAT would also replace business tax in telecommunication industry. Most of our consolidated affiliated entities are located in these pilot regions, and the revenues recognized from part of our businesses operated by Shanghai Shengran, Shanghai Taomee, Shanghai Animation and Shanghai Xinsheng are subject to VAT at a rate of 6% for certain other services such as advertisement, merchandise licensing and film box office revenue sharing and 17% for software sales, while other part of our business are still subject to PRC business tax at a statutory tax rate of 5%. If this plan is extended to apply to other part of our business, we may be subject to VAT rate which is higher than the business tax rate, which could harm our financial condition and results of operations.

Pursuant to the Notice on Several Economic Policies for Supporting the Development of Films promulgated jointly by the Ministry of Finance, the National Development and Reform Commission, the Ministry of Land and Resources, and other departments on May 31, 2014, which took effective on the same day, from January 1, 2014 to December 31, 2018, film producing companies will be exempted from paying VAT on the revenues generated from their sale of film copies (including digital copies) or the transfer of copyright, and film distribution companies will be exempted from paying VAT on revenues generated from distribution of films. Shanghai Taomee has obtained such VAT exemption for revenues generated from *Mole II* film and Shanghai Animation has obtained such VAT exemption for revenues generated from *Seer IV* film and *Mole III* film.

We principally rely on dividends and other distributions on equity paid by our PRC subsidiary to fund any cash and financing requirements we may have, and any limitation on the ability of our PRC subsidiary to make payments to us, or the tax implications of making payments to us, could have a material adverse effect on our ability to conduct our business.

We are a holding company, and we rely principally on dividends and other distributions on equity from our subsidiary in China for our cash requirements, including the funds necessary to service any

debt we may incur. Current PRC regulations permit our PRC subsidiary to pay dividends to us only out of its accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. In addition, our subsidiary in China is required to set aside at least 10% of its after-tax profits each year, if any, to fund a statutory reserve until such reserve reaches 50% of its registered capital. These reserves are not distributable as cash dividends. The registered capital of Shanghai Shengran is RMB77.075 million (US\$12.4 million). As of the date of this annual report, Shanghai Shengran has made allocations to its statutory reserve fund in compliance with the applicable PRC laws and regulations. Furthermore, if our subsidiary in China incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other payments to us. Most of our assets are held by, and substantially all of our earnings and cash flows are attributable to, our PRC subsidiary. If earnings from our PRC subsidiary were to decline, our earnings and cash flow would be materially and adversely affected. Our cash flows are principally derived from dividends paid to us by our PRC subsidiary. As a result, our ability to distribute dividends largely depends on earnings from our PRC subsidiary and its ability to pay dividends out of its earnings. Our PRC subsidiary does not have a history of paying dividends. We cannot assure you that our PRC subsidiary will generate sufficient earnings and cash flows in the near future to pay dividends or otherwise distribute sufficient funds to enable us to meet our obligations, pay interest and expenses or declare dividends.

In addition, under the PRC Enterprise Income Tax Law and the Implementing Rules, both of which became effective on January 1, 2008, dividends generated from the business of our PRC subsidiary after January 1, 2008 and payable to us may be subject to a 10% withholding tax if the PRC tax authorities determine that we are a non-resident enterprise, unless there is an applicable tax treaty with China that provides for a different withholding arrangement and we are deemed to be entitled to such favorable treatment.

We may be classified as a "resident enterprise" for PRC enterprise income tax purposes, which could result in our global income becoming subject to 25% PRC enterprise income tax.

The PRC Enterprise Income Tax Law provides that enterprises established outside China whose "effective management" is located in China are considered "resident enterprises" and will generally be subject to the uniform 25% EIT rate as to their global income. Under the implementation regulations, "effective management" is defined as substantial and overall management and control over such aspects as the production and business, personnel, accounts and properties of an enterprise.

In April 2009, the State Administration of Taxation released a circular that sets out the standards and procedures for recognizing the location of the "effective management" of an enterprise registered outside of the PRC and funded by Chinese enterprises as controlling investors, or a Chinese Funded Enterprise. Under the circular, a Chinese Funded Enterprise is considered a resident enterprise if all of the following applies: (i) a Chinese Funded Enterprise's major management department and personnel who are responsible for carrying out daily operations are located in the PRC; (ii) the department or the personnel who have the right to decide or approve the Chinese Funded Enterprise's financial and human resource matters are located in the PRC; (iii) the major assets, account book, company seal and meeting minutes of the Chinese Funded Enterprise are located or stored in the PRC; and (iv) the directors or management personnel holding no less than 50% voting rights of the Chinese Funded Enterprise habitually reside in the PRC. The circular explicitly provides that the above standards apply to the enterprises which are registered outside the PRC and funded by Chinese enterprises as controlling investors, and therefore such standards may be cited for reference only and may not be directly adopted when considering whether our "effective management" is in the PRC or not. Accordingly, it is still uncertain whether we may be considered a resident enterprise under the PRC EIT Law. If we are considered a resident enterprise and earn income other than dividends from our PRC subsidiary, we will be subject to a 25% PRC income tax on our global income and such 25% PRC EIT on our global income could significantly increase our tax burden and materially and adversely affect our cash flow and profitability.

If we are classified as a "resident enterprise" for PRC enterprise income tax purposes, you may be subject to PRC withholding tax on dividends from us and to PRC income tax on gain realized on the transfer of our ADSs or ordinary shares.

Under the PRC Enterprise Income Tax Law and related implementation regulations, PRC EIT withholding tax at the rate of 10% is applicable to dividends payable to investors that are "non-resident enterprises," which do not have an establishment or place of business in the PRC, or which have such establishment or place of business if the relevant income is not effectively connected with the establishment or place of business, to the extent such dividends have their sources within the PRC. In addition, any gain realized on the transfer of ADSs or shares by such investors is subject to 10% PRC income tax if such gain is regarded as income derived from sources within the PRC unless a treaty otherwise provides. If we are considered a PRC "resident enterprise," it is unclear whether dividends we pay with respect to our ordinary shares or ADSs, or the gain you may realize from the transfer of our ordinary shares or ADSs, would be treated as income derived from sources within the PRC and be subject to PRC tax. If we are required under the PRC EIT Law to withhold PRC income tax on dividends payable to our non-PRC investors that are "non-resident enterprises," or if you are required to pay PRC income tax on the transfer of our ordinary shares or ADSs, the value of your investment in our ordinary shares or ADSs may be materially and adversely affected.

Uncertainties with respect to the PRC legal system could have a material adverse effect on us.

We conduct our business primarily through our subsidiary and affiliated entities in China. Our operations in China are governed by PRC laws and regulations. The PRC legal system is based on statutes. Prior court decisions may be cited for reference but have limited precedential value.

Since 1979, PRC legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until some time after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

Substantially all of our cash inflows and outflows are denominated in Renminbi. We may convert a portion of our revenues into other currencies to meet our foreign currency obligations such as payment of dividends declared in respect of our ordinary shares. Under China's existing foreign exchange regulations, our PRC subsidiary is able to make payments of current accounts, such as dividends to its offshore holding companies, in foreign currencies, without prior approval from SAFE, by complying with certain procedural requirements. However, we cannot assure you that the PRC authorities will not take further measures in the future to restrict access to foreign currencies for current account transactions. We may also have different views with the PRC authorities with respect to certain foreign exchange transactions. These and other uncertainties with respect to currency exchange controls may have a material adverse impact on our operations and financial condition.

Governmental control of currency conversion may affect the value of your investment.

The PRC government imposes controls on the convertibility of the RMB into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in RMB. Under our current corporate structure, our income is primarily derived from

dividend payments from our PRC subsidiary. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiary to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy its foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from SAFE by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

We may be subject to penalties, including restriction on our ability to inject capital into our PRC subsidiary and our PRC subsidiary's ability to distribute profits to us, if our PRC resident shareholders or beneficial owners fail to comply with relevant PRC foreign exchange rules.

SAFE issued a public notice in October 2005 (the SAFE Circular 75) requiring PRC residents to register with the local SAFE branch before establishing or controlling any company outside of China for the purpose of capital financing with assets or equities of PRC companies, referred to in the notice as an "offshore special purpose vehicle." SAFE promulgated the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Offshore Investment and Financing and Roundtrip Investment through Special Purpose Vehicles, or SAFE Circular 37, on July 4, 2014, which replaced the SAFE Circular 75. SAFE Circular 37 requires PRC residents to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a "special purpose vehicle." SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as the change of its PRC resident individual shareholder, its name or business term, increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary. Moreover, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls.

All our individual shareholders who are subject to the SAFE Circular 37 have completed registration with SAFE with regard to the capital contribution to our company or their shareholding in our company as required under SAFE Circular 37, and they have also filed application for change of registration to reflect our company's investment activities and later share subdivision. We are committed to compliance with SAFE Circular 37 and have taken steps to ensure that our shareholders and beneficial owners who are subject to SAFE Circular 37 also comply with the relevant rules. However, we cannot provide any assurance that all of our shareholders and beneficial owners who are PRC residents will comply with our request to make, obtain or update any applicable registrations or comply with other requirements required by the SAFE notice or other related rules. In case of any non-compliance on any of our PRC resident shareholders or beneficial owners, our PRC subsidiary and such shareholders and beneficial owners may be subject to fines and other legal sanctions, including restriction on our ability to contribute additional capital into our PRC subsidiary and our PRC

subsidiary's ability to distribute dividends to our offshore holding companies, which will adversely affect our business.

All employee participants in our share incentive plans who are domestic individuals may be required to register with SAFE. We may also face regulatory uncertainties that could restrict our ability to adopt additional option plans for our directors and employees under PRC law.

In December 2006, the People's Bank of China promulgated the Administrative Measures for Individual Foreign Exchange, which set forth the respective requirements for foreign exchange transactions by PRC individuals under either current account or the capital account. In January 2007, SAFE issued the Implementation Rules of the Administrative Measures for Individual Foreign Exchange, which, among other things, specified approval requirements for certain capital account transactions such as a PRC citizen's participation in the employee stock ownership plans or stock option plans of an overseas publicly-listed company. On February 15, 2012, SAFE promulgated the *Notice regarding Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Option Plan of Overseas-Listing Companies*, or the Stock Option Rule, which substitutes the *Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Companies* promulgated by SAFE on March 28, 2007. Under the Stock Option Rule, the domestic individuals as defined under the *Foreign Exchange Administration Regulations* who are granted stock options or other incentive alternatives by an overseas publicly listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly listed company, to register with SAFE and complete certain other procedures.

We and our relevant employees participating in our stock incentive plan are subject to the Stock Option Rule. Failure to comply with the Stock Option Rule and other relevant rules will subject us or our relevant employees participating in our stock incentive plan to fines and other legal or administrative sanctions and impose restrictions on our execution of option plans, including the grant of options under such plans to our employees, which could adversely affect our business operations. As the laws and regulations of PRC in relation to domestic individual's participation in the stock option plan of overseas companies are developing, we may also face regulatory uncertainties that could restrict our ability to adopt additional option plans for our directors and employees under PRC law.

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

The value of the RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy resulted in an over 20% appreciation of the RMB against the U.S. dollar over the following three years. For almost two years after reaching a high against the U.S. dollar in July 2008, however, the Renminbi traded within a narrow band against the U.S. dollar. As a consequence, the Renminbi fluctuated sharply since July 2008 against other freely traded currencies, in tandem with the U.S. dollar. In June 2010, the PRC government announced that it would increase RMB exchange rate flexibility. However, it remains unclear how this flexibility might be implemented. There remains significant international pressure on the PRC government to adopt a more flexible currency policy, which could result in greater fluctuation of the RMB against the U.S. dollar. Substantially all of our revenues and costs are denominated in RMB, and a significant portion of our financial assets are also denominated in RMB. We principally rely on dividends and other distributions paid to us by our subsidiary in China. Any significant revaluation of the RMB may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our ADSs in U.S. dollars. Any fluctuations of the exchange rate between the RMB and the U.S. dollar could also result in foreign currency translation losses for financial reporting purposes.

The approval of the China Securities Regulatory Commission, or the CSRC, may be required in connection with our initial public offering under a PRC regulation. The regulation also establishes more complex procedures for acquisitions conducted by foreign investors that could make it more difficult for us to grow through acquisitions.

On August 8, 2006, six PRC regulatory agencies, including the Ministry of Commerce, the State Assets Supervision and Administration Commission, or SASAC, the State Administration for Taxation, the State Administration for Industry and Commerce, the CSRC, and SAFE, jointly adopted the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the New M&A Rule, which became effective on September 8, 2006 and was amended by the Ministry of Commerce on June 22, 2009. The regulations require offshore special purpose vehicles that are controlled by PRC companies or residents and that have been formed for the purpose of seeking a public listing on an overseas stock exchange through acquisitions of PRC domestic companies or assets to obtain CSRC approval prior to publicly listing their securities on an overseas stock exchange. On September 21, 2006, the CSRC published a notice on its website specifying the documents and materials that special purpose vehicles are required to submit when seeking CSRC approval for their listings outside of China. The interpretation and application of the above regulations remain unclear, and the initial public offering which we completed in June, 2011 may require approval from the CSRC, and if it does, it is uncertain how long it will take us to obtain the approval. If CSRC approval is required for the initial public offering, our failure in obtaining or delay in obtaining the CSRC approval for the initial public offering would subject us to sanctions imposed by the CSRC and other PRC regulatory agencies, which could include fines and penalties on our operations in China, restrictions or limitations on our ability to pay dividends outside of China, and other forms of sanctions that may materially and adversely affect our business, results of operations and financial condition.

Our PRC counsel, Allbright Law Offices, has advised us that, based on their understanding of the current PRC laws, regulations and rules and the procedures announced on September 21, 2006, we will not be required to submit an application to the CSRC for the approval of the listing and trading of our ADSs on the New York Stock Exchange, because we do not constitute a special purpose vehicle, as defined by the New M&A Rules, which is required to obtain approval from the CSRC for overseas listing, no provision in the New M&A Rules clearly classifies contractual arrangements as a type of transaction subject to the New M&A Rules, and no public record is found indicating that any of the issuers having similar onshore corporate structures and already listed on an off-shore stock exchange has been required by the CSRC to procure the approval of the CSRC prior to its listing. However, our PRC counsel has further advised us that there remains some uncertainty as to how the New M&A Rules will be interpreted or implemented in the context of an overseas offering and its opinions summarized above are subject to any new laws, rules and regulations or detailed implementations and interpretations in any form relating to the New M&A Rules.

The new regulations also established additional procedures and requirements that are expected to make merger and acquisition activities in China by foreign investors more time-consuming and complex, including requirements in some instances that the Ministry of Commerce be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise, or that the approval from the Ministry of Commerce be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies. We may grow our business in part by acquiring other companies operating in our industry. Complying with the requirements of the new regulations to complete such transactions could be time-consuming, and any required approval processes, including approval from Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

We face risks of health epidemics and other disasters, which could severely disrupt our business operations.

Our business could be materially and adversely affected by the outbreak of swine influenza, avian influenza, severe acute respiratory syndrome, or SARS, or another epidemic. In March 2013, a new virus subtype H7N9, commonly known as "bird flu" or "avian flu," was discovered in eastern China and has already sickened and killed some people. Any adverse public health developments in China could require the temporary closure of our offices. Such closures could severely disrupt our business operations and adversely affect our results of operations.

Our operations are vulnerable to interruption and damage from man-made or natural disasters, including wars, acts of terrorism, earthquakes, fire, floods, environmental accidents, power loss, communications failures and similar events, all of which may disrupt our business. If any significant man-made or natural disaster were to occur in the future, our ability to operate our business could be seriously impaired.

The enforcement of labor contract law and increase in labor costs in the PRC may adversely affect our business and our profitability.

China adopted a labor contract law effective on January 1, 2008, which was amended by the Standing Committee of the National People's Congress on December 28, 2012, and its implementation rules effective on September 18, 2008, respectively. The labor contract law and its implementation rules impose more stringent requirements on employers with regard to, among others, minimum wages, severance payment upon permitted termination of the employment by an employer and non-fixed term employment contracts, time limits for probation period as well as the duration and the times that an employee can be placed on a fixed term employment contract. Due to the lack of clarity with respect to their implementation and potential penalties and fines, it is uncertain how they will impact our current employment policies and practices. Our employment policies and practices may violate the labor contract law or its implementation rules and we may be subject to related penalties, fines or legal fees. Compliance with the labor contract law and its implementation rules may increase our operating expenses, in particular our personnel expenses, as the continued success of our business depends significantly on our ability to attract and retain qualified personnel. In the event that we decide to terminate some of our employees or otherwise change our employment or labor practices, the labor contract law and its implementation rules may also limit our ability to effect those changes in a manner that we believe to be cost-effective or desirable, which could adversely affect our business and results of operations.

If additional remedial measures are imposed on the Big Four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, with respect to requests for the production of documents, we could be unable to timely file future financial statements in compliance with the requirements of the Securities Exchange Act of 1934.

Starting in 2011, the Chinese affiliates of the "big four" accounting firms, including our independent registered public accounting firm, were affected by a conflict between the U.S. and PRC law. Specifically, for certain U.S. listed companies operating and audited in mainland China, the SEC and the PCAOB sought to obtain from the Chinese firms access to their audit work papers and related documents. The firms were, however, advised and directed that under PRC law they could not respond directly to the U.S. regulators on those requests, and that requests by foreign regulators for access to such papers in China had to be channeled through the China Securities Regulatory Commission ("CSRC").

In late 2012 this impasse led the SEC to commence administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act of 2002 against the Chinese accounting firms, including our independent registered public accounting firm. A first instance trial of the proceedings in July 2013 in the SEC's internal administrative court resulted in an adverse judgment

against the firms. The administrative law judge proposed penalties on the firms including a temporary suspension of their right to practice before the SEC, although that proposed penalty did not take effect pending review by the Commissioners of the SEC. On February 6, 2015, before a review by the Commissioner had taken place, the firms reached a settlement with the SEC. Under the settlement, the SEC accepts that future requests by the SEC for the production of documents will normally be made to the CSRC. The firms will receive matching Section 106 requests, and are required to abide by a detailed set of procedures with respect to such requests, which in substance require them to facilitate production via the CSRC. If they fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure. Remedies for any future noncompliance could include, as appropriate, an automatic six-month bar on a single firm's performance of certain audit work, commencement of a new proceeding against a firm, or in extreme cases the resumption of the current proceeding against all four firms.

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

If our independent registered public accounting firm were denied, even temporarily, the ability to practice before the SEC and we were unable to timely find another registered public accounting firm to audit and issue an opinion on our financial statements, our financial statements could be determined not to be in compliance with the requirements of the Exchange Act of 1934, as amended. Such a determination could ultimately lead to the delisting of our ordinary shares from the NYSE or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

Risks Related to Our ADSs

The market price for our ADSs has fluctuated and may be volatile.

The market price for our ADSs may be highly volatile and subject to wide fluctuations in response to factors within and outside our control including, but not limited to, the following:

- actual or anticipated fluctuations in our quarterly results of operations;
- regulatory developments affecting us or our industry;
- changes in the economic performance or market valuations of other companies operate in our industry;
- changes in financial estimates by securities research analysts;
- announcements by us or our competitors of new services, acquisitions, strategic relationships, joint ventures or capital commitments;
- fluctuations of exchange rates between RMB and the U.S. dollar;
- intellectual property litigation;
- economic or political conditions in China;
- additions to or departures of our senior management;
- release or expiry of lock-up or other transfer restrictions on our outstanding ordinary shares or ADSs; and
- sales or perceived potential sales of additional ordinary shares or ADSs.

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

Substantial future sales or the perception of sales of our ADSs or ordinary shares in the public market could cause the price of our ADSs to decline.

Additional sales of our ADSs or ordinary shares, including ADSs or ordinary shares issuable upon the exercise of our outstanding stock options, in the public market, or the perception that these sales could occur, could cause the market price of our ADSs to decline. If our shareholders sell substantial amounts of our ADSs, including those issued upon the exercise of outstanding options, in the public market, the market price of our ADSs could fall. Such sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. If any existing shareholder or shareholders sell a substantial amount of ordinary shares, the prevailing market price for our ADSs could be adversely affected.

In addition, we may issue additional ordinary shares or ADSs. If we pay for our future acquisitions in whole or in part with additionally issued ordinary shares or ADSs, your ownership interests in our company would be diluted and this, in turn, could have a material adverse effect on the price of our ADSs.

You may not have the same voting rights as the holders of our ordinary shares and must act through the depositary to exercise your rights.

As an ADS holder, you may only exercise voting rights with respect to the underlying ordinary shares in accordance with the provisions of the deposit agreement. Under the deposit agreement, you must vote by giving voting instructions to the depositary. Upon receipt of your voting instructions, the depositary will vote the underlying ordinary shares in accordance with these instructions. Otherwise, you will not be able to exercise your right to vote unless you withdraw the ordinary shares underlying your ADSs.

Pursuant to our third amended and restated memorandum and articles of association, we may convene a shareholders' meeting upon ten calendar days' notice. When a shareholder's meeting is convened, you may not receive sufficient advance notice to withdraw the ordinary shares underlying your ADSs to allow you to vote with respect to any specific matter. If we give timely notice, the depositary will notify you of the upcoming vote and arrange to deliver our voting materials to you. We cannot assure you that you will receive the voting materials in time to instruct the depositary to vote the ordinary shares underlying your ADSs. In addition, the depositary and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that you may not be able to exercise your right to vote and there may be nothing you can do if the ordinary shares underlying your ADSs are not voted as you requested.

You may not be able to participate in rights offerings and may experience dilution of your holdings as a result.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. Under the deposit agreement for the ADSs, the depositary will not offer those rights to ADS holders unless both the rights and the underlying securities to be distributed to ADS holders are registered under the Securities Act, or the distribution of them to ADS holders is exempted from registration under the Securities Act with respect to all holders of ADSs. We are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to cause such a registration statement to be declared effective. In addition, we may not be able to rely on an exemption from registration under the Securities Act to distribute such rights and securities.

Accordingly, holders of our ADSs may be unable to participate in our rights offerings and may experience dilution in their holdings as a result.

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

Your ADSs are transferable on the books of the depository. However, the depository may close its transfer books at any time or from time to time when it deems expedient in connection with the performance of its duties. In addition, the depository may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depository are closed, or at any time if we or the depository deem it advisable to do so due to any requirement of law or of any government or governmental body.

You may face difficulties in protecting your interests, and your ability to protect your rights through the U.S. federal courts may be limited because we are incorporated under Cayman Islands law, conduct substantially all of our operations in China and the majority of our directors and officers reside outside the United States.

We are incorporated in the Cayman Islands and substantially all of our assets are located outside of the United States. We conduct substantially all of our current operations in China through our subsidiary and affiliated entities in China. The majority of our officers and directors reside outside the United States and a substantial portion of the assets of those persons are located outside of the United States. As a result, it may be difficult for you to effect service of process within the United States upon us or these individuals or to bring an action against us or against these individuals in the United States in the event that you believe that your rights have been infringed under the securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the Cayman Islands and of China may render you unable to enforce a judgment against our assets or the assets of our directors and officers. In addition, there is uncertainty as to whether the courts of the Cayman Islands or the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state, and it is uncertain whether such Cayman Islands or PRC courts would be competent to hear original actions brought in the Cayman Islands or the PRC against us or such persons predicated upon the securities laws of the United States or any state.

There is no statutory enforcement in the Cayman Islands of judgments obtained in the federal or state courts of the United States (and the Cayman Islands are not a party to any treaties for the reciprocal enforcement or recognition of such judgments), a judgment obtained in such jurisdiction will be recognized and enforced in the courts of the Cayman Islands at common law, without any re-examination of the merits of the underlying dispute, by an action commenced on the foreign judgment debt in the Grand Court of the Cayman Islands, provided such judgment (a) is given by a foreign court of competent jurisdiction, (b) imposes on the judgment debtor a liability to pay a liquidated sum for which the judgment has been given, (c) is final, (d) is not in respect of taxes, a fine or a penalty, and (e) was not obtained in a manner and is not of a kind the enforcement of which is contrary to natural justice or the public policy of the Cayman Islands. However, the Cayman Islands courts are unlikely to enforce a judgment obtained from the U.S. courts under civil liability provisions of the U.S. federal securities law if such judgment is determined by the courts of the Cayman Islands to give rise to obligations to make payments that are penal or punitive in nature. Because such a determination has not yet been made by a court of the Cayman Islands, it is uncertain whether such civil liability judgments from U.S. courts would be enforceable in the Cayman Islands.

Our corporate affairs are governed by our memorandum and articles of association, as amended from time to time, and by the Companies Law (2013 Revision) of the Cayman Islands and the common law of the Cayman Islands. The rights of shareholders to take legal action against our directors and us, actions by minority shareholders and the fiduciary duties of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the

Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary duties of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in some jurisdictions in the United States. In particular, because the Cayman Islands law has no legislation specifically dedicated to the rights of investors in securities, and thus no statutorily defined private causes of action to investors in securities such as those found under the Securities Act or the Securities Exchange Act of 1934 in the United States, it provides significantly less protection to investors. In addition, shareholders of Cayman Islands companies may not have standing to initiate a shareholder derivative action before the federal courts of the United States.

As a result of all of the above, our public shareholders may have more difficulty in protecting their interests through actions against our management, directors or controlling shareholders than would shareholders of a corporation organized in a jurisdiction in the United States.

Our articles of association contain anti-takeover provisions that could discourage a third party from acquiring us, which could limit our shareholders' opportunity to sell their shares, including ordinary shares represented by our ADSs, at a premium.

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

We believe we may be a passive foreign investment company for U.S. federal income tax purposes, which could result in adverse U.S. federal income tax consequences to U.S. Holders of our ADSs or ordinary shares.

Based on the market price of our ADSs and composition of our income and assets, we believe we were a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for our taxable year ended December 31, 2014. A non-U.S. corporation will be a PFIC for any taxable year if either (i) at least 75% of its gross income for such year is passive income or (ii) at least 50% of the value of its assets (based on an average of the quarterly values of the assets) during such year is attributable to assets that produce passive income or are held for the production of passive income. Because the value of our assets for purposes of the PFIC test may be determined, in part, by reference to the market price of our ADSs or ordinary shares, our PFIC status will depend in large part on the market price of the ADSs or ordinary shares, which may fluctuate significantly. Because we believe we were a PFIC for our taxable year ended December 31, 2014, certain adverse U.S. federal income tax consequences could apply to U.S. Holders (as defined in "Item 10. Additional Information—E. Taxation—United States Federal Income Taxation") of our ADSs or ordinary shares with respect to any "excess distribution" received from us and any gain from a sale or other disposition of our ADSs or ordinary shares. See "Item 10. Additional Information—E. Taxation—United States Federal Income Taxation—Passive Foreign Investment Company."

We have incurred increased costs as a result of being a public company, and we cannot predict or estimate the amount of additional future costs we may incur or the timing of such costs.

As a public company, we have incurred a significantly higher level of legal, accounting and other expenses than we did as a private company. In addition, the Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the SEC and the New York Stock Exchange, have required changes in the corporate governance practices of public companies. These rules and regulations have increased our legal, accounting and financial compliance costs and made some of our corporate activities more time-consuming and costly.

After we became a public company, we have established additional board committees and adopted and implemented additional policies regarding internal controls over financial reporting and disclosure controls and procedures. In particular, compliance with Section 404 of the Sarbanes-Oxley Act, which requires public companies to include a report of management on the effectiveness of their internal control over financial reporting, has increased our costs. In addition, we have incurred costs associated with public company reporting requirements, such as the requirements to file an annual report and other reports with the SEC. We expect these rules and regulations to increase our legal and financial compliance costs going forward, but we cannot predict or estimate the additional costs or the timing of initially additional costs we may incur.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Our legal and commercial name is Taomee Holdings Limited. We commenced operations of our business of children's online entertainment in October 2007 through Shanghai Taomee, a limited liability company established in China. Shanghai Taomee holds our licenses required for the above business under PRC laws and is in charge of the operation of our websites for our virtual worlds. To enable us to raise capital from international investors, our holding company, Taomee Holdings Limited, was incorporated under the laws of the Cayman Islands in September 2008.

In November 2008, we incorporated Taomee Holdings (HK) Limited, or Taomee HK, our wholly-owned subsidiary in Hong Kong. In June 2009, Taomee HK established its wholly-owned subsidiary, Shanghai Shengran, in China. We operate our virtual worlds through our VIE, Shanghai Taomee. In June 2009, through Shanghai Shengran, we entered into certain contractual arrangements with Shanghai Taomee and its shareholders through which we gained effective control over the operations of Shanghai Taomee.

On November 11, 2010, we incorporated Shanghai Taomee Animation Co., Ltd., or Shanghai Animation, a PRC company wholly owned by Shanghai Taomee which focuses on developing and distributing animated film and cartoon animations. On June 19, 2012, we increased Shanghai Animation's share capital from RMB5.0 million (US\$0.8 million) to RMB25.0 million (US\$4.0 million). On February 3, 2015, we were approved to increase Shanghai Animation's share capital from RMB25.0 million (US\$4.0 million) to RMB60.0 million (US\$9.7 million) and as of the date of this annual report, we have not paid the additional RMB35.0 million share capitals.

On June 10, 2011, our ADSs began trading on the New York Stock Exchange under the ticker symbol "TAOM." We issued and sold a total of 7,187,500 ADSs, representing 143,750,000 ordinary shares, at an initial offering price of US\$9.00 per ADS.

On July 13, 2011, the underwriters of our initial public offering exercised their over-allotment option to purchase an additional 525,224 ADS from us at the initial public offering price of US\$9.00 per ADS, less the underwriting discount. With this exercise, we issued and sold a total of 7,712,724 ADSs, representing 154,254,480 ordinary shares.

[Table of Contents](#)

On November 28, 2011, we announced a share repurchase plan to repurchase up to US\$10.0 million worth of outstanding American Depositary Shares, or ADSs, (each ADS represents twenty ordinary shares of the Company) over a 12-month period. On September 28, 2012 and November 26, 2013, respectively, we extended the share repurchase plan for another 12 months from November 23, 2012 to November 23, 2013, and from November 24, 2013 to November 23, 2014, respectively. On March 28, 2014, we announced a second share repurchase plan to repurchase up to an additional US\$10.0 million worth of outstanding ADSs over a 12-month period. As of December 31, 2014, we had repurchased an aggregated of 2,940,370 ADSs, representing 58,807,400 ordinary shares on the open market for total cash consideration of US\$14.7 million. On March 21, 2015, we extended the second share repurchase plan for an additional year from March 29, 2015 to March 28, 2016.

In the first quarter of 2012, we entered into an investment agreement of US\$0.1 million with Guangzhou Chuangyou Information Technology Co., Ltd., or Chuangyou, a company principally engaged in the design and development of online games in China, to acquire 6.0% of Chuangyou's equity interest and a contingent call option to further subscribe 13.16% newly issued equity interest for US\$0.6 million. In September 2012, Shanghai Taomee exercised the call option and completed the further acquisition in January 2013, resulted in 19.16% equity interest in Chuangyou. In December 2013, Chuangyou entered into an agreement to issue new shares for RMB2.5 million (US\$0.4 million) to a new investor. The Company's equity share in Chuangyou was diluted to 9.58% upon the closing of the transaction. Chuangyou is a related party of us, as one of Chuangyou's investors is our director and principle shareholder.

On June 1, 2012, we incorporated Guangdong Taomee Animation Technology Co., Ltd., or Guangdong Taomee, under the laws of PRC, which primarily focuses on the design and distribution of toys, trading cards as well as other products. Shanghai Taomee and an individual shareholder, Mr. Jinjun Zhao, are registered as the shareholders of Guangdong Taomee, holding 80% and 20% of the equity interest in Guangdong Taomee, respectively. Notwithstanding the foregoing, among the equity interest in Guangdong Taomee currently registered under the name of Mr. Jinjun Zhao 15% of the equity interest in Guangdong Taomee is nominally held by Mr. Jinjun Zhao and is subject to a vesting schedule as provided under the Subscription Agreement entered into between Shanghai Taomee and Mr. Jinjun Zhao on June 1, 2012, where two thirds of the foregoing 15% equity interest will be allocated to Mr. Jinjun Zhao annually upon the anniversary of each one year period for his employment in Guangdong Taomee. As a result, as of December 31, 2014, two thirds out of the 15% equity interest in Guangdong Taomee nominally held by Mr. Jinjun Zhao, i.e. 10% equity interest in Guangdong Taomee, has been allocated to Mr. Jinjun Zhao, and therefore Mr. Jinjun Zhao actually held 15% equity interest in Guangdong Taomee and our equity interest in Guangdong Taomee was 85%.

In September 2012, we obtained a minor equity interest in Gamespedia Holdings Limited, or Gamespedia, a Cayman Island company which operates its mini game portal website through its wholly owned subsidiaries and VIEs in China, with total consideration of US\$6.2 million.

In October 2012, we incorporated Shanghai Xinsheng Information Technology Co., Ltd., or Shanghai Xinsheng, a PRC company wholly owned by Shanghai Shengran, which focuses on mobile game development. In June 2014, Shanghai Shengran entered into a capital injection agreement with an unrelated individual, Mr. Min Chen, under which Shengran agreed to pay RMB15.0 million (US\$2.4 million) share capital and own 90% of Shanghai Xinsheng's total share equity, including 5% of which is held as nominee shareholder and reserved as an option pool with no dividend sharing right and voting right. Mr. Min Chen owns the remaining 10% of Shanghai Xinsheng's share equity, of which, 1.67% is funded through a two-year, interest-free loan of RMB0.3 million (US\$0.05 million) lent by Shanghai Shengran, while 8.33%, or RMB1.7 million (US\$0.3 million), is in exchange for Mr. Chen's future service from November 11, 2013 to November 11, 2016 at Shanghai Xinsheng. Of the remaining 8.33% of Shanghai Xinsheng's total share equity allocated to Mr. Chen, 5.33% was vested as soon as

[Table of Contents](#)

Shanghai Xinsheng's capital injection was completed, and another 3% will be vested in increments of 1% on each January 1, following the first, second and third anniversaries, respectively, of the starting date of Mr. Min Chen's labor contract. As of December 31, 2014, Mr. Min Chen held 7% equity interest in Shanghai Xinsheng and our equity interest in Shanghai Xinsheng was 93%.

In February 2013, we acquired a minority equity interest in Voozclub, a Korea-based character and animation studio with an established presence in global brand licensing, online games, publishing and theme parks for a cash consideration of US\$1.4 million. In 2014, we assessed that there was a non-temporary decrease in the investment value, due to the deteriorating operating and financial performance of Voozclub and so we fully impaired this investment.

In May, October and November 2013, we incorporated Shanghai Taomee Wireless Technology Co., Ltd., Shanghai Taomee Software Development Co., Ltd. and Shanghai Taomee Property Service Co., Ltd., respectively, all of which are PRC subsidiaries of Shanghai Shengran. The three companies are incorporated for the purchase of land use rights and building in Songjiang, Shanghai.

In September 2013, we entered into an investment agreement to acquire minority stake of a Beijing-based pre-school education service provider for a consideration of US\$2.0 million.

In September 2013, we entered into an investment agreement with two third-parties to establish a joint venture, Jiangxi Haomi Network Technology Co., Ltd., or Jiangxi Haomi, a company which develops family entertainment and education application on mobile and multi-screen platforms in China. We paid a consideration of RMB12.9 million (US\$2.1 million) for 43.0% equity interests in Jiangxi Haomi.

In December 2013, we entered into an investment agreement to acquire the minority interest in a company incorporated in New York City, which develops mobile applications, animation and products for pre-school children, for a cash consideration of US\$150,003.

In January 2014, we entered into an agreement with Shanghai Weiju Network Technology Co., Ltd. or Shanghai Weiju, a Hi-tech toy design and R&D company to subscribe for 25% of Shanghai Weiju's newly issued ordinary shares for cash consideration of RMB3.0 million (US\$0.5 million). In December 2014, Shanghai Taomee increased its equity shareholding in Shanghai Weiju from 25% to 45% for considerations of RMB10.0 million (US\$1.6 million).

In July 2014, we incorporated Shanghai Jushou Wireless Technology Co., Ltd., or Jushou Wireless, a PRC company, which focuses on distributing and operating mobile games. Shanghai Taomee and an individual shareholder, Mr. Min Chen, are registered as shareholders of Jushou Wireless, holding 90% and 10% equity interest in Jushou Wireless, respectively. Shanghai Taomee's 90% equity interest includes 5% held as nominee shareholder, which is reserved as option pool with no rights for dividend sharing and voting. Mr. Min Chen owns the remaining 10% of Jushou Wireless's share equity, of which, 1.67% is funded by a two-year interest-free loan of RMB0.2 million (US\$0.03 million) lent by Shanghai Taomee, while 8.33%, or RMB0.8 million (US\$0.1 million), is in exchange for his future service at Jushou Wireless from November 11, 2013 to November 11, 2016. Of the 8.33% of Jushou Wireless's total share equity, 5.33% vested immediately upon Jushou Wireless's establishment, and another 3% will be vested in increments of 1% on each January 1, following the first, second and third anniversaries, respectively, of the starting date of Mr. Min Chen's labor contract. As of December 31, 2014, Mr. Min Chen held 7% equity interest in Jushou Wireless and our equity interest in Jushou Wireless was 93%.

In November 2014, Shanghai Taomee entered into an investment agreement with two third-parties to set up a joint venture, Beijing Caviar Communications Co., Ltd to operate the "Voice Kids China" live show and other family entertainment shows focusing on kids and teenagers. Shanghai Taomee acquired 20% of the joint venture for a cash consideration of RMB 25.0 million (US\$4.1 million).

[Table of Contents](#)

On February 3, 2015, we incorporated Shanghai Junran Information Technology Co., Ltd., a PRC company wholly owned by Shanghai Shengran which focuses on developing web games.

On February 4, 2015, we incorporated Shanghai Shengyu Network and Technology Co., Ltd. ("Shanghai Shengyu"), a PRC company wholly owned by Shanghai Taomee which focuses on strategic investment.

Our principal executive offices are located at 16/F, Building No. A-2, No. 1528 Gumei Road, Xuhui District, Shanghai 200233, People's Republic of China. Our telephone number at this address is (86-21) 6128-0056 and our fax number is (86-21) 3367-4012. Our registered office in the Cayman Islands is at the offices of Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands.

Investor inquiries should be directed to us at the address and telephone number of our principal executive offices set forth above. Our corporate information website is located at www.taomee.com. The information contained on our corporate information website is not part of this annual report. Our agent for service of process in the United States is CT Corporation System located at 111 Eighth Avenue, New York, NY 10011.

B. *Business Overview*

We are one of the leading children's entertainment and media companies in China. We attribute our market position to our content development and cross-media platform capabilities that leverage our innovative culture, experience in the children's entertainment market in China, and knowledge of virtual worlds and online entertainment to create enduring and iconic characters, images and story lines that attract a loyal following among children of the targeted age groups. Our success in developing branded entertainment experiences across online and mobile platforms has translated into growing demand for our franchises offline. By investing and building a cross-media platform that expands to film, cartoon animation, mobile and offline products, we hope to reduce our dependency on content distribution through online virtual worlds and web games, which we believe could enhance our brand awareness and extend franchise life cycle. We are committed to delivering exceptional entertainment to children and families and leveraging our cross-media platform and child-centric culture.

We have a proven track record in creating branded franchises popular with children and their families through our cross-media platforms comprised of virtual worlds, print media, film, television, live events, online video streaming sites, mobile applications, and mobile games. In 2014, as a confirmation of our positive and significant influence on children, we were jointly awarded the "Important National Culture Export Enterprises" designation by the Ministry of Culture, the Ministry of Commerce, the Propaganda Department, the Treasury Department and the General Administration of Press and Publication, Radio, Film and Television. This award is a specially designated business classification which the central government grants to Chinese cultural and media-related enterprises with leading influence and international market development potential in this field.

Established in 2007 in Shanghai as the first children's entertainment company in China, we launched our first online product Mole's World in September 2008, which became a leading popular brand among children and families. By encouraging participation and feedback from users, we successfully launched several online virtual worlds and other entertainment products in the following years, including our major franchises Seer, Flower Angel and Mole's World. To further strengthen our leading market position, we established our publishing and licensing businesses in 2010, and expanded into merchandise licensing, film and cartoon animation. As of December 31, 2014, we have launched six films featuring Mole's World and Seer. To promote our brand further, we have produced approximately 330 episodes of cartoon animation broadcasted over more than 350 TV channels throughout mainland China and Taiwan. In October 2011, we also expanded into our mobile front by releasing the mobile version of Mole's World, our first mobile game. Since then, we have released mobile versions of some of our other virtual worlds. For example, in June 2013, we launched the

[Table of Contents](#)

mobile game *Seer: Universal Force* on Apple's iOS platform in conjunction with related film and offline products. While we are transitioning our business to better adapt to user habits of trending from PC to mobile for entertainment, monetization on mobile gaming for children has been a difficult transition due to higher resistance from parents to accept mobile gaming as a form of paid entertainment for children. The mobile migration of users continues to be both an opportunity and a challenge to our business, evidenced by a new genre of mobile games and revenue contribution beginning in the second half of 2014 but decreasing active playing and paying accounts to our virtual worlds in 2014, respectively. We intend to combat our decreasing user trend by further investing in our franchises and increasing its popularity through films and cartoon animations, while translating into more offline products such as toys and consumer goods as well, thereby also increasing our franchise popularity among fans who play our franchise online games.

In December 2013, we reorganized our wireless division and launched a new studio named "Glove Game" to develop mobile games. Our "Glove Game" brand and studio focus on developing mainstream mobile games, and no longer focuses solely on the children entertainment market. On July 25, 2014, we launched the mobile game *Reverse World* commercially in App Store. On August 6, 2014, we launched the English Version of *Reverse World* commercially in Google Play through IGG. Our accumulated mobile downloads on Apple iOS and Android platforms have increased to over 36.8 million as of December 31, 2014.

Our success is partly due to our efforts to reinforce parental trust by creating a safe and enjoyable entertainment environment with wholesome, age-appropriate content and standard-setting security safeguards. We set corporate social responsibility standards and nurture a corporate culture that embraces family values and encourages education and learning.

Our net revenues amounted to US\$40.2 million in 2012, US\$48.4 million in 2013 and US\$42.2 million in 2014. For 2012, 2013 and 2014, 80.0%, 73.1% and 78.9% of our net revenues, respectively, were generated from subscription fees that allow users to access premium features, sales of virtual items, mobile games, online video platform, as well as other online services. The remaining 20.0%, 26.9% and 21.1% of our net revenues, respectively, were generated primarily from royalties, license fees, film box office sharing, and sales of toys from our offline business. Our gross profit amounted to US\$30.2 million in 2012, US\$35.1 million in 2013 and US\$30.5 million in 2014. Our net income was US\$8.9 million in 2012, US\$5.4 million in 2013 and US\$1.0 million in 2014.

Our Franchises

We have created and developed branded entertainment franchises, including our major franchises of *Mole's World*, *Seer* and *Flower Angel*. Historically these franchises were born out of our virtual world popularity, in which we would then develop animations and films around the virtual world characters to further expand its influence among its users. In addition, we have also obtained from Voozclub the exclusive license to operate the franchise of *Canimals* in China. Our brands and franchises have expanded into various online and offline platforms including the virtual worlds, video streaming site, mobile games and applications, social networking, films and cartoon animations, merchandising and toys.

Mole's World

Introduced in September 2008, *Mole's World* is our first and oldest franchise. This franchise features a community of cuddly red-nosed moles living in a variety of settings and landscapes, and who collaborate and interact in many social activities that promote wholesome family values, friendships, and happiness.

We have launched virtual worlds including *Mole's World* and *Mole Hero* based on this franchise, and also introduced mobile games such as *Mole Kart* and *Mole's Baby*. We plan to launch other virtual worlds and mobile games based on this franchise in the future.

[Table of Contents](#)

Certain animated characters of our Mole's World franchise, including Princess Momo, Uncle Bodhi and Professor Kevin, have become popular among children in China. We license these characters to publishers, makers of consumer products in areas such as clothing, toys, food and beverages. Since 2011, we have launched three films and an animated television series based on this franchise. The film *Mole's World II* received the "Monkey King Award" for best writing in 2012. During the 2012 annual meeting of China's Animation Committee, the Mole's World animation series was ranked the sixth most beloved domestic cartoon animation in 2012 by the China Animation Association. We have not launched any new Mole's World cartoon animation since March 2013. In February 2015, we launched the third installment of its Mole's World film franchise, *Legend of the Moles—The Magic Train Adventure*.

Seer

The Seer franchise, launched in September 2009 and our most popular franchise, primarily appeals to boys aged between six and 14 with a theme of space exploration and adventure. Virtual worlds and games in the Seer franchise offer a sci-fi adventure experience which fosters children's interest in science and environmental protection. For example, in the Seer virtual world, users travel through various different planets in search of new energy sources and often have to form teams with other users to defend against attacks launched by space pirates who seek to monopolize energy reserves in outer space.

We believe the Seer virtual world encourages strong teamwork and high levels of interaction among users. The Seer virtual world integrates mini-challenges that encourage children to explore, discover and learn about physics, chemistry and mathematics. Our users often interact with classmates, parents and teachers to solve challenges.

In November 2011, we launched a sequel virtual world Seer II, which became a popular virtual world among children and a major revenue contributor as part of our Seer franchise. In June 2013, we launched the mobile game *Seer: Universal Force* on Apple's iOS platform in conjunction with related film and offline products. We plan to launch other virtual worlds and mobile games based on this franchise in the future.

Certain animated characters of our Seer franchise, including Mechanic Xixi, Captain Roger and Elf Rey, have become highly popular among children in China and we license these characters to publishers, as well as makers of consumer products, such as clothing, toys and food and beverages. Since 2011, we have launched four films and an animated television series based on this franchise. In 2014, we launched the film *Seer IV: Magic Stone Wars* based on the Seer franchise, a storyline launched simultaneously across film, and, as well as consumer products and books.

The Seer franchise has received numerous awards. Seer was granted three awards in the second Animation Award Selection hosted by the Ministry of Culture in 2014. These were the Best Cartoon Image Award for the Seer image, the "Best Animation International Market Development Award" for the Seer series and the "Best Animated Film Award" for the film *Seer III*. Seer's image "A Tie Da" was selected as "the fourth of China's Top Ten Cartoon Image" in 2014.

Flower Angel

We introduced Flower Angel, originally named "Flower Fairy", our first franchise appealing to younger girls, aged five to 10, in June 2010. In the Flower Angel virtual world, each user chooses from a variety of angel attributes and flower worlds to create a dream-like fairytale storyline. The user's angel is in charge of tending her own garden, cultivating various flowers and plants, and decorating her homes. The storyline promotes artistic expression, happiness, creativity, responsibility and cooperation. Certain animated characters, including Princess Wisdom and Princess Benevolence, have become highly popular among children in China. We have integrated many of the aforementioned attributes that promote healthy development of children into the franchise.

In February 2014, we introduced an animated television series based on this franchise to promote our products further. We believe that cartoon animation series could extend the life cycle of the online game, expand the audience's fan base, and bring additional monetization opportunities.

Other Franchises

Canimals

In 2012, we obtained from Voozclub the exclusive license to operate the Canimals franchise in Mainland China. Voozclub, incorporated in Korea, is a character development and animation studio that produces merchandise concepts and style guides, digital applications and animation, and also licenses the content and characters to global partners. The characters produced by Voozclub differ from our own set of characters, and therefore they help diversify our platform franchises. Canimals includes the alien animal characters of Ato, Nia, Fizzy, Mimi, Pow, Toki, Leon, Uly and Oz, and is a franchise appealing to tweener and teenagers, primarily girls aged between 9 and 18. We have also launched Canimals mobile applications and animations produced by Voozclub. In 2014, we impaired our investment in Voozclub but the Canimal franchise has not been impaired.

Our Business Segments

We provide a diverse portfolio of services and products through two business segments: online business and offline business.

Online Business

The online business includes developing and operating online virtual worlds, mobile games and other online entertainment services. Our online business achieved scale through the strength of our technology platform and targeted distribution network. Our reliable and flexible proprietary technology platform, coupled with our experienced research and development team, allows us to expand our user base quickly, enhance the online experience of our users and shorten development cycles.

Our virtual worlds

Since our inception in 2007, we have successfully launched over ten virtual worlds including our most popular virtual worlds, namely, Seer series, Gong Fu Pai, Flower Angel and The Monsters, for children aged between five and 15. Historically if our virtual worlds generate enough user interest and popularity, we will consider creating animation and film for this virtual world in hopes of developing it into an entertainment franchise. In our virtual worlds, all of which are all accessible through our online community, www.61.com, children adopt avatars and participate in interactive games and activities set in fantasy landscape with evolving story lines. We have also licensed several third-party games hosted on our servers and have links on our website to third-party hosted games. We have licensed the content to a partner in Taiwan.

We believe all our virtual worlds provide a safe and educational entertainment experience for children. We have adopted a number of safety measures to protect our young users and reassure their parents by providing them with a certain level of family supervision through our uniquely designed monitoring system. Taomee MaMa, for example, is a website dedicated to parents and caregivers to assist in the finding, reviewing, sharing and monitoring of children's entertainment websites, applications and products targeting the parenting community. See "—Online security features." Our virtual worlds also encourage the development of positive morals and values in children by rewarding acts of diligence, social responsibility and teamwork. From time to time, we design virtual worlds that focus on fostering children's interest in science and the environment through interactive playing with our NPCs and other users.

[Table of Contents](#)

Our virtual worlds adopt a free-to-play model while offering premium features to users who pay for a 30-day subscription or virtual items. These users enjoy additional capabilities and special privileges, such as having a higher upper limit for the total number of friends that the users can have and access to exclusive online parties.

In addition to generating revenues through subscriptions, we also have an item-based revenue stream. Our virtual world currency, the Mibi, can purchase coveted items such as special edition clothing, accessories, and upgrades, which cannot be redeemed by virtual rewards from the in-community experience.

Our mobile games

We remain focused on developing and expanding our mobile game as we anticipate more users interacting with our characters and franchises through mobile devices, following the general industry trend of user migration from PC to mobile. In October 2011, we expanded into the mobile front by releasing the mobile version of Mole's World, our first mobile game. Since then, we have released mobile versions of our Mole and Seer virtual worlds. For example, in June 2013, we launched the mobile game *Seer: Universal Force* on Apple's iOS platform in conjunction with related film and offline products. In December 2013, we reorganized our wireless division and launched a new studio named "Glove Game" to develop mainstream mobile games, which expands our focus beyond solely developing applications for the children entertainment market. On July 25 2014, we commercially launched the mobile game Reverse World in App Store and reached No. 26 among the best-selling apps. On August 6, 2014, we commercially launched Reverse World English Version in Google Play through IGG and achieved over 40,000 downloads on the first day of commercial launch. From August to November 2014, we launched Reverse World in multiple countries and regions other than mainland China, including North America, Europe, Taiwan, Thailand, Hong Kong, Macau and Singapore. In December 2014, we launched Reverse World Korean Version in Korea via Netmarble. Reverse World Korean Version has been distributed through the KAKAO Talk channel, which is similar to Tencent's Wechat and Facebook's Whatsapp. As of the date of this annual report, our mobile games are licensed in numerous countries and regions including North America, Europe, Korea, Thailand, Taiwan, Hong Kong, Macau and Singapore.

All of our mobile games can be downloaded onto iPhones and iPads through Apple's App Store, or downloaded onto Android based mobile devices through Google Play Store or other app portals. We may charge a fee for download or provide free download of our mobile products, depending on the nature of our different types of products and relevant distribution strategies. As of December 31, 2014, the number of downloads for the mobile applications operated by us has reached approximately 36.8 million on Apple iOS and Android platforms collectively.

Our other online service

In January 2012, in cooperation with a number of China's leading online video websites that have obtained the audio/video program transmission licenses, we launched v.61.com, a website that offers animation series based on our franchises, such as Seer and Mole's World, as well as other content from these websites. In 2014, our monthly average page views were approximately 110.3 million. By the end of 2014, we had over 130,000 cartoon animation series available online.

In November 2012, we jointly developed with Turner Broadcasting System Asia Pacific (the parent company of Cartoon Network) ben10.61.com, a dedicated Chinese online zone for Ben 10 fans featuring videos, online games, wallpaper downloads, e-comics and character profiles.

Online security features

We have established a system of stringent protection mechanisms which employ a number of different approaches to improve child safety and facilitate parental supervision. Our security features

[Table of Contents](#)

include powerful content and language filters, restrictions on advertisements and access time, as well as a separate parental community and monitoring site, "Taomee MaMa" which was launched in 2010. We believe these measures reinforce parental trust, promote the healthy use of our virtual worlds in moderation at a young age, and protect children from inappropriate content online.

Recognizing the importance of protecting children's privacy online, we take extensive measures to safeguard our users' identities. Our weekly newsletters and user notifications remind users not to share personal information online. We encourage children to use a series of pre-designed phrases to communicate with others within our fantasy world. While we allow online chatting to foster our user communication, we also have powerful content and language filters to prevent the sharing of telephone numbers or other personal information and screen out language that may be inappropriate for children. Chats are also monitored by our staff moderators to prevent the use of abusive language and other inappropriate behavior, and we impose bans of varying length on users who are found to have engaged in inappropriate behavior. We encourage users to report potential offenses to us in an online "neighborhood watch" program.

In addition, we aim to create a healthy online environment suitable for children playing our self-developed virtual worlds. There is daily server downtime between the hours of 00:00 and 06:00 in Mainland China to encourage children to form healthy Internet usage habits. For every one hour of continued access, children receive a visual reminder and after three hours of continued access, users will experience a decrease in the rate of virtual reward accumulation. These measures encourage our users to develop moderate and sustainable usage habits.

Through cooperation with the Children and Internet Laboratory at Fudan University's Media Research Center, we developed the first set of guidelines in China for families that want to understand the influence of Internet use on children. The guidelines address concerns over safety, security and educational value of Internet usage for children in China.

Account management

To access our interactive virtual worlds, a user must register an account by setting up a unique account number. Once registered, the user may access all of the interactive virtual worlds in our online entertainment community with their unique account number. Once the user accesses his or her account, the user may view information on Mibi account balance, payment history and recharge the Mibi account.

Pricing, payment and distribution

Virtual worlds

Pricing

We offer the basic functions of our virtual worlds to users for free, and we charge subscription fee per virtual world for accessing premium features. Premium features significantly enhance user experience by providing users with more in-community credit and free virtual items. We also sell in-game virtual items. Our virtual items include props, clothing, home decor and accessories. We have generally maintained stable pricing for subscriptions to premium features of our virtual world and in-community items since their launch.

Payment

Users conduct all of the transactions on the www.61.com interactive community with our own virtual currency, the Mibi. Users may recharge their Mibi accounts through prepaid cards or other third-party payment channels.

[Table of Contents](#)

Users can purchase our prepaid cards through various distribution channels. Each of our prepaid cards contains a unique access code and password that enables users to recharge their Mibi account. Our prepaid cards are offered in denominations of RMB10 (US\$1.6), RMB30 (US\$4.8) and RMB50 (US\$8.1), to provide flexibility to users. Our physical prepaid cards will expire on the expiration date printed thereon, which is generally two years after the date of card production and in November 2014, we changed the expiration term of newly issued prepaid cards to five years after the date of card production. We offer both physical cards and cards in virtual form which are sold online through a third-party vendor.

Distribution

We sell our physical prepaid cards through a network of third-party distributors. We typically collect payment from our distributors upon delivery of our prepaid cards. We sell the prepaid cards to our distributors at a pre-negotiated discount on the face value of the cards. Our distribution agreements also contain pre-set sales targets and offer a volume rebate to distributors if they achieve certain pre-set sales targets. The rebate is provided to these distributors in the form of free prepaid cards. The pre-negotiated discount rate is generally more favorable to wholesale distributors with higher sales volume. Our distribution agreements generally have a term between half a year and one year, which can be renewed through the agreement of both parties. We require our distributors to distribute prepaid cards in designated geographical areas. We also require that each distributor work closely with our marketing team and support its activities. Our virtual prepaid cards are sold via third-party online distributors and via SMS through telecom operators. We also offer the distributors of our virtual cards a pre-negotiated discount on the face value of the cards and a volume rebate. As of December 31, 2014, these distributors resell the cards to sub-distributors who, in turn, distribute the cards to over 97,000 retail outlets, such as newsstands and convenience stores, in over 1,700 towns and cities across China, many of which are strategically located near schools and other places frequented by target users.

Users may purchase the Mibi at the www.61.com payment center, where they can directly charge their account. We also accept online payment from a variety of payment channels popular in China, such as debit cards, Shanda game cards, China Mobile recharge cards and Alipay, among others. We pay a processing fee to banks and other third-party payment channels in connection with such payments.

Mobile Games

Pricing

Our mobile games are generally free to play. Players may choose to enhance their game experience by purchasing virtual items from us. By allowing players to play our mobile games without initial costs, this business model enables us to quickly attract new players to experience our games and then gradually develop their interest in purchasing our and virtual items.

We offer a range of virtual items to our customers. We currently offer three categories of virtual items:

- **Faster upgrade.** Players can purchase certain virtual items to decrease the amount of time it takes to upgrade their levels.
- **Skill enhancements.** Players can buy a wide variety of boosters that enhance their skills to help them to progress through the game.
- **Access to content.** To unlock new episodes and new in-game virtual items with premium features.

Distribution

The ultimate customers of our mobile games are individual players. We license our self-developed mobile games, which are played on iOS or Android based smartphones and tablets, to certain publishers including Chukong, IGG, True Digital Plus and Netmarble. They publish such games to end players through distribution channels. Our game distribution channels primarily comprise online application stores and mobile app portals, such as Apple App Store for iOS; Google Play Store for international distribution and 360 Mobile Assistant, UC Web, 91 Wireless and SnapPea for Android. Players access our mobile games by downloading the games onto their smart mobile devices through these channels. We rely on local distribution partners for our sales in the overseas market. Our mobile game licensing agreements typically are two to three years. Under these agreements, our primary responsibility is to offer mobile games and related technical support and customer services. We will also be held liable for the losses incurred by the application stores or mobile app portals as a result of the violation of any applicable laws and regulations or the infringement upon other third parties' intellectual property rights by our mobile games. In these cases, if they were to occur, the affected application stores or the mobile app portals may terminate the agreement. Such agreements can also generally be terminated by mutual consent. In addition, due to the significant bargaining power of some of the application stores we cooperate with, such as Apple App Store, we are required to enter into the application stores' standard terms and conditions that are generally applicable to all games on their platforms and are not negotiable. These application stores and mobile app portals charge us fees for their services, which generally range between 30% and 50% of the proceeds from purchases by players.

Payment

We utilize third-party payment collection channels to collect proceeds from our players' purchases of our virtual items. Many of our game distribution channels have their own payment systems. Players who download our mobile games from these game distribution channels use the payment options offered by these distribution channels to make payments and purchase our virtual items by credit card, online wire transfer through third-party online payment vendors, or through the use of virtual currency offered by these distribution channels. Payments collected by these systems are settled to us upon confirmation of total proceeds collected and after deductions of certain fees and taxes and surcharges by the distribution channels, if applicable. Many of these game distribution channels have their own virtual currency, such as 91 Beans on 91 Wireless and 360 Credit on 360 Mobile Assistant. Our players may need to purchase such virtual currency first, and then convert them, at a ratio agreed upon by us and each of these game distribution channels, into our virtual items. Players of our mobile games distributed through distribution channels without their own payment collection channels, through our own website and through games pre-installed on smart mobile devices make payments through third-party online payment vendors, such as Alipay when purchasing our virtual items.

Offline Business

Our offline business focuses on merchandise licensing, publishing, design and distribution of toys, as well as the development of media and entertainment products, animation, toys, films and self-branded TV shows.

Licensing and Royalties

Due to the growing popularity of the Taomee brand and our many franchises, we began licensing characters and images to third parties in 2009. We believe there is demand to license our content, but we seek to enter into licensing arrangements selectively in order to ensure the quality and integrity of our brands and franchises when they are associated with third-party content, products and services. Therefore, we have only licensed our characters and images to companies that are leaders in their respective sectors, such as traditional print, film, television media, manufacturing and select retailers of

[Table of Contents](#)

consumer merchandise such as toys, apparel, beverages and electronic devices. While we currently leverage our franchises developed for virtual worlds for our offline franchising, our goal is to develop original content for our offline business as well. Our coverage in offline business aims not only to diversify our revenues but also to raise our brand profile and extend our corporate reach as a leading children's entertainment and media company in China.

We develop and popularize children's books and magazines featuring our franchises and characters in conjunction with third-party publishers. We typically license our franchises to publishers and earn royalties from these licenses.

We license our franchises to leading brands in China, such as "Bright Dairy", "China Citic Bank" and "Haier". As of December 31, 2014, we licensed our franchises to companies operating in major consumer product categories including apparel, accessories, toys, stationery, consumer electronics, food, beverage, books, theme parks, live shows, and carnivals. Our license fees are usually based on a fixed percentage of the wholesale or retail selling price of the products with a guaranteed minimum payment for a given year. Terms of our license agreements are generally between one to two years.

Film and Television

We have invested in the development of animated film and television content in China due to the growing popularity of our franchise and characters. Our investments include the development of animation films and animation series based on our Mole's World, Seer and Flower Angel franchises. In addition, we have set up a dedicated team that focuses on content development for film, which work with experienced producers of films and televisions series.

We have co-produced and invested in seven featured films, based on our "Mole's World" and "Seer" franchises. Our two animated films based on our franchises, *Seer: The Search for the Sacred Phoenix* and *Legend of the Moles—The Frozen Horror*, were released in theaters across China in July and August 2011 respectively. As a follow up to those successful films, we launched three sequels nationwide, *Seer II*, *Mole's World II* and *Seer III*, in 2012 and 2013. On July 10, 2014, we further launched the fourth sequel film of Seer franchise, *Seer IV: Magic Stone Wars*, in conjunction with a series of promotional campaigns and live events throughout major cities in China. The film has been watched by over 1.78 million viewers according to the public information provided by EntGroup.cn. Our film was also released on several China's leading online video and internet TV platforms, including Best TV, Tencent Video, iQiyi and Youku Tudou. On February 5, 2015, we launched the third sequel film of Mole's World franchise, *Mole III: The Magic Train Adventure*, in conjunction with a series of promotional campaigns and live events throughout major cities in China.

To further promote our franchise and brand, we have also co-produced and invested in animation series of approximately 330 episodes combined based on our "Mole's World", "Seer" and "Flower Angel" franchises, which have been broadcasted on over 380 channels including China Central Television, major satellite channels, China's leading cartoon networks and our website v.61.com.

We also operate a self-branded children's television show called *Taomee Dream School* which was launched in 2013 on major cartoon channels and TV stations across China. The television show, which also can be seen at <http://dream.61.com/>, serves as the designated television platform for premiering our original animation content.

Toys design and Sales and Other

We also procure and sell toys featuring our franchises. In the second quarter of 2012, we established Guangdong Taomee Animation Technology Co., Ltd. or Guangdong Taomee, a company incorporated in Guangzhou, Guangdong, China which primarily focuses on the design and distribution of toys, trading cards as well as other products.

Our products may also offer unique promotional and interactive features that allow our customers to explore and interact with our online platform. As we continue to gain experience in our offline business, we are always seeking new offline business and marketing opportunities to expand our portfolio and to attract users to our online community.

Offline business brand and quality control

As our franchises are our valuable assets, we focus on the protection of these franchises through careful selection of leading and reputable merchandising partners and other licensees, and through enforcing the implementation, primarily through contract terms and through our course of dealings and active monitoring mechanisms, of procedures on the branding of our franchise assets. These include stringent production quality measures, standards on the portrayal or presentation of our franchises in different media formats and in merchandises, and strict pre-approval processes. For films and television productions, we control the development of each story line, including the shooting scripts; for books, we have approval rights on the plot lines and character presentations; for merchandise, our approval is often required during the development of prototypes and packaging and, under most circumstances, we also have the right to conduct onsite inspections and to request modifications of displays.

Leveraging the extensive user base of our online entertainment community, we also employ in-community market surveys to analyze user demand and preferences before licensing our franchises for specific commercial productions of our licensed franchises, which we believe improves the success of the products that bear our franchise assets.

Our pipeline

We plan to release more virtual worlds every year, and to increase our product development capabilities into more interactive online entertainment platforms including mobile games in order to expand our audience and to satisfy our users as they mature and grow older. We will continue to release more mobile games for both iOS and Android platforms. In our offline business, we will continue to invest in films, animation series, books, and TV programming including Seer and Flower Angel. We also plan to design and develop toys and merchandise that may integrate features that interact with our online platform.

Seasonality

Our quarterly results of operations may be affected by seasonal trends caused by user behavior and demand for our online and offline offerings. We expect our net revenues from online business to be higher during winter and summer vacations when there are more active users and children have more online playtime during these non-school days, which usually falls in the first and third quarters of each calendar year. Decreases in our net revenues from online business, if any, as a result of seasonality may be most visible from the third quarter to the fourth quarter of each year, as the fourth quarter has less than half of the non-school days compared to the third quarter. Moreover, the sequential decline from the first to the second quarters is accentuated because Chinese New Year, a period when children have increased pocket money, typically falls in the first quarter. These seasonality trends generally manifest themselves more clearly with respect to more mature virtual worlds and less clearly during periods of high growth that accompany the introductory stages of a highly popular virtual world.

Seasonality of our offline business is affected by the different consumption patterns influencing different media formats or product categories for our licensed franchises and the mix of media formats and product categories. For instance, sales of certain toys and stationery sold near primary schools may decrease during winter and summer vacations, while sales of clothing may increase during such periods. In addition, our business may also be affected by the timing of new launches of content and product, such as the release of a film, cartoon animation series and new toy launches.

Competition

As a leading children's entertainment and media company, we face competition from both online and offline players who seek to develop brands and franchises through the licensing or creation of content for children.

[Table of Contents](#)

Currently, we believe our principal competitors in China's online children's entertainment industry includes Tencent, the developer of Roco Kingdom, and BAIOO Family Interactive Limited (2100 HK), the developer of Aola Star and Aobi Island. Potential competitors also include major Internet portal operators, other domestic and foreign virtual world developers and operators, media companies focused on children's entertainment and alliances between our existing and new competitors. Meanwhile, the children's online entertainment industry in China is characterized by relatively low capital requirements and barriers to entry. There are a number of existing competitors in the children's online entertainment industry and we expect more entrants to offer a range of virtual worlds and digital contents targeting children in China in a relatively short period of time.

As we expand into the mobile game market, we also compete with other mobile game developers and operators. The mobile game market is evolving and highly competitive. Unforeseen changes in this market may prove to be more advantageous to certain competitors than they will be to us. We may face further competition on the mobile front, as there are an increasing number of Internet companies in China tapping into the mobile game market which may compete directly with our mobile products.

Our offline competitors are primarily companies that produce, license, or distribute entertainment content and merchandise to similar target groups in China. We also face online competitors entering the offline markets we compete in, along with large traditional offline competitors such as Guangdong Alpha Animation and Culture Co., Ltd, a company listed in Shenzhen Stock Exchange which primarily engages in toy and animation industry (Ticker: 002292).

Some of our competitors, especially major foreign and China-based publicly listed media content producers, virtual world operators and mobile game developers, have significantly greater financial and marketing resources and name recognition than we have. Our competitors may adopt loss-leading pricing or other tactics or business models to attract our users. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Business—We may not be able to maintain our revenues and profitability as we operate in a competitive industry and compete against many companies."

We believe we compete primarily on the basis of our innovative culture and proven content development capabilities, our understanding of children and the industry, our brand recognition and our cross-media platform.

Customer Services

As of December 31, 2014, our dedicated customer service team had 58 employees, mostly serving our online users. From our inception, we have focused on catering to the needs of children and their parents and this focus is reflected in all major aspects of our service.

All members of our customer service team receive training on how to communicate with children and their parents. Our call center functions as an extension to users' online experience. For instance, unlike most call centers where customer support is identified by a numeric ID, each member of our customer service team is assigned a unique nickname. Users can reach our customer service by telephone, email or our online bulletin board. Periodic reports based on these feedbacks are provided to our management and operational team. We frequently hold "Taomee Superdays" when we invite children and parents to visit our office and meet our creative team.

Marketing and Promotion

We believe user referral is a significant and effective medium for promoting our franchises among children as they share their experiences with friends and schoolmates.

We also leverage the large user base of our online community to engage in effective and targeted cross-selling of our online and offline products and services. We publicize the launch of new franchises primarily through promotion campaigns in our existing virtual worlds, online services and mobile applications. We also embed promotional messages in our digital products for certain licensed products

sold offline. We believe such cross-selling through our online community is one of the most effective means for promoting online and offline services to our users. We also place advertisements on search engines and popular casual game portals in China to reach new users. Our distributors, who cover over 97,000 retail outlets in over 1,700 towns and cities as of December 31, 2014, are obligated to promote our prepaid cards according to the terms of our distribution agreements with them.

We believe the films and television series based on our franchises, such as the films and television series based on Mole's World and Seer that were released in 2011, 2012, 2013 and 2014 as well as Flower Angel cartoon animation series released in 2014, are an important part our effort to build brand awareness and promote our franchises to a broader audience within a short time. See "—Our Business Segments—Offline Business."

For a number of our licensed products, such as trading cards and books, we bundle the products with labels and promotion materials containing redemption codes for virtual items to promote cross-selling of our online and our licensees' products.

We have also attended animation and toy exhibitions and expos, such as the China International Cartoon & Game Expo and China Licensing Expo that usually attract a large number of children and their parents to reach more potential users.

Intellectual Property

We actively safeguard our copyrights, trademarks, trade secrets and similar intellectual property. We rely on trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, suppliers and others to protect our proprietary rights. All of our research and development personnel have entered into confidentiality and proprietary information agreements or contract clauses with us. These agreements address intellectual property protection issues and require our employees to assign to us all of the inventions, designs, and technologies they develop during their employment with us.

As of December 31, 2014, we had received approval for 376 and 7 trademark registrations in China and Taiwan respectively and are in the process of applying for registration of 70 trademarks in China. In addition, we have obtained 105 copyright registrations for software we developed, 177 copyright registrations for Mole's World, Seer and Flower Angel animation series and 416 copyright registrations for artworks which were produced by our employees and owned by us. We also registered 38 domain names, including www.61.com, our primary operation website, and www.taomee.com, our corporate information website.

Under the contractual arrangements we enter into with producers of film and television series, we either wholly own or jointly own the intellectual property rights for newly created characters in the television series and films we help develop.

While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. This is particularly the case in China where the laws may not protect our proprietary rights as fully as in the United States. Infringement or misappropriation of our intellectual property could materially harm our business.

Employees

We had 640, 623 and 626 employees as of December 31, 2012, 2013 and 2014, respectively. The following table sets forth the number of our employees categorized by areas of operations as of December 31, 2014:

<u>Function</u>	<u>Number of Employees</u>	<u>Percentage of total</u>
Online operations	91	14.5%
Offline operations	30	4.8%
Product development	386	61.7%
Sales and marketing	59	8.0%
General and administrative	69	11.0%
Total	626	100.0%

Our success depends on our ability to attract, retain and motivate qualified personnel. We believe we offer our employees competitive compensation packages, and we have generally been able to attract and retain qualified personnel and maintain a stable core management team. For a description of the employment agreement we signed with some members of our senior management, see "Item. 6. Directors, Senior Management and Employees—C. Board Practices—Employment Agreements."

Substantially all of our employees are based in the PRC. In accordance with PRC laws, we participate in employee benefit plans organized by municipal and provincial governments, including pension, work-related injury benefits, maternity insurance, medical insurance, unemployment benefit and housing fund plans. We are required under PRC laws to make contributions to the employee benefit plans at specified percentages of the salaries, bonuses and certain allowances of our employees, up to a maximum amount specified by the local government. A labor union of our employees was established to represent employees with respect to labor disputes and other employee matters. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes or disputes with the labor department of the PRC government since our inception.

Facilities

We are headquartered in Shanghai. As of December 31, 2014, we leased an aggregate of approximately 7,091 square meters of offices in Shanghai and 161 square meters of offices in Guangzhou, Guangdong Province, respectively, from independent third parties, and we are in the course of developing our own corporate offices to better facilitate our further investments in gaming and animation studios.

In May 2013, we entered into a land pre-development cooperation agreement with respect to our intention to purchase the land use rights of two parcels with an aggregated area of approximately 23,300 square meters in Songjiang District, Shanghai for a total consideration of RMB8.9 million (US\$1.4 million), which has been paid in full. In December 2014, we entered into a land use right transfer agreement with Songjiang Planning and Land Administration Bureau of Shanghai Municipality to purchase the land use right of the above mentioned two parcels for considerations of RMB11.0 million (US\$1.8 million) and RMB10.4 million (US\$1.7 million), respectively, which have been paid in full.

Insurance

We do not maintain any property insurance other than insurance for our vehicles. Consistent with customary industry practice in China, we do not maintain business interruption insurance or key employee insurance for our executive officers. Uninsured damage to any of our equipment or buildings

or a significant product liability claim could have a material adverse effect on our results of operations. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Business—We have a limited insurance coverage which could expose us to significant costs and business disruption."

Legal and Administrative Proceedings

We are accused by Xi'an Jiayunsheng Digital Entertainment Distribution Ltd. for Shanghai Taomee's unauthorized broadcast of four series of TV cartoons on v.61.com on December 31, 2014, and the accused compensation amount was RMB200,000 (US\$32,234) with all litigation expenses. We are still in the process of evidence exchanging.

Except the legal proceeding as foregoing, we are not a party to, and we are not aware of any other threat of, any other legal, arbitral or administrative proceedings, which, in the opinion of our management, is likely to have a material and adverse effect on our business, financial condition or results of operations. We may from time to time become a party to various legal, arbitral or administrative proceedings arising in the ordinary course of our business.

Regulations Related to Our Business

Our online and offline business are subject to various PRC laws and regulations relating to the telecommunications, Internet information services, information security and censorship, online games and media industries, and are regulated by various PRC government authorities, including:

- the Ministry of Industry and Information Technology, or MIIT (formerly the Ministry of Information Industry, or MII);
- the Ministry of Culture, or MOC;
- the General Administration of Press and Publication, or GAPP;
- the State Administration of Radio Film and Television, or the SARFT;
- the Ministry of Public Security, or MPS;
- the People's Bank of China, or PBOC;
- the Ministry of Commerce, or MOFCOM;
- the State Administration of Industry and Commerce, or SAIC;
- the State Administration of Foreign Exchange, or SAFE; and
- the National Copyright Administration, or NCAC.

According to the *Proposal on the Institutional Reform and Functional Transformation of the State Council* promulgated by the State Council on March 10, 2013, among the other things, GAPP and SARFT are integrated to form the State General Administration for Press, Publication, Radio, Film and Television. The foregoing proposal was approved by the National People's Congress according to the *Decision of the First Session of the 12th National People's Congress on the Proposal on the Institutional Reform and Functional Transformation of the State Council* promulgated by the National People's Congress on March 14, 2013.

New laws and regulations may be adopted from time to time to address new and developing issues in the Internet information service and other industries, and such laws and regulations may require licenses and permits in addition to those we currently have. As a result, uncertainties may exist with respect to the interpretation and implementation of current and any future PRC laws and regulations applicable to our business.

Restrictions on Foreign Ownership of Telecommunications Services

Among all of the applicable laws and regulations, the *Telecommunications Regulations of the PRC*, or the Telecom Regulations, implemented on September 25, 2000 and amended on July 29, 2014, are the primary regulations governing our online business activities. The Telecom Regulations set forth extensive guidelines on various aspects of telecommunications operations in China and draw a distinction between "basic telecommunications services" and "value-added telecommunications services." The *Catalog of Telecommunications Business*, which was amended on February 21, 2003 and became effective on April 1, 2003, and issued as an attachment to the Telecom Regulations, provides that Internet information services are value-added telecommunications services. Under the Telecom Regulations, a telecommunication business operator in China must obtain an operating license from MII or its provincial-level counterparts.

According to the *Administrative Regulations on Foreign-Invested Telecommunications Enterprises* issued by the PRC State Council on December 11, 2001 and amended on September 10, 2008, foreign-invested value-added telecommunications enterprises must be in the form of a Sino-foreign equity joint venture. The regulations restrict the ultimate capital contribution percentage held by foreign investor(s) in a foreign-invested value-added telecommunication enterprise to 50% or less (China (Shanghai) Pilot Free Trade Zone, or Shanghai FTZ opened up seven types of value-added telecommunications services to foreign-invested value-added telecommunications enterprises that are incorporated in the Shanghai FTZ and that have all their service facilities located in the Shanghai FTZ from January 2014; from March 2015, Guangdong Province opened up certain types of value-added telecommunications services to foreign-invested value-added telecommunications enterprises that are invested by Hong Kong or Macau investors). In July 2006, the MII issued the *Circular of the Ministry of Information Industry on Strengthening the Administration of Foreign Investment in Value-added Telecommunication Business*, according to which, a foreign investor in the telecommunication service industry of China must establish a foreign invested enterprise and apply for a telecommunication businesses operation license. On March 1, 2009, the MIIT promulgated the *Administrative Measures for Telecommunications Business Operating License*, or the Telecom License Measures, effective from April 10, 2009, which set forth the types of licenses required to provide telecommunication services in China and the procedures and requirements for obtaining such licenses. The licenses for foreign invested telecommunications business operators must be sought from the MIIT.

In order to comply with foreign ownership restrictions, we conduct our operations in China primarily through Shanghai Taomee via a series of contractual arrangements that were entered into with it and its shareholders. We exercise effective control through these arrangements and receive economic benefits generated from them. See "Item 4. Information on the Company—C. Organizational Structure."

Internet information services

The Internet information services are regulated by the *Administrative Measures on Internet Information Services*, or the ICP Measures, issued on September 25, 2000 and amended on January 8, 2011 by the State Council. The ICP Measures define "Internet information services" as services that provide information to online users through the Internet. Internet information services are divided into commercial services and non-commercial services. According to the ICP Measures, the Internet information commercial service providers are required to obtain an operating license, or an ICP license, from the MIIT or the relevant provincial counterparts while the Internet information non-commercial service providers are required to undertake the filing procedures with the MIIT or the relevant provincial counterparts. We obtained the ICP license from the Shanghai branch of the MIIT in 2009.

The PRC government has promulgated measures relating to Internet information service specifically prohibiting Internet activities that result in the publication of any content which is found to,

among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise state security or secrets. When an Internet information service provider finds that information falling within the above scope is transmitted on its website, it must terminate the transmission of such information or delete such information immediately, maintain records and report to relevant authorities. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

Internet publication and culture activities

GAPP and the MII jointly promulgated the *Tentative Measures for Internet Publication Administration*, or Internet Publication Measures, on June 27, 2002, which took effect on August 1, 2002 and imposed a license requirement for any company that intends to engage in Internet publishing, defined as any act by an Internet information service provider to select, edit and process content or programs and to make such content or programs publicly available on the Internet. Since the provision of online games is deemed an Internet publication activity, an online game operator must obtain an Internet publishing license in order to directly offer its online games to the public in the PRC. We have been approved by the MIIT to conduct Internet publication activities.

We obtained the Internet publishing license from GAPP in December 2010. Prior to obtaining an Internet publishing license from GAPP, we worked with third party publishers to publish Mole's World, Seer, Flower Angel, Magic Haqi and Gong Fu Pai. If this practice is later challenged by the GAPP, we may be subject to various penalties. See "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—The laws and regulations governing virtual worlds and online games in China are developing and are subject to future changes. If we or the third-party publishers we work with fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected." For more information on the pre-approval by the GAPP, see "—Online games administration measures."

On May 10, 2003, the MOC promulgated the *Provisional Regulations for the Administration of Internet Culture*, or the Internet Culture Measures, which were revised in July 2004 and February 2011 respectively. The Internet Culture Measures apply to entities engaging in the provision of "Internet culture products" and the relevant services. The term "Internet culture products" refers to the culture products produced and disseminated via the Internet, further divided into two categories, (1) culture products specifically produced for Internet, such as online audio-video entertainment, online games, online plays, online performance, online works of art and online cartoons, and so forth; (2) culture products such as audio-video entertainment, games, plays, performance, works of art and cartoons, and so forth, reproduced onto Internet by technical measures. According to the Internet Culture Measures, commercial entities are required to apply for, in addition to the ICP license, an Internet culture operation license from the MOC, if they engage in any of the following types of activities: the production, duplication, importation, distribution or broadcasting of Internet culture products; the dissemination of Internet culture product on the Internet or transmission thereof to computers, fixed-line or mobile phones, radios, television sets or gaming consoles for the purpose of browsing, reading, using or downloading such products; or the exhibition or holding of contests related to Internet culture products. We obtained the ICP license and Internet culture operation license in 2009.

Online games administration measures

The *Provisional Administration Measures of Online Games*, or the Online Games Administration Measures, were promulgated by the Ministry of Culture on June 3, 2010 and became effective as of August 1, 2010. The Online Games Administration Measures govern the activities in respect of online game development and operations, issuance of virtual currency, and provision of virtual currency exchange service. In addition, it provides that the MOC will be responsible for the censorship of imported online games and record-filing of domestic online games. Record-filing procedures for

domestic online games, which include the virtual worlds we develop, will be carried out with the MOC within 30 days from the date such online games begin to be operated online, and in the case of material change, within 30 days from the date when the relevant alteration takes effect.

All operators of online games, issuers of virtual currencies, and virtual currency exchange service providers (collectively, "Online Game Business Operators") are required to obtain the abovementioned Internet culture operation license. An online cultural operating permit is valid for three years, and an application of renewal should be filed 30 days before the permit expires in order to renew the permit. As to Online Game Business Operators, they must (1) request a valid identity certificate of game users for real name registration, and save their information; (2) make the information public 60 days ahead when they terminate online games or transfer the franchising to operate online games, and return the unused virtual currencies and the currently effective game services to the users by legal money or other means accepted by users; and they must not: (1) set compulsory battles between users without their consents in games; (2) promote and propagandize games with any aforementioned prohibited content; and (3) induce game users to devote legal money or virtual currencies in exchange for game products and services, by any incidental means such as random draw. It is also provided that the state culture activity administration will be responsible to promulgate the requisite terms of a standard online game service agreement, which must be incorporated in the services agreement of each online game operator. The game operators' services agreement cannot contravene these requisite terms.

On July 11, 2008, the General Office of the State Council issued the *Regulation on Main Functions, Internal Organization and Staffing of the PRC General Administration of Press and Publication*, or the Regulation on Three Provisions. On September 7, 2009, the Central Organization Establishment Commission issued the corresponding interpretation, or the Interpretation on Three Provisions, collectively as the Regulation on Three Provisions and Interpretation thereof. The Regulation on Three Provisions and Interpretation thereof authorized the MOC with overall jurisdiction to regulate the online gaming industry, while granting GAPP the authority to grant approvals for the Internet publication of online games, by expressly stating that (1) administration over online games (other than pre-examination and approval before Internet publication of online games) is granted to the MOC; (2) subject to MOC's overall administration, GAPP is responsible for the pre-examination and approval for Internet publication of online games; and (3) once games are launched online, the online games will be only administrated and regulated by MOC. As of the date hereof, we have obtained 21 approvals from the GAPP in total, covering the Internet publications of all the virtual worlds and mobile games which are developed by us and have been commercially launched, including Mole's World, Seer, Magic Haqi, Flower Angel and Gong Fu Pai, The Monsters and Reverse World. We used to work with third party publishers for the publication of such franchises prior to our obtaining of the Internet publishing license.

On September 28, 2009, the GAPP together with several other governmental authorities jointly published the *Notice Regarding the Consistent Implementation of the "Regulation on Three Provisions" of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games*, or the GAPP Notice. The GAPP Notice is issued for the purpose of consistent implementation of the Regulation on Three Provisions and Interpretation thereof. However, Article IV of the GAPP Notice prohibits foreign investors from controlling or participating in online game operating businesses directly or indirectly via wholly owned, equity joint venture or cooperative joint venture investments in China, or via contractual or technical support arrangements, or the Contractual Arrangements. As to the implementation of Article IV of the GAPP Notice, please see "Item 3. Key Information—D. Risk Factors—Risks Related to Our Corporate Structure—If the PRC government determines that our ownership structure does not comply with the restrictions contained in the GAPP Notice, we could be subject to severe penalties" and "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—The laws and regulations governing virtual worlds and online games in China are developing and are subject to future changes. If

we, as the developer of our mobile games, are required to obtain applicable permits and licenses in addition to those we have obtained for online games, it may materially and adversely affect our business results and future growth."

Virtual currency

We issue virtual currency to our users, in the form of a prepaid charge card and prepaid points that function as virtual exchange instruments, in exchange for services in our virtual worlds. On February 15, 2007, the MOC, the SAIC and other relevant governmental authorities jointly issued the *Circular on Further Strengthening the Administration of Internet Cafes and Online Games*, or the Internet Cafes Circular. Under the Internet Cafes Circular, the SAIC is directed to strengthen the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. The Internet Cafes Circular provides that, (i) the total amount of virtual currency issued by online game operators and the amount purchased by individual game players should be strictly limited; (ii) a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce must be observed, in that virtual currency should only be used for purchasing virtual items and services within the online games and not for purchasing tangible or physical products; (iii) in case the virtual currency is redeemed, the value of the payment cannot be more than the original purchase price; and (iv) the resale for a profit (i.e., scalping) of virtual currency is prohibited. Such prohibition provided by the Internet Cafes Circular in 2007 is for the purpose of preventing an adverse impact on financial stability caused by the issuance of virtual currency.

On June 4, 2009, the MOC and the Ministry of Commerce jointly issued the *Notice on Strengthening the Administration of Virtual Currency in Online Games*, or the Virtual Currency Notice, which is designed to standardize the issuance and exchange service of virtual currency, or VCOG, in online games through establishing a market access threshold for the issuance and exchange of virtual currency in online games, as well as to strengthen the management of the relevant qualifications for market players. The Virtual Currency Notice requires that enterprises issuing virtual currency or providing virtual currency exchange services must meet the relevant requirements for setting up a commercial Internet culture enterprise and must apply for an Internet culture operation license from the MOC.

The Virtual Currency Notice further requires VCOG exchange service enterprises to (i) require a VCOG seller to register in its real name and be associated with a domestic bank account registered with the same registration information, and retain all transaction and accounting records for no less than 180 days; (ii) develop recovery systems and technologies to detect illegal VCOG transactions and examine the exchange information it receives to prevent illegal transactions; (iii) promptly delete the improper transaction information and stop providing service once the VCOG exchange service enterprise is aware of or has confirmed after receiving notice that the VCOG was illegally obtained; and (iv) not provide service to underage game players. We do not believe our business involves VCOG exchange services, which is the provision of a marketplace or platform to exchange VCOG among users.

Pursuant to the Online Games Administration Measures, game operators who issue virtual currencies are required to ensure: (1) the virtual currencies can only be exchanged for the online game services and products provided by themselves, but not for the purchase of services and products that are provided by other game operators; (2) the prepaid money of users for purchase of virtual currencies shall not be misappropriated; (3) the game operators will keep purchase records of users for at least 180 days since the last time they receive services; (4) the game operators will file the category, price, amount, and so forth, with the provincial culture administration which they register with.

Information security and censorship

Internet content in China is also regulated and restricted from a state security standpoint. The Standing Committee of National People's Congress enacted a decision on December 28, 2000 and amended such decision on August 27, 2009 that makes it unlawful to: (i) gain improper entry into a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak state secrets; (iv) falsify or disseminate false commercial information that influences trading of stock exchange or future exchanges or disrupts financial orders; or (v) infringe intellectual property rights. The MPS has promulgated measures that prohibit the use of the Internet in ways which, among other things, result in a release of State secrets or a distribution of socially destabilizing content. The MPS has supervision and inspection rights in this regard, and we may be subject to the jurisdiction of the local security bureaus. If an ICP operator violates these measures, the PRC government may revoke its ICP license and shut down its websites.

On May 14, 2004, the MOC issued the *Notice Regarding the Strengthening of Network Game Censorship*. This notice mandates that all imported and domestic online games are required to be filed with the MOC. We have made such filings for all of our existing virtual worlds. The filings of Mole's World, Seer, Gong Fu Pai, Flower Angel, Universal Force, The Monsters, Avatar Star, Ultraman Zero, Magic Haqi II and Speed Hunter have been completed, and the filings of other virtual worlds are being reviewed as of the date of this annual report.

On July 12, 2005, the MOC and the MII promulgated the *Opinions on the Development and Administration of Online Game* reflecting the PRC government's intent to foster and control the development of the online game industry in China. In addition, the MOC will censor online games that threaten state security, disturb the social order, or contain obscenity or violence.

Privacy Protection

On July 16, 2013, MIIT issued the *Provisions on Protecting the Personal Information of Telecommunications and Internet Users*, effective on September 1, 2013. Pursuant to these provisions, an Internet content provider (i) shall not collect or use the personal information of users unless such collection or usage is agreed by the users; (ii) should keep user personal information collected under the users' consent strictly confidential and take relevant measures to prevent such information from being divulged, impaired or lost; and (iii) may not sell or illegally provide user personal information collected under the users' consent to any third parties. We require our users to accept a user agreement whereby they agree to provide certain personal information to us and keep such personal information strictly confidential. If an Internet content provider violates these regulations, the MIIT or its local bureaus may impose penalties and the Internet content provider may be liable for damages caused to its users.

Addiction prevention and identity verification system

In April 2007, GAPP and several other governmental authorities issued a circular requiring the implementation of addiction prevention and the identity verification system by all PRC online game operators, in an effort to curb addictive online game play behaviors in minors under 18. Game operators are required to reduce in-game gains or benefits after three hours of continuous play and eliminate in-game gains or benefits after five or more hours of continuous play.

To identify whether a game player is a minor and thus subject to the addiction prevention system, an identity verification system is also adopted, which requires online game players to register their real identity information before they play online games and requires us to submit the identity information of game players to the public security authority for verification. We have implemented addiction prevention programs for all of our virtual worlds and have established the identity verification system in all of our virtual worlds as one of the ways for registration. Please see "Item 3. Key Information—Risk Factors—Risks Related to Doing Business in China—Uncertainties in PRC government policies and

regulations regarding virtual worlds and online games and children's Internet use in China may adversely affect our business."

Internet infringement

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

Regulations on Television and Film Industry

We have expanded into film and television production through the co-production of, or investments in, two animation series and two feature films, based on our "Mole's World" and "Seer" franchises. On July 19, 2004, SARFT promulgated the *Administration Rules on the Production and Operation of Broadcast and Television Programs*, pursuant to which an entity that plans to produce and operate television and broadcast programs in China is required to obtain the License for Producing and Operating Television and Broadcast Programs. On July 11, 2006, SARFT issued *Provisional Regulations on Filing and Publicity of Domestic Television Animations*, stipulating that registrations for domestic television animations must be filed with, and be publicly displayed by SARFT prior to their production. On February 14, 2008, SARFT promulgated the *Notice of the State Administration of Radio, Film and Television on Strengthening the Administration of the Broadcasting of Animation Series* and later on May 14, 2010, SARFT further promulgated *Regulations on Content of Television Series*, pursuant to which for each domestic television animation completed, the animation production entity is required to obtain the Domestic Animation Publication License prior to the broadcast of such domestic television animation to the public. On December 25, 2001, the State Council promulgated *Regulations on the Administration of Movies*, according to which, an entity other than film production entities that intends to independently engage in movie production shall report to SARFT for approval and obtain a One-Time Film Production License for each single film to be produced from SARFT. We cooperate with third parties with the requisite qualifications and licenses in the production and distribution of the animation series and film based on our Mole's World franchise, the animation series and film based on our Seer franchise and the animation series based on our Flower Angel franchise. Shanghai Taomee Animation Co., Ltd. has obtained (i) the license for the production and broadcasting of radio and television program, and the license for the broadcasting of Seer I, Seer II, Mole's World III and Flower Angel animation series, (ii) the license of public screening for the third and fourth film based on our Seer franchise, and (iii) the license of public screening for the third film based on our Mole's World franchise.

Policies to Foster Growth of Domestic Animation Industry

Since 2004, several circulars have been issued to encourage the development of the still nascent animation industry in China. On April 20, 2004, SARFT promulgated *Several Opinions on Developing Domestic Animation and Film Industry*, which restricts foreign animation content by putting a time limit

on total hours allowed to be broadcast in television stations in China. SARFT issued the *Circular on Further Regulating the Broadcasting of Animations* in 2006, and the *Notice of the State Administration of Radio, Film and Television on Strengthening the Regulation on the Broadcasting of Animations* in 2008, effectively prohibiting the broadcasting of foreign animation content by nationwide television stations from 17:00 to 21:00 every day. In 2006 and 2008, circulars were issued by various governmental departments including the Ministry of Finance and MOC, supporting domestic animation industry and promoting the animation production industrial chain. Furthermore, on July 17, 2009, the Ministry of Finance and State Administration of Taxation jointly promulgated the *Circular on Tax Policy to Support Animation Industry*, which provides domestic animation producers a series of preferential tax treatment with regard to their self-developed products. The Ministry of Finance and State Administration of Taxation further promulgated the *Circular on the Value-Added Tax Policy of Software Products* on October 13, 2011 and the *Circular on the Tax Policies of Value-Added Tax and Business Tax for Animation Industry* on November 28, 2013, which update the tax policies on value-added tax and business tax for animation industry.

Regulation on Broadcasting Audio/Video Programs through the Internet

On July 6, 2004, the SARFT promulgated the Rules for the Administration of Broadcasting of Audio/Video Programs through the Internet and Other Information Networks, or the Audio/Video Broadcasting Rules. The Audio/Video Broadcasting Rules apply to the opening, broadcasting, integration, transmission or download of audio/video programs via the Internet and other information networks. Anyone who wishes to engage in Internet broadcasting activities must first obtain an audio/video program transmission license, with a term of two years, issued by the SARFT and operate pursuant to the scope as provided in such license. Foreign-invested enterprises are not allowed to engage in the above business.

On December 20, 2007, the SARFT and the MIIT jointly issued the Rules for the Administration of Internet Audio and Video Program Services, commonly known as Document 56, which came into effect as of January 31, 2008. Document 56 reiterates the requirement set forth in the Audio/Video Broadcasting Rules that online audio/video service provider must obtain a license from the SARFT. Furthermore, Document 56 requires all online audio/video service providers to be either wholly state-owned or state-controlled. According to relevant official answers to press questions published on the SARFT's website dated February 3, 2008, officials from the SARFT and the MIIT clarified that online audio/video service providers that already had been operating lawfully prior to the issuance of Document 56 may re-register and continue to operate without becoming state-owned or controlled, provided that such providers have not engaged in any unlawful activities. This exemption will not be granted to online audio/video service providers established after Document 56 was issued.

In January 2012, in cooperation with a number of China's leading online video websites which have obtained the audio/video program transmission licenses, we launched v.61.com, a website that offers animation series based on our franchises, such as Seer and Mole's World, as well as other content from these websites. In November 2012, we jointly developed with Turner Broadcasting System Asia Pacific (the parent company of Cartoon Network) the website of ben10.61.com, a dedicated Chinese online zone for Ben 10 fans to get access to featuring videos, online games, wallpaper downloads, e-comics and character profiles. If the governmental authorities determine that our online website falls within Document 56, we may not be able to obtain the audio/video program transmission license, and we may become subject to significant penalties, fines, legal sanctions or an order to suspend our online website.

Regulations on E-Books

On October 9, 2010, GAPP promulgated *The Opinions of GAPP on the Development of E-Books Industry*, which came into effect on the same day, according to which enterprises engaging in e-book

industries are subject to approvals and administration from relevant governmental authorities. In addition, enterprises engaging in the creation, editing and publication of e-books or in the operation of platform where the e-book resources are delivered to users are deemed as e-book publisher and are subject to approvals for the publication of e-books. We have released over twelve e-books as of December 31, 2014 which featured the Mole's World franchise, and Seer animation application on Apple's iOS platform. Since there is no official or public interpretation on the definition of e-book publication, we are not sure whether our release of e-books on mobile platforms will be deemed as publication and therefore be subject to the approval of GAPP.

Regulations Related to Intellectual Property Rights

The State Council and the NCAC have promulgated various rules and regulations relating to the protection of software in China. Under these rules and regulations, software owners, licensees and transferees may register their rights in software with the NCAC or its local branches and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process to enjoy better protections of registered software rights.

On March 5, 2009, the MIIT promulgated the *Administrative Measures on Software Products*, or the Software Measures, which replaced the original *Administrative Measures on Software Measures* promulgated by MII in October 2000, to regulate software products and promote the development of the software industry in China. Pursuant to the Software Measures, software products which are developed in China and registered with the local provincial government authorities in charge of the information industry and filed with MIIT may enjoy the relevant encouragement policies. Software developers or producers may sell or license their registered software products independently or through agents. Upon registration, the software products will be granted registration certificates. Each registration certificate is valid for five years and may be renewed upon expiration.

On February 24, 2015, the State Council issued the *Decision on Cancelling and Adjusting a Batch of Administrative Approval Items and other Matters*, pursuant to which the government approval of qualification of "software enterprise" and registration of software products are released.

The *PRC Trademark Law*, adopted in 1982 and revised in 2001 and 2013, with its implementation rules adopted in 2002, protects registered trademarks. The PRC Trademark Office of the SAIC handles trademark registrations and grants a protection term of ten years to registered trademarks.

The MII amended its *Administrative Measures on China Internet Domain Names* in 2004. According to these measures, the MII is in charge of the overall administration of domain names in China. The registration of domain names in PRC is on a "first apply-first-registration" basis. A domain name applicant will become the domain name holder upon the completion of the application procedure.

Regulations Related to Employment

On June 29, 2007, the Standing Committee of the National People's Congress adopted the *Employment Contract Law*, or ECL, which became effective as of January 1, 2008. The ECL was further amended by the Standing Committee of the National People's Congress on December 28, 2012. The ECL requires employers to provide written contracts to their employees, restricts the use of temporary workers, and aims to give employees long-term job security.

Pursuant to the ECL, employment contracts lawfully concluded prior to the implementation of the ECL and continuing as of the date of its implementation will continue to be performed. Where an employment relationship was established prior to the implementation of the ECL but no written employment contract was concluded, a contract must be concluded within one month after the ECL's implementation.

Regulations Related to Foreign Currency Exchange and Dividend

Foreign currency exchange

The principal regulations governing foreign currency exchange in China are the *Foreign Exchange Administration Regulations*, as amended in August 2008. Under this regulation, the RMB is freely convertible for current account items, including the trade and service-related foreign exchange transactions and other current exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities, unless the prior approval of SAFE is obtained and prior registration with SAFE is made.

Pursuant to the *Administration Rules of the Settlement, Sale and Payment of Foreign Exchange* promulgated on June 20, 1996 by the PBOC, foreign-invested enterprises in China may purchase or remit foreign currency for settlement of current account transactions without the approval of the SAFE. Foreign currency transactions under the capital account are still subject to limitations and require approvals from, or registration with, the SAFE and other relevant PRC governmental authorities.

In October 2005, the SAFE issued the *Circular on Issues Relating to the Administration of Foreign Exchange in Fund-raising and Return Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies*, or SAFE Circular 75, which became effective as of November 1, 2005. This was further supplemented by an implementing notice issued by SAFE on November 24, 2005. SAFE Circular 75 suspends the implementation of two prior regulations promulgated in January and April of 2005 by SAFE. In July 2014, the SAFE issued the *Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Offshore Investment and Financing, and Roundtrip through Special Purpose Vehicles*, or SAFE Circular 37, which replaced SAFE Circular 75 and became effective as of July 4, 2014. SAFE Circular 37 states that PRC residents, whether individuals or institutions, must register with the relevant local SAFE branch prior to making any capital contributions to a special purpose vehicle. The term "special purpose vehicle" as used in SAFE Circular 37 refers to an offshore entity established for the purpose of overseas investment or equity financing involving onshore or offshore assets or equity interests held by PRC residents. The term "PRC institutions" as used in SAFE Circular 37 refers to those entities with legal person status or other economic organizations established within the territory of the PRC. The term "PRC resident individuals" as used in SAFE Circular 37 includes all PRC citizens who hold PRC identity cards, military identity documents or identity documents for PRC armed police, and overseas individuals who do not have legal PRC legal identity document but habitually reside in China for economic benefit. Under SAFE Circular 37, PRC resident individuals are required to register the first level of the special purpose vehicles owned or controlled by them, instead of registering all special purpose vehicles they own or control (as required in the past under SAFE Circular 75 and its implementing rules); in addition, the PRC resident individuals are also required to apply for change registration when the registered special purpose vehicle incurs significant changes, including in respect of its PRC resident individual shareholder or the name, capital or shareholding structure, etc. of the registered special purpose vehicle invested or controlled by such PRC resident individual shareholder. PRC residents are also required to complete amended registrations or deregistration with the local SAFE branch in a timely manner when a PRC resident no longer has interests in a registered special purpose vehicle or where a PRC resident is no longer required to apply for the registration of the special purpose vehicles, whether due to share transfer, bankruptcy, dissolution, liquidation, expiry of the operating term of the registered special purpose vehicles or identity change of the PRC resident individual shareholders or other reasons. PRC residents who have already made capital contributions to a special purpose vehicle with legitimate domestic and overseas assets or interests, but failed to apply for the requisite SAFE registration before SAFE Circular 37 was implemented, shall submit an explanatory statement regarding its prior failure in completing the registration to the local SAFE branch, and the local SAFE branch will determine whether to accept such remedial registration and whether to assess any administrative punishment.

On February 13, 2015, SAFE issued the *Circular on Further Simplifying and Improving the Foreign Exchange Administrative Policies for Direct Investment*, or SAFE Circular 13, which will take effect as of June 1, 2015. Pursuant to SAFE Circular 13, the PRC residents should apply to the local bank instead of the local SAFE branch for the initial registration or amended registration as required under SAFE Circular 37. However, in case of any remedial registration as required under SAFE Circular 37, the PRC residents should still apply to the local SAFE branch.

The registration and filing procedures under the SAFE Circular 37 are prerequisites for other approval and registration procedures necessary for capital inflow from the offshore entity, such as inbound investments or shareholders loans, or capital outflow to the offshore entity, such as the payment of profits or dividends, liquidating distributions, equity sale proceeds, or the return of funds upon a capital reduction. All our individual shareholders who are subject to SAFE Circular 37 have obtained registration with regard to the capital contribution to our company and the later changes of their shareholding in our company as required under SAFE Circular 37. Please see "Item 3. Key Information—Risk Factors—Risks Related to Doing Business in China—We may be subject to penalties, including restriction on our ability to inject capital into our PRC subsidiary and our PRC subsidiary's ability to distribute profits to us, if our PRC resident shareholders or beneficial owners fail to comply with relevant PRC foreign exchange rules."

On February 15, 2012, SAFE promulgated the *Notice regarding Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Option Plan of Overseas-Listing Companies*, which substitutes the *Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Companies* promulgated by SAFE on March 28, 2007. Under the Stock Option Rule, the domestic individuals as defined under the *Foreign Exchange Administration Regulations* who are granted stock options or other incentive alternatives by an overseas publicly listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly listed company, to register with SAFE and complete certain other procedures.

Dividend distribution

The principal regulations governing distribution of dividends of foreign holding companies include the *Foreign Investment Enterprise Law* issued in 1986 and amended in 2000, and the *Implementation Rules under the Foreign Investment Enterprise Law* issued in 1990 and amended in 2001. Under these regulations, foreign investment enterprises in the PRC may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, foreign investment enterprises in the PRC are required to allocate at least 10% of their respective accumulated profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. Funds held in these reserves are not distributable as cash dividends.

Regulations Related to Taxation

On March 16, 2007, the National People's Congress, the PRC legislature, passed the new *Enterprise Income Tax Law*, or the new EIT Law which became effective on January 1, 2008. On December 6, 2007, the State Council approved and promulgated the *Implementation Rules of PRC Enterprise Income Tax Law*, which took effect simultaneously with the new EIT Law.

The new EIT Law applies a uniform 25% Enterprise Income Tax rate to both foreign-invested enterprises and domestic enterprises and eliminates many of the preferential tax policies afforded to foreign investors. Furthermore, dividends out of post-2007 earnings paid by a foreign-invested enterprise to a non-resident shareholder are now subject to a withholding tax of 10%, which may be reduced under any applicable bi-lateral tax treaty between the PRC and the jurisdiction where the non-resident shareholder resides. According to the *Administrative Measures for Non-residents Enjoying*

[Table of Contents](#)

Tax Treaty Benefits (Trial Implementation) issued by the State Administration of Taxation on August 24, 2009, which became effective on October 1, 2009, an applicant seeking a preferential withholding tax rate under a bilateral tax treaty must apply to the competent PRC tax authorities for recognition of eligibility for such treaty benefits. According to the *Circular of the SAT on How to Understand and Identify "Beneficial Owner" under Tax Treaties*, which became effective on October 27, 2009, or Circular 601, the PRC tax authorities must evaluate whether an applicant for treaty benefits with respect to dividends, interest and royalties qualifies as a "beneficial owner" on a case-by-case basis, and must follow the "substance over form" principle. Circular 601 sets up criteria to identify a "beneficial owner" and provides that an applicant that does not carry out substantial business activities, an agent or a conduit company, will not be regarded as a "beneficial owner" and therefore cannot enjoy treaty benefits.

Pursuant to the *Arrangement between Mainland of the PRC and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income* signed on August 21, 2006, which in Hong Kong, applies to income derived in any year of assessment commencing on or after April 1, 2007, and in the PRC, in any year commencing on or after January 1, 2007, a company incorporated in Hong Kong will be subject to withholding income tax at a rate of 5% on dividends it receives from its PRC subsidiaries if it is deemed the beneficial owner by PRC tax authorities and holds a 25% or more equity interest in that particular PRC subsidiary at the time of the distribution, or 10% if it holds less than a 25% equity interest in that subsidiary or is not the beneficial owner of the income.

An enterprise registered under the laws of a jurisdiction outside the PRC may be deemed a PRC tax resident if its place of effective management is in the PRC. According to the implementation rules, an enterprise's place of effective management may be deemed to be in the PRC if the PRC is the location of its "de facto management bodies", which are defined as the bodies that have substantial and overall management and control over such aspects as the production and the business, personnel, accounts and properties of the enterprise.

In addition, under the new EIT Law, foreign shareholders could become subject to a 10% income tax on any gains they realized from the transfer of their shares, if such gains are regarded as income derived from sources within the PRC, and the enterprise in which their shares invested is considered a "tax resident enterprise" in the PRC. Once a non-PRC company is deemed to be a PRC tax resident by following the "place of effective management" concept and any dividend distributions from such company are regarded as income derived from sources within the PRC, PRC withholding income tax may be imposed and applied to dividend distributions from the deemed PRC tax resident to its foreign shareholders, and dividends distributed by its PRC subsidiaries to such deemed PRC tax resident would be exempt from PRC tax if certain requirements are met.

Pursuant to the *PRC Individual Income Tax Law*, or the Individual Income Tax Law, adopted on December 29, 2007 and amended on June 30, 2011, individuals who are domiciled in the PRC or who are not domiciled but have resided in the PRC for at least one year are required to pay Individual Income Taxes in accordance with the Individual Income Tax Law on income derived from sources in and outside the PRC. For those individuals who are neither domiciled in nor residents of the PRC, or who are not domiciled and reside for less than one year in the PRC, are required to pay Individual Income Taxes in accordance with this law on income derived from sources within the PRC.

Pursuant to the PRC Provisional Regulations on Business Tax, taxpayers providing taxable services falling under the category of service industry in China are required to pay a business tax at a normal tax rate of 5% of their revenues. In November 2011, the Ministry of Finance and the SAT promulgated the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax. Pursuant to this pilot plan and relevant notices, or Circular 111, pursuant to which from January 1, 2012, VAT has replaced business tax in the transport and shipping industry and some of the modern service industries in Shanghai. In July 2012, the Ministry of Finance and the SAT promulgated the Circular concerning

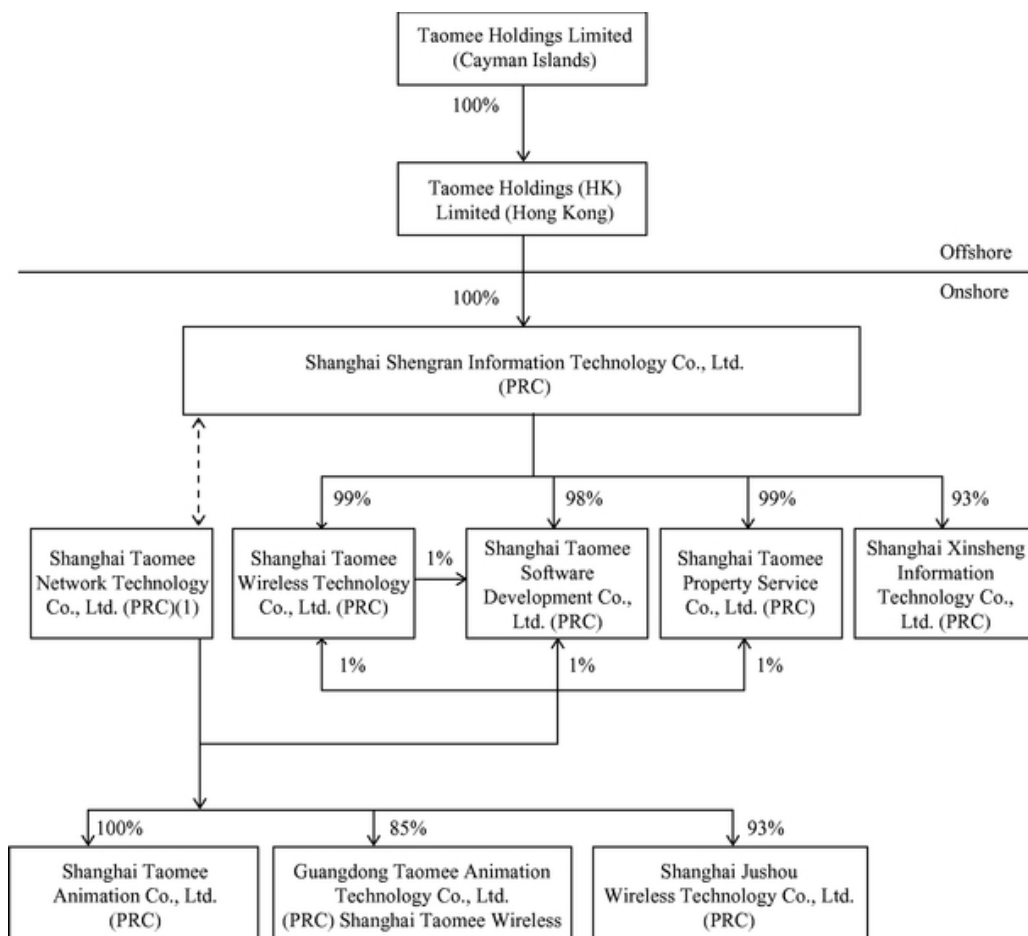
Implementing the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax for Transport and Shipping Industry and Certain Modern Service Industries in Eight Provinces and Municipalities (including Beijing), or Circular 71, which expanded the pilot regions to other eight provinces and municipalities including Beijing, Tianjin, and Shenzhen. In May 2013, the Ministry of Finance and the State Administration of Taxation promulgated the *Circular concerning Implementing the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax for Transport and Shipping Industry and Certain Modern Service Industries across the Country*, or Circular 37, which expanded the pilot regions to the whole nation and Circular 111 and Circular 71 were annulled accordingly. In December 2013, the Ministry of Finance and the State Administration of Taxation promulgated the *Circular on Expanding the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax to Railway Transport and Postal Service*, or Circular 106, pursuant to which, from January 1, 2014, VAT would replace business tax in the transport and shipping industry, postal service and some of the modern service industries in PRC and Circular 37 was annulled accordingly. Under Circular 106, a VAT rate of 6% applies to certain modern service industries. In April 2014, the Ministry of Finance and the State Administration of Taxation promulgated the *Circular on Expanding the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax to Telecommunication Industry*, or Circular 43, pursuant to which, from June 1, 2014, VAT would also replace business tax in telecommunication industry. The revenues recognized from part of our businesses operated by Shanghai Shengran, Shanghai Taomee, Shanghai Animation and Shanghai Xinsheng are subject to VAT at a rate of 6% for certain other services such as advertisement, merchandise licensing and film box office revenue sharing and 17% for software sales, while other part of our business are still subject to PRC business tax at a statutory tax rate of 5%. If this plan is extended to apply to other part of our business, we may be subject to VAT rate which is higher than the business tax rate, which could harm our financial condition and results of operations. Pursuant to the Notice on Several Economic Policies for Supporting the Development of Films promulgated jointly by the Ministry of Finance, the National Development and Reform Commission, the Ministry of Land and Resources, and other departments on May 31, 2014, which took effect on the same day, from January 1, 2014 to December 31, 2018, film producing companies will be exempted from paying VAT on the revenues generated from their sale of film copies (including digital copies) or the transfer of copyright, and film distribution companies will be exempted from paying VAT on revenues generated from distribution of films. Shanghai Taomee has obtained such VAT exemption for revenues generated from *Mole II* film and Shanghai Animation has obtained such VAT exemption for revenues generated from *Seer IV* film and *Mole III* film.

Regulations Related to M&A and Overseas Listings

On August 8, 2006, six PRC regulatory agencies, including the Ministry of Commerce, the State-owned Assets Supervision and Administration Commission, the State Administration of Taxation, the SAIC, the CSRC and SAFE, jointly issued the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or the New M&A Rules, which became effective on September 8, 2006 and was amended by the Ministry of Commerce on June 22, 2009. The New M&A Rules, among other things, require that (i) PRC entities or individuals obtain MOFCOM approval before they establish or control a special purpose vehicle, or SPV, overseas, provided that they intend to use the SPV to acquire their equity interests in a PRC company at the consideration of newly issued share of the SPV, or Share Swap, and list their equity interests in the PRC company overseas by listing the SPV in an overseas market; (ii) the SPV obtains MOFCOM's approval before it acquires the equity interests held by the PRC entities or PRC individual in the PRC company by Share Swap; and (iii) the SPV obtains CSRC approval before it lists overseas. Please see "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—The approval of the China Securities Regulatory Commission, or the CSRC, may be required in connection with the initial public offering under a PRC regulation. The regulation also establishes more complex procedures for acquisitions conducted by foreign investors that could make it more difficult for us to grow through acquisitions."

C. Organizational Structure

The following diagram illustrates our corporate structure and the place of incorporation of each of our significant subsidiaries, VIEs and VIEs' subsidiaries as of December 31, 2014.



—> Direct ownership

←—> Contractual arrangements: See "—Contractual Arrangements with Shanghai Taomee and its Shareholders."

- (1) Shanghai Taomee is our VIE in China and is 30% owned by Mr. Jason Liqing Zeng, our chairman, 23.75% owned by Mr. Benson Haibing Wang, our co-founder, director and chief executive officer, 17.375% owned by Mr. Crow Zhen Wei, our co-founder and director, 15.75% owned by Mr. Roc Yunpeng Cheng, our co-founder, director and president, 8.125% owned by Mr. Bin Wang and 5% owned by Mr. Yuliang Feng.

We have entered into contractual arrangements with Shanghai Taomee and its shareholders, through which we exercise effective control over operations of Shanghai Taomee and receive economic benefits generated from it. As a result of these contractual arrangements, under U.S. GAAP, we are considered the primary beneficiary of Shanghai Taomee and thus consolidate its results in our consolidated financial statements. However, these contractual arrangements may not be as effective in

providing us with control over the VIE as direct ownership of it. In addition, the VIE or its shareholders may breach the contractual arrangements with us. In such cases, we would have to rely on legal remedies under PRC law, which may not always be effective, particularly in light of uncertainties in the PRC legal system. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Corporate Structure—If the PRC government determines that the contractual arrangements that establish the structure for operating our business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties" and "Item 3. Key Information—D. Risk Factors—Risks Related to Our Corporate Structure—If the PRC government determines that our ownership structure does not comply with the restrictions contained in the GAPP Notice, we could be subject to severe penalties."

Contractual Arrangements with Shanghai Taomee and its Shareholders

Our relationships with Shanghai Taomee and its shareholders are governed by a series of contractual arrangements. Under PRC laws, each of Shanghai Taomee and Shanghai Shengran is an independent legal person and neither of them is exposed to liabilities incurred by the other party. Other than pursuant to the contractual arrangements between Shanghai Taomee and Shanghai Shengran, Shanghai Taomee is not required to transfer any funds generated from its operations to Shanghai Shengran.

Loan Agreement. Certain shareholders of Shanghai Taomee, namely Messrs. Jason Liqing Zeng, Benson Haibing Wang, Crow Zhen Wei, Roc Yunpeng Cheng and Bin Wang entered into a loan agreement with Shanghai Shengran, under which Shanghai Shengran provided an interest-free loan of RMB2.5 million (US\$0.4 million) to these shareholders, solely for their respective contributions to the increased capital of Shanghai Taomee. The loan has a term of ten years, which can be extended if mutually agreed by the parties. Shanghai Shengran has the right to determine the method of loan repayment, including requiring the shareholders to transfer all of their respective equity interest in Shanghai Taomee to Shanghai Shengran and/or its designee.

Option Agreement. Shanghai Taomee's shareholders have entered into an option agreement with Shanghai Shengran, under which each shareholder of Shanghai Taomee granted Shanghai Shengran an exclusive option to purchase or have its designee purchase his equity interest in Shanghai Taomee at the purchase price equal to the lowest price permitted by the PRC laws, and agreed to assist Shanghai Shengran in obtaining all necessary government approvals as may be then required in connection with the purchase. Shanghai Shengran may exercise such option at any time to the extent permitted by the PRC laws. In addition, Shanghai Taomee and its shareholders agree that without Shanghai Shengran's prior written consent, they will not engage in certain actions including transferring or otherwise disposing of the equity interest in Shanghai Taomee.

Proxy Agreement. Shanghai Taomee and its shareholders have entered into a proxy agreement with Shanghai Shengran, under which each shareholder of Shanghai Taomee granted an irrevocable power of attorney to Shanghai Shengran that authorizes Shanghai Shengran to vote as the shareholder's attorney-in-fact on all of the matters of Shanghai Taomee requiring shareholders' approval, including the appointment of board members and senior management members.

Business Operation Agreement. Shanghai Taomee and its shareholders have entered into a business operation agreement with Shanghai Shengran, under which each of the shareholders agrees that, without the prior written consent of Shanghai Shengran or its designee, Shanghai Taomee will not conduct any transactions which might substantially affect its assets, businesses, personnel, obligations, rights or operations confirmed by Shanghai Shengran. Shanghai Taomee and its shareholders agree to fully comply with the advices in connection with its business operation and financial management provided by Shanghai Shengran from time to time and to elect directors and officers of Shanghai Taomee in consistence with the direction of Shanghai Shengran. In addition, the shareholders agree to

unconditionally transfer to Shanghai Shengran, without any consideration, any dividends or other proceeds received from Shanghai Taomee in their capacity as shareholders of Shanghai Taomee.

Commercial Cooperation Agreement. Under the commercial cooperation agreement between Shanghai Taomee and Shanghai Shengran, Shanghai Shengran agrees to place certain game updates and value-added components developed by it, or the objects, on Shanghai Taomee's platform for operation. Shanghai Shengran will provide routine maintenance, updates, technical support and debugging for the operation of the objects, and Shanghai Taomee will provide platform servers, broadband resources and customer services. Unless Shanghai Shengran directs otherwise and subject to applicable laws, any intellectual property in relation to the objects will belong to Shanghai Shengran and cannot be used by Shanghai Taomee beyond the agreed scope of uses. Shanghai Shengran will enjoy the profits generated from this operation after the deduction of a reasonable portion thereof by Shanghai Taomee. The rate for the deduction will be determined through negotiation by both parties based on the principles of arm's-length pricing.

Equity Interest Pledge Agreement. Shanghai Taomee and its shareholders have entered into an equity interest pledge agreement with Shanghai Shengran, under which the shareholders of Shanghai Taomee pledged all of their equity interests in Shanghai Taomee to Shanghai Shengran to secure their and Shanghai Taomee's obligations under certain agreements above and as collateral for all of the amounts payable by Shanghai Taomee to Shanghai Shengran under those agreements. If any event of default as defined under this agreement occurs, Shanghai Shengran, as the pledgee, will be entitled to dispose of the pledged equity interests. In addition, any equity proceeds (including but not limited to any dividend or profit) from Shanghai Taomee will be further pledged in favor of Shanghai Shengran excepted otherwise agreed by Shanghai Shengran in writing.

D. *Property, Plant and Equipment*

Our principal executive offices are located at 16/F, Building No. A-2, No. 1528 Gumei Road, Xuhui District, Shanghai 200233, People's Republic of China. Our telephone number at this address is (86-21) 6128-0056 and our fax number is (86-21) 3367-4012. We are headquartered in Shanghai. As of December 31, 2014, we leased an aggregate of approximately 7,091 square meters of offices in Shanghai and 161 square meters of offices in Guangzhou, Guangdong, respectively, from independent third parties, and we are in the course of developing our own corporate offices to better facilitate our further investments in gaming and animation studios.

In May 2013, we entered into a land pre-development cooperation agreement with respect to our intention to purchase the land use rights of two parcels with an aggregated area of approximately 23,300 square meters in Songjiang District, Shanghai for a total consideration of RMB8.9 million (US\$1.4 million), which has been paid in full as of December 31, 2014.

In December 2014, we entered into a land use right transfer agreement with Songjiang Planning and Land Administration Bureau of Shanghai Municipality to purchase the land use right of the above mentioned two parcels for considerations of RMB11.0 million (US\$1.8 million) (the "First Parcel") and RMB10.4 million (US\$1.7 million) (the "Second Parcel"), respectively, which have been paid in full as of January 31, 2015.

Under the land use right transfer agreement in connection with the First Parcel, we agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach annual revenues of RMB259.2 million (US\$41.8 million), (ii) the relevant annual tax expenses will be no less than RMB14.6 million (US\$2.4 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by January 26, 2020. In addition, we also committed to pay a project completion security deposit of RMB2.2 million (US\$0.4 million), adhering us to certain project commencement, completion and operation milestones on specific dates. Should we fail to meet these requirements and depending on the severity of breach, we may be subject to liabilities for breach

including forfeiture of a portion or all of our deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Under the land use right transfer agreement in connection with the Second Parcel, we agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach annual revenues of RMB244.3 million (US\$39.4 million), (ii) the relevant annual tax expenses will be no less than RMB13.8 million (US\$2.2 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by February 11, 2020. In addition, we also committed to pay a project completion security deposit of RMB2.1 million (US\$0.3 million), adhering us to certain project commencement, completion and operation milestones on the specific dates. Should we fail to meet these requirements and depending on the severity of breach, we may be subject to liabilities for breach including forfeiture of a portion or all of our deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Separate from the project completion security deposits, if we fail to comply with the terms of the land use right transfer agreements (and depending on the severity of the breach), we may be subject to liabilities for the breach including the forfeiture of the land use rights by the PRC government. If our land use rights are forfeited, we will not be able to recover the costs incurred for the initial acquisition and will only be refunded the consideration paid for the remaining term of the land use rights, which relies on the government credit for the payment.

We intend to develop the two parcels of land as our Taomee campus to facilitate the growth of our gaming, media and animation studios. The cooperation by the Songjiang government will play an integral part in the success, timing and final cost of the development project. Please see "Item 3. Key Information—D. Risk Factors—Risks Related to Our Business—Our Songjiang land development relies heavily on the cooperation by the government and also requires a substantial amount of investment to complete, of which if we do not manage effectively due to our limited knowledge of land development, could adversely affect our cash balance."

In August 2013, we entered into a letter of intent with respect to our intention to purchase a building with an aggregated construction area of approximately 4,860 square meters in Songjiang District, Shanghai for a total consideration of RMB46.6 million (US\$7.5 million) and made a prepayment of RMB14.0 million (US\$2.3 million) in 2013. Given the current business landscape, we decided to terminate the purchase and are in the process of taking back the prepayment. Pursuant to the agreements we have entered into with the parties thereto, we will be fully refunded of the prepayments if we fail to obtain the land use rights, or if we decide to terminate our intent under no cause. Please see "Item 3. Key Information—D. Risk Factors—Risks Related to Our Business—We may not be able to obtain the land use rights or properly develop our office buildings in Songjiang, Shanghai in a timely manner and we may not successfully recover our prepayment for building ownership thereunder, which may have a material adverse effect on our results of operations and financial condition."

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

A. *Operating Results*

Overview

We are one of the leading children's entertainment and media companies in China. We provide a diverse portfolio of services and products through two business segments: online business and offline business. Our online business includes developing and operating online virtual worlds, mobile games and other online entertainment services. Our offline business focuses on merchandise licensing, publishing, design and distribution of toys, as well as the development of media and entertainment products, such as animated films. In the past, our success online business has translated into growing demand for our offline products.

In our virtual worlds, which are predominantly web game based, children adopt avatars and learn through interactive games and group activities set in imaginative landscapes with evolving story lines of exploration and adventure. Our business is facing both an opportunity and a challenge from user trends of migrating from PC to mobile mediums for entertainment, evidenced by a new genre of mobile games we have or are developing, and also the decreasing active account trends in our virtual worlds. While mobile games are still a new category for us, our transition towards mobile gaming signifies our approach to further suit our user needs and market trends. As mobile gaming for children has thus far shown higher challenges of monetization for us versus our tradition web-based games for children, we tend to focus more on mainstream type of mobile games targeted not just for children, while also developing mobile games based off our most popular franchises.

In order to leverage our investment and expansion into offline products, we have developed a cross media platform. We work with publishers to offer a wide range of children's books and magazines, featuring iconic characters, story lines and images we have developed and popularized. We license our franchises to leading brands in toys and other consumer products for children in China. We also design and distribute toys, trading cards and products through our own subsidiaries and channels. We have also developed content for animation films, which we released in 2011, 2012, 2013 and 2014. We refer to these other businesses as our offline business.

We generate revenues from our online business primarily through the sales of subscriptions and virtual items in our virtual worlds, and the licensing of our self-developed mobile games. We generate revenues from our offline business mainly from license fees and royalties based on contracts with book publishers, makers of consumer products and other licensees, distribution of our films, as well as wholesale of toys.

For 2012, 2013 and 2014, approximately 80.0%, 73.1% and 78.9%, respectively, of our net revenues were generated from online business, and approximately 20.0%, 26.9% and 21.1%, respectively, of our net revenues were generated from offline business.

Our net revenues were US\$40.2 million in 2012, US\$48.4 million in 2013 and US\$42.2 million in 2014. Our gross profit was US\$30.2 million in 2012, US\$35.1 million in 2013 and US\$30.5 million in 2014. Our net income was US\$8.9 million in 2012, US\$5.4 million in 2013 and US\$1.0 million in 2014. The number of active paying accounts, in our online entertainment community were 1.2 million in the three months ended December 31, 2012, 1.3 million in the three months ended December 31, 2013 and 0.8 million in the three months ended December 31, 2014, and per paying account average gross revenues from the operation of our virtual communities in China, or ARPU, increased from approximately US\$4.8 to US\$6.0 and US\$7.0 in the same periods.

Our decreasing revenue and active paying users in our business reflect the increasing competitive landscape in the children's online gaming, entertainment and toys plus licensing industries we conduct in China. The migration of our users from PC to mobile mediums for entertainment can be viewed as both a challenge and an opportunity for us. As we are aware of these decreasing trends and the increasing challenges in our business, our strategy is to further increase our franchise influence among

our users through media such as film and animation, while monetizing through gaming, toys and licensing. We expect to increase our franchise content investment. We are also exploring new online to offline, or O2O, types of models that may provide synergies to our business lines. To achieve our goals we will invest diligently in film and gaming studios, build up our brand and franchise presence through integrated marketing and media distribution, cooperate with possible third-party studios to co-develop franchises, further invest in mainstream mobile and franchise-based gaming, while also ensuring we are properly prepared to facilitate the expansion of our media and children's entertainment studios through the land development of our office buildings.

Factors Affecting Our Results of Operations

Our results of operations are affected by the factors described in more details in the "—Descriptions of Certain Statement of Operations Items—Net revenues" as well as the general and specific factors, including:

- overall economic growth in China, which has resulted in increases in disposable income and discretionary consumer spending;
- urbanization rate, which has led to the development of a sophisticated consumer market and a greater concentration of children in urban centers with ready access to the Internet;
- discretionary spending on and by children and their caregivers, particularly in media and entertainment, which has increased considerably as a result of Chinese families' growing affluence as well as population control policies of the Chinese government;
- demand for online entertainment among children, which has grown as a result of rapidly increasing popularity of Internet use among children;
- the films and cartoons of our franchises are of high enough quality to continue attracting our targeted audiences, as this is a main method for us to further increase our influence and presence among users;
- development of mobile game industry, which has grown rapidly in China in recent years, driven primarily by (i) increasing numbers of smart mobile device users and the increasing penetration of mobile games among smart mobile device users, (ii) the increasing amount of time spent on smart mobile devices, (iii) the convenience of playing mobile games, and (iv) the development of 3G networks and introduction of 4G technology.
- government policies that restrict the operation by foreign content developers and operators. See "Item 4. Information on the Company—B. Business Overview—Regulations Related to Our Business—Online games administration measures";
- stability and quality of our management and employees;
- competition in the children's entertainment and media industry, which is characterized by rapid change, impact of the new and converging technologies, relatively low capital requirements and barriers to entry. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Business—We may not be able to maintain our revenues and profitability as we operate in a competitive industry and compete against many companies"; and
- our ability to achieve a high level of production and operation efficiency.

Descriptions of Certain Statement of Operations Items

Net revenues

We generate revenues from two sources: (i) online business through the operation of our virtual worlds, licensing of mobile games and provision of other online services and products, and (ii) offline business through publishing and merchandise royalties, merchandise sales and box office revenues.

In 2012, our net revenues from online business decreased together with the decrease of the active paying accounts. We believe the decrease is primarily due to competition and our strategy to decelerate monetization temporarily to attract new users and increase user stickiness, which is evidenced by increased active accounts in 2012. In 2013, our net revenues from online business increased as a result of our revenue growth of our core virtual worlds from the prior year, as well as contribution from several newly launched virtual worlds. In 2014, our net revenues from online business decreased due to the decline of active paying accounts. We believe the decrease is primarily due to a change in user behavior, as more and more children are shifting from web games to mobile games, coupled with intensified competition. Our net revenues from our offline business have increased in both amount and percentage in 2012 and 2013 as a result of our strategy to build our cross-media entertainment platforms. In 2014, our net revenues from offline business decrease primarily because of the decline in our merchandise licensing and toys businesses. The following table sets forth a breakdown of our net revenues from the periods indicated.

	For the Years Ended December 31,					
	2012		2013		2014	
	US\$	%	US\$	%	US\$	%
	(in thousands, except percentages)					
Net revenues:						
Online business	32,169	80.0	35,330	73.1	33,292	78.9
Offline business	8,039	20.0	13,024	26.9	8,897	21.1
Total net revenues	40,208	100.0	48,354	100.0	42,189	100.0

Online Business

Our net revenues from online business amounted to US\$32.2 million, US\$35.3 million and US\$33.3 million in 2012, 2013 and 2014, respectively.

Virtual world revenues

Our net revenues from online virtual worlds are net of discounts and rebates granted to our distributors, as well as business taxes or VAT and related surcharges incurred in connection with our operations. Each of Shanghai Shengran and Shanghai Taomee is subject to PRC business tax at a statutory tax rate of 5% or VAT at a rate of, depending on different product categories, 17% or 6%, and surcharges related to urban construction and education, which we deduct from our gross online business revenues.

We generate revenues from our online virtual worlds primarily through two revenue streams for virtual features—time-based and item-based. While users can access our virtual worlds for free, users may choose to pay a subscription fee to access premium features and gain privileges within each of our virtual worlds for 30 days. Users who pay the subscription fee enjoy additional capabilities, special privileges, such as having a higher upper limit for the total number of friends that the users can have and access to exclusive online parties. In addition, users pay a fee for certain virtual item within our virtual worlds. For more details on revenue recognition, see "Critical Accounting Policies and Estimates—Revenue Recognition." Our online business revenues are also generated from licensing our virtual worlds outside of mainland China, predominantly Taiwan, as well as from licensing arrangements for operation of third-party online casual games on our platform.

[Table of Contents](#)

Users can purchase subscriptions and virtual items using our virtual currency, the Mibi, which in turn can be purchased from different distribution channels, such as our prepaid cards, third-party prepaid cards, online payment channels and cellular telecom operators. We sell the prepaid cards to our distributors at a pre-negotiated discount on the face value of the cards and offer a volume rebate to distributors if they meet a pre-set sales requirement. Net proceeds from distributors are initially recorded as advances from customer. Upon activation or charge of the prepaid cards or the Mibi, these advances from customers are transferred to deferred revenues. The proceeds received from sales of the Mibi directly to users through third-party payment channels are recorded as deferred revenues. For more details on our distribution agreements and payment systems, see "Item 4. Information on the Company—B. Business Overview—Our Business Segments—Online Business—Pricing, payment and distribution."

Our physical prepaid cards will expire on the expiration date printed thereon, which is generally two years after the date of card production. In November 2014, we changed the expiration term of newly issued prepaid cards to five years after the date of card production. The proceeds from the expired physical prepaid cards that have not been activated are recognized as other operating income upon expiration of the cards. In 2012, 2013 and 2014, we recognized US\$1,867,626, US\$1,620,842 and US\$587,274, respectively, as other operating income due to expiration of prepaid cards.

The following table sets forth the number of active accounts, the number of active paying accounts and ARPU for our virtual worlds for each period indicated.

	For the Three Months Periods Ended											
	2012				2013				2014			
	March 31	June 30	September 30	December 31	March 31	June 30	September 30	December 31	March 31	June 30	September 30	December 31
Active Accounts (in thousands)	42,267	43,680	57,348	34,401	43,910	40,645	60,797	38,615	45,139	41,877	59,370	36,798
Active Paying Accounts (in thousands)												
(1)	1,899	1,817	1,716	1,213	1,463	1,340	1,726	1,295	1,309	1,129	1,173	785
ARPU (in US\$)(2)	5.0	4.8	4.6	4.8	5.3	6.0	5.8	6.0	6.4	6.7	7.0	7.0

(1) The number of active paying accounts for each quarter is the number of active accounts that paid subscription fees to access premium features of our virtual worlds or purchased virtual items in the relevant quarter.

(2) Includes gross revenues from online business, and excludes gross revenues from the licensing of our virtual worlds to third-parties.

Mobile game revenues

We generate our mobile game revenues primarily from licensing our self-developed mobile games, which are played on iOS or Android based smartphones and tablets, to certain publishers including Chukong, IGG, True Digital Plus and Netmarble. They publish games to end players through distribution channels, such as the iOS App Store, Google Play Store, 360 Mobile Assistant, UC Web, 91 Wireless, SnapPea. Revenues generated from those games are shared between us and the publishers based on a predetermined percentage for each mobile game. These mobile game licensing agreements typically are termed for two to three years.

We believe net revenue from our online business is primarily affected by the following factors:

- *Our ability to maintain and expand our user base for our online virtual worlds*, which depends on the continued growth of the number of children who use the Internet, our ability to bring appealing content and entertainment experiences to our users, use effective promotion to reach new users, expand our user base in second and third-tier cities in China, and maintain and enhance our reputation among children and their parents. We will also develop new virtual worlds and other services on our community, which may appeal to age groups and demographics that we have yet to reach and increase our revenues as a result. As competition continues to intensify, given our virtual worlds are web-based, we are also currently facing challenges of user migration from PC to mobile mediums for entertainment, as reflected in our active user and paying user trends in 2014.

- *Our ability to increase item-based revenue stream.* We generate revenues primarily through the sales of subscriptions to access premium features and gain privileges in our interactive communities and the sales of virtual items. The increase in sales depends on our ability to frequently enhance and update our virtual items and premium features to cater to children's changing preferences and attract more sales.
- *Our ability to increase our ARPU by:*
 - *Effectively pricing our subscription fees and virtual items, and utilizing bundling.* We price our subscription fees and virtual items to be attractive and affordable for our users and to reflect market trend. While we do not foresee near-term increase in per account subscription fee, we expect greater flexibility in pricing virtual items.
 - *Optimizing revenue mix.* We have built and will continue to build a portfolio of diverse virtual worlds that appeal to children of different age, gender and interests. As children of different gender and age groups exhibit different ARPU patterns, and as virtual worlds with different themes or at different life stages exhibit different ARPU patterns, our revenues will be affected by the mix of virtual worlds and other services and communities we offer. Our ability to continue to launch virtual worlds to create a portfolio with various target users and life cycles is critical to our sustained growth.
- *Our ability to expand the distribution network and negotiate favorable rebates and discounts with distributors.* We maintain an extensive distribution system for our prepaid cards that reached approximately 97,000 retail outlets in over 1,700 towns and cities around China, as of December 31, 2014. Since many children have limited access to online payment channels, we rely on payment through the prepaid cards for a substantial amount of our revenues. We need to identify additional retail outlets that are located near our target users and expand our distribution network to more second and third-tier cities in China. In addition, our ability to negotiate favorable discount and rebate rates with more distributors and continue to optimize our distribution structure is important to our future revenue growth.
- *Managing seasonality in user behavior.* Our quarterly results of operations may be affected by seasonal trends caused by user behavior and demand for our online and offline offerings. We expect our net revenues from online business to be higher during winter and summer vacations when there are more active users and children have more online playtime during these non-school days, which usually falls in the first and third quarters of each calendar year. For instance, there were more non-school days in the first quarter and third quarter of 2014. Decreases in our net revenues from online business, if any, as a result of seasonality may be most visible from the third quarter to the fourth quarter of each year, as the fourth quarter has less than half of the non-school days compared to the third quarter, and from the first quarter to the second quarter as well, not only because the decrease in non-school days in the second quarter as compared to the first quarter, but also because children are generally given extra pocket money during Chinese New Year in the first quarter of each year. These seasonality trends generally manifest themselves more clearly with respect to more mature virtual worlds and less clearly during periods of high growth that accompany the introductory stages of a highly popular virtual world.
- *Our ability to develop, launch and operate mobile games successfully.* As more users migrate to mobile media for entertainment, we will continue to invest in mobile game development to better transition our services to user needs. Mobile games will become an increasingly important segment of our business. The growth of our revenue depends on our ability to offer commercially successful self-developed games. The success of our new self-developed games depends on many factors beyond our control, such as trends in the mobile game industry and player preferences. We believe that our ability to maintain the commercial success of our

existing games and continue to develop new commercially successful self-developed games will have a long-term impact on our sustainable growth and profitability. Mobile gaming for children is more difficult to monetize than web-based games, in our view. That is why we are also developing mainstream mobile games for all ages as well as children's mobile games based off our franchises. Operating mobile games may or may not be similar to operating our traditional web games, and there may be operating challenges that we had not encountered before.

- *Our ability to manage relationships with a mix of mobile publishers and distribution channels.* We license our self-developed mobile games to certain publishers including Chukong, IGG, True Digital Plus and Netmarble. They publish such games to end players through distribution channels which primarily comprise online application stores and mobile app portals. Our ability to expand and deepen our relationships with our mobile game publishers and distribution channels significantly affects the expansion of our business and results of operations. In addition, these publishers and distribution channels charge us revenue sharing fees. Therefore, the changes in the rate of revenue sharing fees charged by our publishers and distribution channels, and the mix of publishers and distribution channels we utilize, can significantly affect the revenue sharing fees we pay, which in turn have a significant impact on our cost of revenue, gross profit and gross margin.
- *Our ability to leverage our offline animation content to attract users to our online games.* Part of our cross-media strategy is to leverage our animation content to attract users to our online games. Our animation and franchise popularity may directly or indirectly affect our online games and its life-cycle longevity.
- *Our ability to operate in a competitive industry.* We operate in the children's online entertainment industry which is highly competitive. See "—Factors Affecting Our Results of Operations." Our ability to maintain our competitive edge in attracting and retaining users, to quickly respond to market trends and user preferences and to strategically promote our brands and services are crucial to our growth.
- *Our ability to expand cooperation with online web game developers.* We operate third-party online casual games on our platform and generate revenues from such licensing arrangements. We plan to continue to enter into licensing arrangements to operate third-party online casual games on our platform.

Offline business

Our net revenues from offline business amounted to US\$8.0 million, US\$13.0 million and US\$8.9 million in 2012, 2013 and 2014, respectively.

Our revenues from offline business mostly consisted of publishing royalties, film and merchandise licensing fees generated from licensing our content in the PRC. In addition to licensing our franchises, we also design and sell toys that bear images of our franchises, and sometimes books featuring our franchises. We take the associated inventory risks in connection with such sales. See "—Cost of Revenues—Offline business."

We invested in the production of, or licensed our franchise to producers of six feature films, based on our "Mole's World" and "Seer" franchises. We released these films in 2011, 2012, 2013 and 2014, and generated revenues through box office sharing proceeds and distribution of films on television and website.

[Table of Contents](#)

Our results of operations will be significantly affected by our ability to grow our offline business by leveraging our brand name and the popularity of our franchise assets and content creation capabilities. We believe net revenue from our offline business is primarily affected by the following factors:

- *Our ability to engage additional licensees in more media formats and product categories.* Currently, we are working with licensees in key categories of consumer goods, such as apparel, accessories, toys, stationery, consumer electronics, food, beverage, books, theme parks, live shows, and carnivals, including many brands well-known in China. We plan to increase our offline revenues by identifying additional media formats and/or product categories for the license of our franchises and number of licensees in each media format or product category;
- *Our ability to generate more popular content and offerings for offline business.* As of December 31, 2014, our content for our offline business had been mostly based on our franchises developed for our virtual worlds. We expect to further develop original and popular content in order for our offline business to grow;
- *Our ability to negotiate favorable royalty rates with our licensees.* We believe if we are able to further enhance our brand recognition, we may be able to negotiate more favorable royalty rates;
- *Our ability to introduce new toys and play methods that are well received by the market.* We believe our franchises provide us with an advantage to selling toys to children, but new toy merchandising, seasonal timing of the release and the unique features of the toy itself will highly determine the success of the product launch.
- *Our ability to engage in cross-marketing and promotions between online and offline media.* We expect our revenues from offline business may be able to increase as the awareness of our brands grows, as we promote our offline business in our large online community and as we tie the offline products and services to our popular online virtual worlds or other offerings, such as placing a redemption code in licensed children's books and toys that allows readers to redeem coveted virtual items; In addition, we also promoted our brands and franchise assets through cartoon animations. As of December 31, 2014, we have produced approximately 330 episodes of cartoon animations and broadcasted on over 350 TV channels throughout mainland China and Taiwan;
- *Seasonality of our offline business* is affected by the different consumption patterns influencing different media formats or product categories for our licensed franchises and the mix of media formats and product categories. For instance, sales of certain toys and stationery sold near primary schools may decrease during winter and summer vacations, while sales of clothing may increase during such periods, or the timing of new launches of content and product, such as the release of a film or cartoon animation series.

Cost of Revenues

The following table sets forth a breakdown of our cost of revenues and as a percentage of total cost of revenues for the periods indicated.

	For the Years Ended December 31,					
	2012		2013		2014	
	US\$	%	US\$	%	US\$	%
	(in thousands, except percentages)					
Cost of revenues:						
Online business	6,950	69.5	7,644	57.6	6,535	55.8
Offline business	3,048	30.5	5,621	42.4	5,182	44.2
Total cost of revenues	9,998	100.0	13,265	100.0	11,717	100.0

Online business

Our cost of revenues relating to our online business primarily consists of bandwidth and server hosting costs, salaries and benefits of our operations staff, production costs for prepaid cards, amortization of upfront licensing fees, depreciation and amortization of equipment and software purchased from third-parties, and other direct costs.

Our bandwidth costs represent the fees we pay to bandwidth vendors, which are typically telecommunications operators such as China Telecom and China Unicom, or independent third parties that purchase bandwidth from major telecommunications operators in China. We also purchase servers from which we incur depreciation expenses and rental expenses for storing our servers. In the foreseeable future, we expect our bandwidth costs and server-related depreciation and rental expenses to continue to increase in absolute amount given the anticipated increase in the volume of our website traffic. We expect this increase in absolute terms to be partially offset to the extent we are able to achieve better economies of scale as a result of increased sales volume and continued technological improvements that optimize bandwidth and server usage.

Salaries and benefits (including share-based compensation) cost for our online business primarily comprise compensation to operations support staff, including employees responsible for database and user system maintenance, bandwidth and server monitoring and maintenance, prepaid card and billing system maintenance, online security, technical support and customer service. As we continue to create new virtual worlds, expand franchises and develop new genre's of web and mobile games, we expect costs associated with salaries and benefits to increase in absolute amount as we continue to expand our operations and hire more staff. Our operations staff for online business decreased from 118 as of December 31, 2012 to 117 as of December 31, 2013, and further decreased to 91 as of December 31, 2014.

Our production costs include the cost of manufacturing and transporting physical prepaid cards to our distributors around China. Such production costs may increase in absolute amount as we continue to expand our operations and enter into distribution agreements with city level distributors. However, we do not expect production costs of the prepaid card to comprise a material part of our cost of revenues going forward.

Offline business

Cost of revenues relating to our offline business is primarily comprised of compensation to our operations employees, film production cost and toy production and distribution cost, which is the inventory costs of our toys and the cost involved in producing labels for the verification of the authenticity of our licensed products.

Operating Expenses

Our operating expenses primarily consist of product development expenses, sales and marketing expenses and general and administration expenses as well as impairment loss on acquired intangible assets and other operating income. The following table sets forth a breakdown of our operating expenses in terms of amount and as a percentage of our total net revenues for the periods indicated. As we continue to expand both our online and offline business, we expect our operating expenses to

increase in absolute amount, and we aim to maintain or enhance our operating efficiency when our business further scales up.

	For the Years Ended December 31,					
	2012		2013		2014	
	US\$	%	US\$	%	US\$	%
	(in thousands, except percentages)					
Total net revenues:	40,208	100	48,354	100	42,189	100
Operating expenses:						
Product development expenses	12,318	30.6	13,886	28.7	14,446	34.2
Sales and marketing expenses	9,966	24.8	9,446	19.5	9,304	22.1
General and administrative expenses	10,078	25.1	13,095	27.1	13,506	32.0
Impairment loss on acquired intangible assets	—	—	1,046	2.2	116	0.3
Other operating (income)	(5,512)	(13.7)	(5,708)	(11.8)	(5,020)	(11.9)
Total operating expenses	26,850	66.8	31,765	65.7	32,352	76.7

Product development expenses

Our product development expenses consist primarily of salaries and benefits, including share-based compensation, for personnel engaged in concept generation, community function development and design, story line development, website structure and content development and design, graphic and audio design, quality control and testing of our virtual worlds and mobile games as well as other online services. Product development also consists of toy design and development fees. Product development expenses accounted for approximately 30.6%, 28.7% and 34.2% of our total net revenues in 2012, 2013 and 2014, respectively. Our product development expenses increased in absolute amount in recent years primarily due to the increase in payroll expenses related to our hiring of additional writers, engineers, development staff, animation and graphic artists as well as the increase in average salary. We expect that our product development expenses will further increase in absolute amount in the future as we continue to devote resources to improve our interactive communities and the overall user experience and to create new virtual worlds, new mobile games and other online products, and to the extent we incur higher share-based compensation expenses.

Sales and marketing expenses

Our sales and marketing expenses primarily consist of advertising and promotional expenses, film promotion and animation production related expenses, salaries and benefits, including share-based compensation, and other overhead expenses incurred by our sales and marketing personnel. Sales and marketing expenses accounted for approximately 24.8%, 19.5% and 22.1% of our total net revenues in 2012, 2013 and 2014, respectively. Our sales and marketing expenses decreased slightly from 2012 to 2013 primarily due to the decreased advertising expenses, partially offset by an increase in payroll expenses related to sales and marketing, and decreased from 2013 to 2014 due to a decrease in payroll plus advertising and promotion expenses, while partially offset by an increase in film promotion cost. We expect that our sales and marketing expenses will increase in absolute amount as we further promote our virtual worlds and mobile games in future periods on search engines and web portals, while also producing more promotional cartoon animations films for our franchises.

General and administration expenses

Our general and administration expenses primarily consist of salaries and benefits, including share-based compensation, for our general and administration, finance and human resources personnel, office rentals, depreciation and amortization expenses relating to property and equipment used in general and administrative functions, professional service fees, indirect tax costs related to intercompany transactions, provisions for bad debt and unrecoverable prepayments, as well as other expenses incurred

in connection with general corporate purposes. General and administration expenses accounted for approximately 25.1%, 27.1% and 32.0% of our total net revenues in 2012, 2013 and 2014, respectively. Our general and administration expenses increased from 2012 to 2013 due to increases in payroll expenses and increases of indirect tax costs related to intercompany transactions. Our general and administration expenses increased from 2013 to 2014 due to increases in payroll expenses and provision for bad debt and unrecoverable prepayments, while partially offset by a decrease in professional service fees and share-based compensation expenses. We expect our general and administration expenses to increase in absolute amount as we incur additional expenses in connection with the expansion of our business and our investment activities, which include hiring more staff for our general and administrative team, expenses related to improving and maintaining our internal control over financial reporting and complying with our reporting obligations, and as we incur higher share-based compensation expenses.

Impairment loss on acquired intangible assets

Our impairment loss on acquired intangible assets in 2013 amounted to US\$1.0 million, incurred by writing off the remaining term of two underperforming games, Wizard 101 and Speed Hunter. Our impairment loss on acquired intangible assets in 2014 amounted to US\$0.1 million, incurred by writing off the remaining term of an underperforming game, Magic Haqi II.

Other operating income

Our other operating income consists of PRC government subsidies granted to our operating subsidiary and significant VIE and VIEs' subsidiaries in China and income recognized as a result of expiration of prepaid cards. Other operating income amounted to US\$5.5 million in 2012, US\$5.7 million in 2013 and US\$5.0 million in 2014. We received government subsidies of US\$3.4 million, US\$3.8 million and US\$4.0 million in 2012, 2013 and 2014. However, the amount we receive may vary depending on government policy, our business operations and other factors. In 2012, 2013 and 2014, we recognized US\$1.9 million, US\$1.6 million and US\$0.6 million as other operating income due to the expiration of prepaid cards, respectively.

Share of Profits (Loss) in Equity Method Investments, net of gain (loss) on disposals

In December 2009, we obtained a minority interest in Elyn Corporation and its wholly owned subsidiary Taiwan Taomee Co., Ltd., of which 20% equity interests was initially held through a related party, as consideration, in exchange for a three-year exclusive right to operate certain of our virtual worlds in Taiwan, Hong Kong and Macau. As we have the ability to exercise significant influence over Elyn Corporation, we account for this investment using the equity method of accounting.

On February 25, 2011, we entered into an agreement to effectively sell a 10.5% equity interest in Elyn Corporation that had been indirectly held by the related party on our behalf. Of the 10.5% equity interest in Elyn Corporation, 9.14% was sold to Qiming Funds which are our existing shareholders and 1.36% was sold to a third party investor for US\$3.4 million and US\$0.5 million, respectively, in cash. A gain of US\$3.7 million was recognized in share of profit in equity method investments in the consolidated statement of operations. In addition, the nominee shareholding agreement was terminated with the related party and we held all of our 29.5% equity in Elyn Corporation directly, and continued to account for this investment using the equity method.

On August 12, 2011, our equity interest in Elyn Corporation was diluted from 29.5% to 28.8% as a result of Elyn Corporation's issuing shares to its employees.

In November 2011, Taiwan Taomee went through a reorganization and contemporaneously issued new ordinary shares to existing shareholders and certain employees. As a result of such transactions, our equity interest in Taiwan Taomee was changed from 28.8% interest held through Elyn Corporation to a 27.6% effective interest which was held through (1) 29.50% in Elyn Corporation, which held

[Table of Contents](#)

72.09% of Taiwan Taomee, and (2) 28.77% in Joy Children Technology Co., Ltd., or Joy Children, a shell company with no operations, which owned 21.86% of Taiwan Taomee after the reorganization. The change in equity interest reflected a dilution resulting from shares issued to Taiwan Taomee's employees, which were accounted for by Taiwan Taomee as stock compensation. In addition, we paid total consideration of US\$668,992 in cash for the newly issued shares of Taiwan Taomee through Joy Children, which was recorded as an increase in equity method investment.

In July 2012, our aggregated equity interest through Elyn and Joy Children in Taiwan Taomee was diluted from 27.6% to 27.1%, i.e. (1) 29.50% in Elyn, which holds 70.88% of Taiwan Taomee and (2) 28.77% in Joy Children, which holds 21.49% of Taiwan Taomee. The dilution was mainly due to the issue of new ordinary shares by Taiwan Taomee from capital surplus and appropriations of 2011 earnings to certain existing shareholders and employees.

In June 2013, as part of a legal reorganization of Taiwan Taomee, our equity interest in Taiwan Taomee was held through Playgame Sdn. Bhd, a holding company established in Malaysia, and Elyn was liquidated. Our aggregated equity interest in Taiwan Taomee was not changed. In September 2013, Playgame transferred 3% of Taiwan Taomee's shares to Taiwan Taomee's underwriters upon its initial public offering in Taiwan Emerging Stock Market. As a result, Playgame's equity interest in Taiwan Taomee was accordingly diluted from 70.88% to 67.87%, resulting in a gain from investment of approximately \$287,790 recognized in the year 2013, reported within share of profit in equity method investees in the consolidated statements of operations.

We received cash dividends of US\$6,318, US\$424,483, and US\$337,659 from Elyn/Playgame and US\$616,802, US\$156,755 and US\$63,728 from Joy Children, which were recorded as return on investment in Elyn/Playgame and Joy Children in 2013, 2013 and 2014, respectively.

As of December 31, 2013 and 2014, we effectively held 26.2% and 26.2% in Taiwan Taomee through Playgame and Joy Children. Our share of profit in these equity method investments recorded in the consolidated statements of operations for in 2012, 2013 and 2014 was US\$0.5 million, US\$0.5 million and US\$0.03 million of Elyn Corporation (or Playgame, as applicable) and US\$0.2 million, US\$0.1 million and US\$9,347 of Joy Children, respectively.

In the first quarter of 2012, Shanghai Taomee paid RMB900,000 (US\$142,694) to acquire a 6% of equity interest in Guangzhou Chuangyou Information Technology Co., Ltd., or Chuangyou, a company principally engaged in the design and development of online games in China, and a call option to further subscribe for a 13.16% newly issued equity interest in the future at RMB3,500,000 (US\$555,476) if certain operating targets are met ("Call Option"). In September 2012, Shanghai Taomee exercised the call option and completed the further acquisition in January 2013, resulted in 19.16% equity interest in Chuangyou.

In December 2013, Chuangyou entered into an agreement to issue new shares for RMB2.5 million (approximately US\$0.4 million) to a new investor. The Company's equity share in Chuangyou was diluted to 9.58% upon the closing of the transaction and we recorded a gain of US\$41,826 as the deemed disposal of investment. Chuangyou is a related party of us, as one of Chuangyou's investors is our director and principle shareholder.

In December 2013, we assessed that Chuangyou had experienced a deterioration financial position and performance since 2013 and we did not expect Chuangyou to generate positive future cash flows. Accordingly, we recorded an impairment loss of US\$370,407 on Chuangyou investment based on its fair value. Our equity loss in Chuangyou was US\$35,310 in 2012, US\$212,240 in 2013 and US\$108,027 in 2014.

In March 2013, we entered into an agreement to set up Shanghai Taoyue Information Technology Co., Ltd., or Taoyue, a new online game development company, with five third-party individuals, of which we held a 40% equity interest for a consideration of RMB2.0 million (US\$0.3 million).

[Table of Contents](#)

In January 2014, we agreed to transfer such 40% equity interests in Taoyue to an existing shareholder of Taoyue for a consideration of RMB2.0 million (US\$0.3 million) and recorded an investment gain of US\$156,530 upon the completion of the transaction. Our equity in loss in Taoyue was US\$150,052 in 2013 and US\$5,627 in 2014.

In September 2013, we entered into an investment agreement with two unrelated individuals to establish a joint venture, Jiangxi Haomi Network Technology Co., Ltd., or Jiangxi Haomi, a company which develops family entertainment and education application on mobile and multi-screen platforms, including Smart TV portal for children in China. We paid a consideration of RMB12.9 million (US\$2.1 million) for 43.0% equity interests in Jiangxi Haomi. Our equity in loss in Jiangxi Haomi was US\$27,199 in 2013 and US\$489,140 in 2014.

In January 2014, we entered into an agreement with Shanghai Weiju Network Technology Co., Ltd ("Shanghai Weiju"), an hi-tech smart toy design and R&D company, to acquire 25% of Shanghai Weiju's newly issued shares at a consideration of RMB3.0 million (US\$0.5 million). In December 2014, we increased our equity shareholding in Shanghai Weiju, from 25% to 45% for cash consideration of RMB10.0 million (US\$1.6 million).

Our investment in Shanghai Weiju incurred a loss of US\$64,824 in 2014 and was recognized as share of loss in equity method investments in the consolidated statements of operations.

In November 2014, we entered into an investment agreement with two unrelated parties to set up a joint venture, Beijing Caviar Communications Co., Ltd, or Caviar Communications, to operate "the Voice Kids China" live show other family entertainment shows focusing on kids and teenagers in China. We acquired a 20% equity interest for a cash consideration of RMB25.0 million (US\$4.1 million). Our share in the profit or loss of Caviar Communications in 2014 was nil as the Caviar Communications was newly formed in December and there were no operations in 2014.

Taxation

Cayman Islands

We are an exempted company incorporated in the Cayman Islands. Under the current law of the Cayman Islands, we are not subject to income, corporate or capital gains tax. In addition, payment of dividends and capital by us to our shareholders in respect of our shares will not be subject to taxation in the Cayman Islands and no withholding will be required on the payment of dividends or capital to any holder of our shares, nor will gains derived from the disposal of our shares be subject to Cayman Islands income or corporation tax. The Cayman Islands currently have no income, corporation or capital gains tax and no estate duty, inheritance tax or gift tax.

Hong Kong

Our subsidiary in Hong Kong is subject to profits tax at the rate of 16.5% on assessable profits determined under relevant Hong Kong tax legislation.

Under the new EIT Law, the dividends paid by a foreign invested enterprise, or a FIE, to its immediate holding company outside the PRC (to the extent that such holding company does not have a business organization or business place in China, or if it has a business organization or business place in China, its profits generated from PRC are not related to the foregoing business organization or business place) are subject to withholding tax at a rate of 10.0% or a lower rate if such foreign investor's jurisdiction of incorporation has a tax treaty with the PRC. According to the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed in August, 2006, or the Tax Treaty, dividends payable by a FIE to a Hong Kong resident company which directly owns at least 25.0% of the equity interest in that FIE will be subject to withholding tax at a lower rate of 5.0%.

[Table of Contents](#)

Taomee HK, a company incorporated in Hong Kong in November 2008, currently holds all the equity interest in Shanghai Shengran. However, according to Circular 124 issued by the SAT, which came into effect on October 1, 2009, the 5.0% withholding tax rate for dividends under the Tax Treaty does not apply automatically and Taomee HK needs to obtain an approval from the competent local tax authority before it can enjoy such a preferential tax rate. According to Circular 81 issued by the SAT in February 2009, a key condition for a foreign investor to enjoy the preferential withholding tax rate for dividends payable by a FIE is that such foreign investor is the "beneficial owner" of such dividends. Circular 601 issued by the SAT on October 27, 2009 further clarifies that, generally the "beneficial owner" shall engage in substantive business operations such as manufacturing, distribution or management and, among others, the fact that the immediate offshore holding company does not have any other business operations except holding property or rights generated from dividend income from the FIE would adversely affect such offshore shareholder in the determination of its "beneficial owner" status by the tax authority.

In respect of financial years 2012, 2013 and 2014, Taomee HK recorded a loss and therefore did not apply for approval to enjoy the 5.0% preferential tax rate under the Tax Treaty. Given that Taomee HK is not engaged in substantive business operations and it does not have any other business operations except for its holding in Shanghai Shengran, Taomee HK may be subject to the 10.0% withholding tax rate if it is not regarded as the "beneficial owner" of the dividends.

Dividends paid by Taomee HK to its shareholder is not subject to any withholding tax in Hong Kong.

China

PRC Enterprise Income Tax, or EIT

Prior to January 1, 2008, companies established in China were generally subject to state and local EIT at statutory rates of 30.0% and 3.0% respectively. On March 16, 2007, the National People's Congress of China enacted a new enterprise income tax law, i.e. the PRC Enterprise Income Tax Law, which took effect beginning January 1, 2008. On December 6, 2007, the State Council also adopted the Implementing Rules for the Enterprise Income Tax Law, or the Implementing Rules, which also took effect beginning January 1, 2008. Under the PRC Enterprise Income Tax Law, foreign invested enterprises, or FIEs, and Chinese domestic companies are subject to EIT at a uniform rate of 25.0%. On February 22, 2008, the Ministry of Finance and the State Administration of Taxation, or the SAT, promulgated the Notice on Several Preferential Policies in Respect of Enterprise Income Tax, or Notice No. 1 2008, reiterating the policy that a software enterprise newly established within China may, upon determination, be exempted from income taxes for its first two profit-making years and shall be subject to the income tax at half the standard rate for the next three years. On April 24, 2009, the Ministry of Finance and SAT promulgated the Notice on Several Issues Relevant to the Implementation of the Preferential Policies on Enterprise Income Tax, which states that, software enterprises established prior to the end of 2007 may, upon certification, enjoy the preferential policies on the EIT reductions and exemptions within specified periods as provided in the Notice No. 1 2008. On April 20, 2012, the Ministry of Finance and SAT promulgated the *Notice on Enterprise Income Tax for Further Encouraging the Development of Software and Integrated Circuit Industries*, which reiterates the preferential policy on EIT of software enterprises in Notice No. 1 2008, limits the scope of applicable software enterprises to enterprises which are profitable before December 31, 2017 and suspends the implementation of certain provisions in Notice No. 1 2008.

In addition, an enterprise may benefit from a preferential tax rate of 15.0% under the EIT Law if it qualifies as a "High and New Technology Enterprise", or HNTE. Pursuant to the *Administrative Measures on the Recognition of High and New Technology Enterprises*, the provincial counterparts of the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation shall jointly determine whether an enterprise is qualified as a HNTE under the EIT Law. In making

such determination, these government agencies shall consider, among other factors, ownership of core technology, whether the products or services fall within the scope of high and new technology strongly supported by the state as specified in the measures, the ratios of technical personnel and research and development personnel to total personnel, the ratio of research and development expenditures to annual sales revenues, the ratio of revenues attributed to high and new technology products or services to total revenues, and other measures set forth in relevant guidance. All enterprises that had been granted the HNTE status before the effectiveness of the EIT Law are required to be re-examined in accordance with the measures mentioned above before they can be entitled to the preferential tax rate. A HNTE certificate is effective for a period of three years and could be renewed thereafter. Before the expiration of the term of the HNTE certificate, an entity needs to apply for renewal of the "High and New Technology Enterprise" status in order to be able to enjoy the preferential tax rate of 15.0%.

Our VIE, Shanghai Taomee, which was established in 2007 and qualified as a "software enterprise" in 2009, enjoys a full exemption from EIT in 2009 and 2010 and a reduced EIT rate of 12.5% from 2011 to 2013. Shanghai Taomee's tax holiday period was approved by relevant tax authorities in May 2010. In addition, in 2010, Shanghai Taomee obtained HNTE qualification, which is effective for a period of three years and could be renewed thereafter. In 2013, Shanghai Taomee applied for the renewal and received a new HNTE qualification and in 2014 Shanghai Taomee was approved by local tax authority to enjoy a preferential tax rate of 15.0% from January 2014 to December 2015.

Our wholly-owned subsidiary, Shanghai Shengran, which was established in 2009 and qualified as a "software enterprise" in 2010 and was informed in April 2011 that the full EIT exemption would apply retroactively in 2009 and 2010, and 50% reduction in EIT rate will apply from 2011 to 2013. In May 2012, Shanghai Shengran further received a written approval from local tax authorities, according to which Shanghai Shengran was entitled to the full EIT exemption for 2010 and 2011, and 50% reduction in EIT rate, i.e. EIT rate of 12.5%, from 2012 to 2014, which resulted in an adjustment of US\$2.1 million as a one-time tax benefit in 2012. In 2012, Shanghai Shengran obtained "High and New Technology Enterprise" qualification, or HNTE qualification, which is effective for a period of three years and could be renewed thereafter. Currently, Shanghai Shengran has not applied to the relevant tax authority for preferential tax treatment as a HNTE.

Our WFOE's subsidiary, Shanghai Xinsheng, which was established in 2012 and qualified as a "software enterprise" in 2013, has not applied to the relevant tax authority for the two-year EIT exemption and a three-year 50% EIT rate reduction preferential tax treatment as an "software enterprise" in 2014 due to its accumulated loss position.

Our VIE's subsidiary, Shanghai Animation was recognized as an "animation enterprise" in November 2013. Animation enterprises as recognized by the relevant department of the State Council which independently develop or produce animation products can apply for certain tax preferential treatment as applied to the software enterprises. Currently Shanghai Animation has not applied to the relevant tax authority for the two-year EIT exemption and a three-year 50% EIT rate reduction preferential tax treatment as an "animation enterprise" due to its accumulated loss position.

Continued qualification as a "software enterprise" or as an "animation enterprise" or as a "HNTE" is however subject to assessment by the relevant government authorities in China. As mentioned above, being qualified as a "software enterprise" by the relevant governmental authority is a condition precedent to enterprise's application to the relevant tax authority to apply for preferential tax treatment for the two-year EIT exemption and a three-year 50% EIT rate reduction as a "software enterprise". On February 24, 2015, the State Council issued the *Decision on Cancelling and Adjusting a Batch of Administrative Approval Items and other Matters*, pursuant to which the government approval of qualification of "software enterprise" and registration of software products are released. There is no specific regulation or implementation issued by the relevant tax authority on how the software enterprise's preferential tax treatment application may be adapted to such release.

[Table of Contents](#)

See "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Our business benefits from certain government tax incentives. Expiration, reduction or discontinuation of, or changes to, these incentives will increase our tax burden and reduce our net income".

Under the PRC Enterprise Income Tax Law and the Implementing Rules, dividends generated from the business of our PRC subsidiary after January 1, 2008 and payable to us may be subject to a withholding tax rate of 10.0% if we are considered a non-resident enterprise incorporated outside of the PRC unless there is an applicable tax treaty with China that provides for a different withholding arrangement and we are deemed to be entitled to such favorable treatment. Distributions of earnings generated before January 1, 2008 are exempt from PRC withholding tax.

The PRC Enterprise Income Tax Law provides that enterprises established outside China whose "effective management" is located in China are considered "resident enterprises" and will generally be subject to the uniform 25.0% EIT rate as to their global income. Under the implementation regulations, "effective management" is defined as substantial and overall management and control over such aspects as the production and business, personnel, accounts and properties of an enterprise. The risk that we may be deemed to be a PRC resident enterprise under the PRC Enterprise Income Tax Law and be subject to the PRC enterprise income tax at the rate of 25.0% on our worldwide income is disclosed in "Risk Factors—Risks Related to Doing Business in China—We may be classified as a "resident enterprise" for PRC enterprise income tax purposes, which could result in our global income becoming subject to 25.0% PRC enterprise income tax."

Share-Based Compensation Expenses

Prior to 2009, we did not grant share-based awards to employees, officers, directors or individual consultants and/or advisors.

2009 Stock Option Plan

On May 6, 2009, our Board of Directors approved the 2009 Stock Option Plan, or the 2009 Plan, which authorized the issuance of options to purchase up to 45,000,000 ordinary shares to our employees, directors, and consultants, as determined by our Board of Directors. The maximum contractual term of the awards under this plan shall be no more than ten years from the date of grant.

In June 2009 and June 2010, 10,500,000, 35,175,000 options were granted to our employees at exercise prices at \$0.04 and \$0.07 under the 2009 Plan, respectively, and these awards vest over a four-year period, with 25% of the options to vest on the each of the anniversary after the grant date.

As of December 31, 2014, options to purchase 6,548,240 ordinary shares were outstanding under the 2009 Plan.

On March 18, 2014, we granted restricted share to our employees which will allow them to purchase up to a total of 1,600,000 restricted shares upon vesting at par value under the 2009 Plan. These non-vested restricted shares vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date.

As of December 31, 2014, there was US\$0.4 million of total unrecognized compensation expense related to non-vested restricted shares granted under the 2009 Plan, which is expected to be recognized over a weighted-average period of 3.2 years.

2010 Share Incentive Plan

On June 13, 2010, our Board of Directors approved the 2010 Share Incentive Plan, or the 2010 Plan, which authorized the issuance of options to purchase up to 55,000,000 ordinary shares to our employees, directors, and consultants, as determined by our Board of Directors. The maximum contractual term of the awards under this plan shall be no more than ten years from the date of grant.

[Table of Contents](#)

On January 4, 2011, we granted options to our employees and a third party consultant to purchase 16,665,000 and 2,500,000 of ordinary shares, respectively, at an exercise price of \$0.36 per share under the 2010 Plan. These options vest over a four-year requisite service period, with 25% of the options to vest on each anniversary after the grant date. The 2,500,000 options were provided in exchange for consulting services which were to have been delivered over the next four years. In September 2011, the options granted to a third party consultant were forfeited as the underlying service contract was terminated.

On May 24, 2011, we granted options to our directors and certain employees to purchase a total of 20,175,000 ordinary shares at an exercise price of \$0.45 per share under the 2010 Plan. These options vest over either a four or three year period, each with a graded vesting schedule, all commencing on May 24, 2011.

On November 21, 2011, we granted options to an employee to purchase up to 150,000 ordinary shares at an exercise price of \$0.26 per share under the 2010 Plan. These options vest over a four-year requisite service period, with 25% of the options to vest on each anniversary after the grant date.

On February 28, 2012, our compensation committee approved a share option exchange program that offered our eligible directors and employees the right to exchange vested and unvested outstanding share options to purchase our ordinary shares granted under the 2010 Plan between January 2011 to May 2011 for our restricted shares at the ratio of 3:1. The exchange ratio was determined based on the fair value of replacement restricted shares so that the fair value of the replacement restricted shares to be issued upon exchange would be approximately equivalent to the fair value of the share options surrendered by an individual on the date of exchange. These replacement restricted shares are subject to substantially the same vesting schedule as the options that are validly tendered in the exchange offer. A total of 102 directors and employees accepted the offer, and tendered options to purchase an aggregate of 28,790,000 ordinary shares, including 14,090,000 shares granted on January 4, 2011 and 14,700,000 shares granted on May 24, 2011, in exchange for an aggregate of 9,596,718 restricted shares at a ratio of 3:1, which were granted on March 30, 2012. The exchange of the share option for restricted shares was accounted for as a modification of share-based award, which involves a cancellation of the original award and an issuance of a new award, with no incremental compensation cost recognized as the fair value of the restricted shares was not more than the fair value of the options given up on the date of exchange.

On July 16, 2012, we granted options to employees and directors to purchase up to a total of 19,840,000 ordinary shares under our 2010 Plan. The exercise price of the options is US\$0.2395 per share. These options vest over a four-year period, each with a graded vesting schedule, all commencing on July 16, 2012.

On July 20, 2012, we granted options to directors to purchase up to a total of 3,600,000 ordinary shares under our 2010 Plan. The exercise price is US\$0.1960 per share. These options vest over a three year period, each with a graded vesting schedule, all commencing on July 20, 2012.

As of December 31, 2014, options to purchase 10,970,000 ordinary shares were outstanding under the 2010 Share Plan.

On May 24, 2011 and July 16, 2012, we granted 4,500,000 and 400,000 non-vested restricted shares to our employees and officers for no consideration, respectively, under the 2010 Plan. These restricted shares will vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date.

On September 4, November 5, and December 11, 2013, we granted a total of 10,190,000, 4,800,000 and 394,560 non-vested restricted shares to employees, officers and an external consultant at par value, respectively, under the 2010 Plan. These restricted shares will vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date.

[Table of Contents](#)

As of December 31, 2014, there was US\$1.4 million of total unrecognized compensation expense related to non-vested restricted shares granted under the 2010 Plan, which is expected to be recognized over a weighted-average period of 2.7 years.

2012 Share Incentive Plan

On July 25, 2012, the our Annual General Meeting approved the 2012 Share Incentive Plan, or the 2012 Plan, which authorized the issuance of options to purchase up to 30,000,000 ordinary shares to our employees, directors, and consultants, as determined by our Board of Directors. The maximum contractual term of the awards under this plan shall be no more than ten years from the date of grant.

As of December 31, 2014, there were no options granted under the 2012 Plan.

On April 22, 2014, we granted 1,000,000 restricted shares to an officer at par value under the 2012 Plan. These restricted shares will vest over a four-year requisite service period, with 25% to vest on the first anniversary of the Grant Date. 75% to vest in 36 equal installments at the ending of each calendar month over a period 36 consecutive months subsequent to the first anniversary of the Grant Date.

On July 1, 2014, we granted 60,000 restricted shares to an independent director, under the 2012 Plan. These restricted shares will vest over a one-year requisite service period, with 100% to vest on the first anniversary after the grant date.

As of December 31, 2014, there was US\$0.3 million of total unrecognized compensation expense related to non-vested restricted shares granted under the 2012 Plan, which is expected to be recognized over a weighted-average period of 3.2 years.

We recognize the share grants as compensation for the relevant employees' services to us and recorded share-based compensation expenses. Our share-based compensation expenses amounted to approximately US\$2.2 million, US\$2.1 million and US\$2.2 million in 2012, 2013 and 2014, respectively.

We are required to estimate the grant-date fair value of the share options and other share-based awards that we grant to our employees. The grant date fair value of the share options granted in the years ended December 31, 2012 was estimated using binomial option-pricing model. The fair value of non-vested restricted shares granted to our employees and officers was computed based on the fair value of our ordinary shares on the grant date, while the fair value of non-vested restricted shares granted to an external consultant was re-measured at the end of each reporting period until the services being provided is completed. We estimated the expected term based on option terms related to vesting schedule and expected option expiration date. The volatility rate estimation is developed based on the volatility of the comparable companies within the expected term commensurate with the expected time period modified to reflect ways in which currently available information indicates that the future of the subject company is reasonably expected. The risk-free interest rate is selected based on the yield of Chinese International Government Bond, which is denominated in U.S. dollars, with duration closest to the expected term.

Since the completion of our initial public offering, we determined the fair value of the ordinary shares for the above option awards to our employees and officers was based on the closing price of our ADSs traded on the NYSE on the grant day, while the fair value of non-vested restricted shares granted to an external consultant was re-measured at the end of each reporting period until the services being provided is completed. The table below sets forth certain information concerning the

options and restricted shares awarded to our directors and executive officers and other individuals as a group in 2012, 2013 and 2014 on the dates indicated:

Grant Date/Award Date	Options	Restricted Shares	Exercise Price/ Purchase Price (US\$)	Fair Value of Ordinary Shares (US\$)
June 24, 2009	10,500,000	—	0.0400	0.0214
June 7, 2010	35,175,000	—	0.0700	0.0700
January 4, 2011	5,075,000	—	0.3600	0.3600
	—	4,696,697	0.00002	0.3600
May 24, 2011	5,475,000	—	0.4500	0.5000(1)
	—	4,500,000	nil	0.5000(1)
	—	1,000,000	0.00002	0.5000(1)
	—	3,900,021	0.00002	0.5000(1)
November 21, 2011	150,000	—	0.2600	0.2600(2)
July 16, 2012	19,840,000	—	0.2395	0.2395(3)
	—	400,000	nil	0.2395(3)
July 20, 2012	3,600,000	—	0.1960	0.1960(4)
September 4, 2013	—	10,190,000	0.00002	0.2390(5)
November 5, 2013	—	4,800,000	0.00002	0.2600(6)
December 11, 2013	—	394,560	0.00002	0.2560(7)
March 18, 2014	—	1,600,000	0.00002	0.3390(8)
April 22, 2014	—	1,000,000	0.00002	0.2990(9)
July 1, 2014	—	60,000	0.00002	0.2500(10)

- (1) Estimated based on the mid-point of the estimated public offering price set forth on the front cover of the preliminary prospectus dated May 24, 2011.
- (2) Determined based on the closing price of our ADSs trade on the NYSE on November 21, 2011.
- (3) Determined based on the closing price of our ADSs trade on the NYSE on March 30, 2012.
- (4) Determined based on the closing price of our ADSs trade on the NYSE on July 20, 2012.
- (5) Determined based on the closing price of our ADSs trade on the NYSE on September 4, 2013.
- (6) Determined based on the closing price of our ADSs trade on the NYSE on November 5, 2013.
- (7) Determined based on the re-measured at the end of each reporting period until the services being provided is completed.
- (8) Determined based on the closing price of our ADSs trade on the NYSE on March 18, 2014.
- (9) Determined based on the closing price of our ADSs trade on the NYSE on April 22, 2014.
- (10) Determined based on the closing price of our ADSs trade on the NYSE on July 1, 2014.

Non-vested Restricted Shares

In June, 2012, we granted a co-founder and senior management of Guangdong Taomee a 15% equity interest in Guangdong Taomee in the form of non-vested restricted shares. These restricted shares will vest over a three-year requisite service period, with 33.3% to vest on each anniversary after the grant date. The fair value of non-vested restricted shares was determined based on estimated fair value of Guangdong Taomee on the grant date. We recorded US\$46,072, US\$80,571 and US\$81,323 compensation expense related to these non-vested restricted shares in 2012, 2013 and 2014. As of December 31, 2014, there was US\$40,681 unrecognized compensation expense to be recognized over the weighted-average period of 0.5 years.

[Table of Contents](#)

In June, 2014, we granted a co-founder and senior management of Shanghai Xinsheng an 8.33% equity interest in Shanghai Xinsheng in the form of non-vested restricted shares. 5.33% of the granted restricted shares will vest upon the completion of Shanghai Xinsheng's capital injection, and another 3% will be vested in increments of 1% on each January 1, following the first, second and third anniversaries, respectively, of the starting date of the co-founder's labor contract. We recorded US\$216,854 compensation expense related to these non-vested restricted shares in 2014. As of December 31, 2014, there was US\$68,516 unrecognized compensation expense to be recognized over the weighted-average period of 2.0 years.

In June, 2014, we granted a co-founder and senior management of Shanghai Jushou an 8.33% equity interest in Shanghai Jushou in the form of non-vested restricted shares. 5.33% of the granted restricted shares will vest upon Shanghai Jushou's establishment, and another 3% will be vested in increments of 1% on each January 1, following the first, second and third anniversaries, respectively, of the starting date of the co-founder's labor contract. We recorded US\$108,163 compensation expense related to these non-vested restricted shares in 2014. As of December 31, 2014, there was US\$34,258 unrecognized compensation expense to be recognized over the weighted-average period of 2.0 years.

Critical Accounting Policies and Estimates

We prepare our financial statements in conformity with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and the disclosure of our contingent assets and liabilities. We continually evaluate these judgments, estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates.

An accounting policy is considered critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time such estimate is made, and if different accounting estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could material impact our consolidated financial statements. We believe the following accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements. The following descriptions of critical accounting policies, judgments and estimates should be read in conjunction with our consolidated financial statements and other disclosures included in this annual report.

When reviewing our financial statements, you should consider (i) our selection of critical accounting policies, (ii) the judgment and other uncertainties affecting the application of such policies, and (iii) the sensitivity of reported results to changes in conditions and assumptions.

Allowance for Doubtful Accounts

We conduct credit reviews for customers to whom we extend credit terms. We determine the allowance for doubtful accounts that may not be collected based on the aging of our accounts receivable and specific evidence relating to the financial condition of our customers that may affect their ability to pay their balances. Allowance for doubtful accounts are charged to general administrative expenses. We recorded nil, US\$0.3 million and US\$0.3 million allowance for doubtful accounts as of December 31, 2012, 2013 and 2014, respectively. In the year 2014, we wrote off accounts receivable and related full allowance for doubtful accounts of \$0.6 million from the settlements agreed with counterparties.

Impairment of Equity Investments

We assess our equity investments for other-than-temporary impairment by considering factors as well as all relevant and available information including, but not limited to, current economic and market conditions, the operating performance of the investees including current earnings trends, the technological feasibility of the investee's products and technologies, the general market conditions in the investee's industry or geographic area, factors related to the investee's ability to remain in business, such as the investee's liquidity, debt ratios, and cash burn rate and other company-specific information including recent financing rounds. The fair value determination, particularly for investments in privately held companies whose revenue models remain unclear, requires significant judgment to determine appropriate estimates and assumptions. Changes in these estimates and assumptions could affect the calculation of the fair value of the investments. If any impairment exists, we will write down the investment to its fair value and take a corresponding charge to our consolidated statements of operations. We recorded nil, US\$0.4 million and US\$1.4 million in impairment loss on equity investees as of December 31, 2012, 2013 and 2014, respectively.

Impairment of Long-lived Assets

We evaluate our long-lived assets with definite useful life, including property and equipment as well as acquired intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Factors that we consider in deciding when to perform an impairment review include, but are not limited to significant under-performance of the assets in relation to expectations, and significant changes or planned changes in the use of the assets. When these events occur, we measure impairment by comparing the carrying amount of the assets to the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the future undiscounted cash flow is less than the carrying amount of the assets, we would recognize an impairment loss equal to the excess of the carrying amount over the fair value of the assets. The impairment tests involve the use of accounting estimates and assumptions that management believed to be reasonable, the result of which form the basis for our conclusions. Significant changes to these estimates and assumptions could adversely impact our conclusion to these impairment tests. There were nil, US\$1.0 million and nil impairment charge recognized for the years ended December 31, 2012, 2013 and 2014.

We test the intangible asset with indefinite useful life for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. If the carrying amount of the intangible asset exceeds its fair value, we recognize an impairment loss in an amount equal to that excess.

Revenue Recognition

Online business revenue

Our online business includes developing and operating online virtual worlds, mobile games and applications, as well as other online entertainment services.

Online virtual world business revenue

We earn revenues through developing and operating proprietary online virtual worlds. We provide such services to children via an online entertainment platform pursuant to a time-based revenue model and an item-based revenue model. Since our inception, we have not licensed or otherwise marketed any of our proprietary software to third parties except in one instance which was immaterial.

Time-based model—Users typically pay RMB10 (US\$1.6) for a 30-day subscription per virtual world to access premium features in each of our virtual worlds. We recognize revenue generated from subscription fees ratably over the users' subscription period.

Item-based model—Users purchase our in-game virtual items under this model. Revenues are recognized over the estimated lives of the in-game virtual premium items purchased or as the virtual premium items are consumed. For the virtual premium items that are immediately consumed, we recognize revenue upon consumption. For the virtual premium items with no predetermined expiration or permanent items, we recognize revenue ratably over the estimated average lives of the permanent items (i.e. estimated period paying players play our games), which range from six to 18 months. The amount of the unamortized permanent items and unconsumed items are recognized as deferred revenue. We recognized US\$16.3 million, US\$22.4 million and US\$20.1 million gross revenue from virtual premium items accounted for under the item-based model for the years ended December 31, 2012, 2013 and 2014, respectively. We estimate the average lives of our permanent items based on an assessment of our historical data and user behavior patterns, including the average period that users typically stay in our virtual worlds, the age group of our target users, and the number of active paying users in our virtual worlds, and the promotional events we launched, with reference to industry research data. We assess the estimated lives of our permanent items periodically. If there are indications of any significant changes to the estimated lives of these permanent items, the revised estimates would be applied prospectively in the period of change. Prior to June 30, 2010, we did not have sufficient historical data from our virtual worlds to estimate the useful life of the permanent items, and used the industry research data and peer company information in developing the estimate of the average life of permanent items, which was determined to be one year for all our virtual worlds. Effective July 1, 2010, we changed the accounting estimate of the useful life of our permanent items in Mole's World from one year to 18 months based on an analysis of the life of the virtual world and user behavior patterns using historical user data since the launch of Mole's World in September 2008, and applied such change prospectively. The effect of the change in accounting estimate on the results of operations for the year ended December 31, 2010 was immaterial. In 2011 and 2012, we did not make changes to the useful life of any of our virtual worlds. In 2013, we assessed our historical data of user behavior as well as industry research data and noticed a shortening trend user lifespan and changed the estimated lives of premium items for newly launched online virtual worlds to half a year. The estimated lives of existing virtual worlds remained unchanged. In 2014, we assessed our historical data of user behavior as well as industry research data again and concluded estimated lives of existing virtual worlds remained unchanged. We will continue to monitor the user behavior patterns of each of our virtual worlds and will utilize such information to update the estimates of the useful lives of permanent items.

We record revenues net of sales discounts and rebates paid to our distributors. The cost of providing free virtual items as a result of promotional activities was immaterial for each of the three years presented.

Users pay subscription fees and purchase virtual items using our virtual currency, the Mibi, which can be purchased via various distribution channels, such as our prepaid cards, third-party prepaid cards, online payment channels, and via short messages, or SMS, through cellular telecom operators. Under both the time-based and the item-based revenue models, proceeds we receive directly from end users for sales of online points are recorded as deferred revenues, while proceeds we receive from sales of online points to parties in the distribution channel and from sales of prepaid cards are initially recorded as advances from customers. As we do not have control over and generally do not know the ultimate selling price of the prepaid cards or online points sold by the distributors, we record net proceeds from the distributors as advances from customers. Upon activation of prepaid cards or purchase of online points, advances from customers are immediately transferred to deferred revenues.

Prepaid cards expire on the expiration date printed thereon, which is generally two years after the date of card production. Proceeds from expired prepaid cards that have not been activated are recognized as other operating income upon expiration of the cards. We recognized US\$1.9 million, US\$1.6 million and US\$0.6 million in other operating income in connection with expired prepaid cards for the years ended December 31, 2012, 2013 and 2014, respectively.

Online mobile game business revenue

We generate such revenues primarily from licensing of our self-developed mobile games, which are played on iOS or Android based smartphones and tablets, to certain publishers including Chukong, IGG, True Digital Plus and Netmarble. They publish such games to end users distribution channels, such as the iOS App Store, Google Play Store, 360 Mobile Assistant, UC Web, 91 Wireless, SnapPea. Revenues from those mobile games are shared between us and the publishers based on a predetermined percentage for each game. These mobile game licensing agreements typically are two to three years.

We perform assessment for each mobile game licensing agreement to determine whether or not we act as the principal or as an agent in the arrangement, in order to determine if relevant revenues should be reported gross or net. The assessment and determination including but not limited to whether we (i) are the primary obligor in the arrangement, (ii) have latitude in establishing the selling price, (iii) have the power to change the product or perform part of the service, and (iv) have involvement in the determination of product and service specifications.

We conclude our responsibilities are limited to delivering game to publishers for whom to operate as well as providing limited ongoing technical and customer services associate with the game contents, hence, we consider ourselves as the agent in the mobile game licensing arrangements. Accordingly, we record revenues generated from these licensed mobile games based on the net amount collected from those third-party publishers.

Besides, we usually receives upfront license fees form the publishers after the licensing agreements are signed and before the commercial launch of these games. Those license fees would be deferred and recognized as revenue until the date of the commercial launch and amortized on a straight-line basis over the licensing terms.

Offline business revenue

Licensing and royalty fee revenue—revenues from our offline business include licensing income and royalty fees for licensing our proprietary cartoon figures to merchandisers and book publishers. Most of the revenues generated under merchandise licensing income and royalty fees are recognized at the end of each month and calculated at the contractual royalty rate times the sales of the licensed merchandise product for the month. The sales of the licensed product are derived from the monthly sales reports provided by the licensee.

In certain of the merchandise licensing arrangements, we receive a guaranteed base fee and additional royalty fees that are contingent on sales volume. Proceeds from minimum guaranteed royalties in excess of royalties earned are generally recognized as revenues at the end of the contract term. In a small number of our merchandise licensing arrangements, we receive a fixed royalty fee from the licensee over the contract period. We recognize this type of royalty revenue ratably over the contract period.

Film revenue—we recognize revenue from the distribution of our films when the film is exhibited in theaters, provided that no significant obligations remain, amounts can be accurately estimated, and collection is reasonably assured.

Revenue from the distribution of the film on television and websites is recognized when the production is made available for exhibition and when other contractual obligations or conditions are met.

Merchandise sales revenue—revenues from selling toys, books and merchandise are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured.

Share-based compensation

Share-based payment transactions with employees, directors and external consultant, such as share options and non-vested restricted shares, are measured based on the grant-date fair value of the equity instrument. We recognize share-based compensation costs net of a forfeiture rate on a straight line basis over the requisite service period of the award, which is generally the same as the vesting period of the award. We adjust the estimated forfeiture rate 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 costs to be recognized in future periods.

We are required to estimate the grant-date fair value of the share options and other share-based awards that we grant to our employees. The grant date fair value of the share options granted in the years ended December 31, 2012 was estimated using binomial option-pricing model. We estimated the expected term based on option terms related to vesting schedule and expected option expiration date. The volatility rate estimation was developed based on the volatility of the comparable companies within the expected term commensurate with the expected time period modified to reflect ways in which currently available information indicates that the future of the subject company is reasonably expected. The risk-free interest rate was selected based on the yield of Chinese International Government Bond, which is denominated in U.S. dollars, with duration closest to the expected term.

Since the completion of our initial public offering, we determined the fair value of the ordinary shares for the above option awards based on the closing price of our ADSs traded on the NYSE on the date of grant.

Our actual share-based compensation expense may be materially different from our current expectations. As of December 31, 2014, we had US\$0.3 million of unrecognized compensation expense related to unvested options granted under our share incentive plans, which we expect to recognize over a weighted-average period of 1.3 years. As of December 31, 2014, we also had US\$2.0 million of total unrecognized compensation expense related to non-vested restricted shares granted under our share incentive plans, which is expected to be recognized over a weighted-average period of 2.8 years.

Other general assumptions used in deriving the fair value of the ordinary shares transferred and our total equity value include the following: (i) there will be no material changes in the existing political, legal, fiscal and economic conditions in China; (ii) there will be no material changes in tax law in China and the tax rates applicable to our subsidiary, VIE and VIEs' subsidiary; (iii) exchange rates and interest rates will not differ materially from currently prevailing rates, (iv) the availability of finance will not be a constraint on our future growth, (v) we will retain and have competent management, key personnel and technical staff to support its ongoing operation, and (vi) there will be no material deviation in industry trends and market conditions from economic forecasts.

Income taxes

We provide for current income taxes in accordance with the laws of the relevant tax authorities. We recognize deferred income taxes when temporary differences exist between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. Net operating loss carry forwards and credits are applied using enacted statutory tax rates applicable to future years. We reduce deferred tax assets by a valuation allowance when, in the opinion of our management, it is more-likely-than-not that a portion of or all of our 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.

We consider positive and negative evidence when determining whether some portion or all of our deferred tax assets will not be realized. This assessment considers, among other matters, the nature,

[Table of Contents](#)

frequency and severity of current and cumulative losses, forecasts of future profitability, the duration of statutory carry-forward periods, our historical results of operations, and our tax planning strategies. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As of December 31, 2014, we believe it is more-likely-than-not that Shanghai Animation, Shanghai Qidong and Shanghai Xinsheng will not realize the deferred tax assets resulted from the tax loss carried forward in the future periods. Thus, a full valuation allowances are provided for the deferred tax assets of Shanghai Animation. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward periods are reduced. Such reduction of deferred tax asset could increase our income tax expense and adversely affect our results of operations in the period in which an allowance is recorded.

Under applicable accounting principles, a deferred tax liability should be recorded for taxable temporary differences attributable to the excess of financial reporting basis over tax basis 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. In 2013, deferred tax liabilities of US\$1.5 million were accrued for undistributed earnings of Shanghai Taomee and Guangdong Taomee, on the basis that distribution of the earnings, in the form of dividends or otherwise, to Shanghai Shengran would be subject to the applicable PRC tax laws and regulations, unless a tax strategy which we determined to avail ourselves of were devised to avoid such tax. Prior to 2013, these entities were in an accumulated loss position. In 2014, we reversed the deferred tax liabilities of US\$1.5 million after completing our feasibility analysis on a method, which we could ultimately execute if necessary to repatriate the undistributed earnings of VIEs without significant tax costs.

We recognize the impact of uncertain income tax positions at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. For a tax position that meets the more-likely-than-not recognition threshold, we initially and subsequently measure the tax benefit as the largest amount that we judge to have a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority. Our liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances, such as the progress of tax audits, case law developments and new or emerging legislation. Such adjustments are recognized entirely in the period in which they are identified. Our effective tax rate includes the net impact of changes in the liability for unrecognized tax benefits and subsequent adjustments as considered appropriate by our management. We classify interest and/or penalties related to uncertain tax positions in income tax expense.

Consolidation of VIEs

PRC laws and regulations currently prohibit or restrict foreign ownership of Internet-related business. In order to comply with these foreign ownership restrictions, we operate our online entertainment community through Shanghai Taomee. We have entered into a series of contractual arrangements with Shanghai Taomee and its equity owners. As a result of these contractual arrangements, we have the ability and intention to exercise control over the entities and the right and obligation to absorb substantially all of their profits and losses. Therefore, we have concluded that we are the primary beneficiary of Shanghai Taomee and have consolidated the entities since the date of execution of the contractual arrangements. This conclusion is predicated on the assumption that the contractual arrangements are legally enforceable, which we have determined based on the advice of our PRC legal counsel. However, there are substantial uncertainties regarding the interpretation and application of current and future PRC laws and regulations. Any changes in PRC laws and regulations that affect our ability to control Shanghai Taomee might preclude us from consolidating Shanghai Taomee in the future. See "Item 3 Key Information—Risks Related to Our Corporate Structure."

Results of Operations

The following table sets forth a summary of our consolidated results of operations for the periods indicated both in absolute amount and as a percentage of our total net revenues.

	For Years Ended December 31,					
	2012		2013		2014	
	US\$	%	US\$	%	US\$	%
	(in thousands, except percentages)					
Net revenues:						
Online business	\$ 32,169	80.0	\$ 35,330	73.1	\$ 33,292	78.9
Offline business	8,039	20.0	13,024	26.9	8,897	21.1
Total net revenues	40,208	100.0	48,354	100.0	42,189	100.0
Cost of revenues:						
Online business	(6,950)	(17.3)	(7,644)	(15.8)	(6,535)	(15.5)
Offline business	(3,048)	(7.6)	(5,621)	(11.6)	(5,182)	(12.3)
Gross profit	30,210	75.1	35,089	72.6	30,472	72.2
Operating income (expenses):						
Product development expenses	(12,318)	(30.6)	(13,886)	(28.7)	(14,446)	(34.2)
Sales and marketing expenses	(9,966)	(24.8)	(9,446)	(19.5)	(9,304)	(22.1)
General and administrative expenses	(10,078)	(25.1)	(13,095)	(27.1)	(13,506)	(32.0)
Impairment loss on acquired intangible assets	—	—	(1,046)	(2.2)	(116)	(0.3)
Other operating income	5,512	13.7	5,708	11.8	5,020	11.9
Total operating expenses	(26,850)	(66.8)	(31,765)	(65.7)	(32,352)	(76.7)
Income (loss) from operations	3,360	8.4	3,324	6.9	(1,880)	(4.5)
Interest income	2,647	6.6	2,932	6.1	2,914	6.9
Other income (expenses), net	859	2.1	771	1.6	(453)	(1.0)
Impairment loss on investment in equity investees	—	—	(370)	(0.8)	(1,400)	(3.3)
Income (loss) before income taxes and share of profit (loss) in equity method investments, net of gain (loss) on disposals	6,866	17.1	6,657	13.8	(819)	(1.9)
Income tax benefit (expense):						
Current	1,279	3.2	(789)	(1.6)	(600)	(1.4)
Deferred	(424)	(1.1)	(630)	(1.3)	2,763	6.5
Total income tax (expenses)/benefits	855	2.1	(1,419)	(2.9)	2,163	5.1
Income (loss) before share of profit (loss) in equity method investments, net of gain (loss) on disposals	7,721	19.2	5,238	10.9	1,344	3.2
Share of profit (loss) in equity method investments, net of gain (loss) on disposals	1,140	2.8	207	0.4	(433)	(1.0)
Net income	8,861	22.0	5,445	11.3	911	2.2
Net income (loss) attributable to non-controlling interest	(1)	0.0	4	0.0	(95)	(0.2)
Net income attributable to holders of ordinary shares	\$ 8,862	22.0	\$ 5,441	11.3	\$ 1,006	2.4

Reportable Segments

For 2012, 2013 and 2014, we had two reportable segments: (i) online business and (ii) offline business. Segment revenues from the online business segment and our offline business segment accounted for 80.0% and 20.0%, respectively, in 2012, 73.1% and 26.9%, respectively, in 2013, and

[Table of Contents](#)

78.9% and 21.1%, respectively, in 2014. The online business segment comprises primarily the operation of the virtual worlds offered through our online virtual community, mobile games and applications, online video platform as well as other online services. In 2012, 2013 and 2014, the offline business segment comprised primarily of the licensing of our franchises to book publishers and makers of consumer products, as well as revenues from film series and toys mainly featuring our cartoon figures. We do not allocate operating expenses to the segments. The following table sets forth our net revenues, gross profit and gross profit margin by segment for the periods indicated.

For the Years Ended December 31,									
2012			2013			2014			
Segment	Segment	Segment	Segment	Segment	Segment	Segment	Segment	Segment	
Net	Gross	Gross	Net	Gross	Gross	Net	Gross	Gross	
Revenues	Profit	Margin	Revenues	Profit	Margin	Revenues	Profit	Margin	
US\$	US\$	%	US\$	US\$	%	US\$	US\$	%	
(in thousands, except percentages)									
Reportable Segments:									
Online business	32,169	25,220	78.4	35,330	27,686	78.4	33,292	26,758	80.4
Offline business	8,039	4,990	62.1	13,024	7,403	56.8	8,897	3,714	41.8
Total	40,208	30,210	75.1	48,354	35,089	72.6	42,189	30,472	72.2

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

Net Revenues. Our net revenues decreased by 12.7% from US\$48.4 million in 2013 to US\$42.2 million in 2014. This decrease was primarily attributable to the decrease in both online business revenues and offline business revenues.

Online Business. Net revenues generated from the online business decreased by 5.8% from US\$35.3 million in 2013 to US\$33.3 million in 2014. The decrease was primarily driven by the decrease in active paying accounts of our virtual worlds, which reflected change of user behavior, as more and more children are shifting from web games to mobile games, and intensified competition. The decrease was partially offset by the increase of revenues from our mobile games business.

Offline Business. Net revenues generated from our offline business decreased by 31.7% to US\$8.9 million in 2014 from approximately US\$13.0 million in 2013. This decrease was primarily attributable to the decrease in our merchandise licensing and toys business.

Cost of Revenues. Our cost of revenues decreased by 11.7% from US\$13.3 million in 2013 to US\$11.7 million in 2014, primarily due to decreases in cost of revenues of both our online and offline businesses.

Online Business. Cost of revenues relating to our online business decreased by 14.5% to US\$6.5 million in 2014 from US\$7.6 million in 2013. This decrease was primarily due to the decrease in payroll expenses, amortization cost associated with game licensing fees and royalties related to our operation of certain third-party developed virtual worlds.

Offline Business. Cost of revenues relating to our offline business decreased by 7.8% to US\$5.2 million in 2014 from approximately US\$5.6 million in 2013. This decrease was primarily due to the decrease in toy costs, while partially offset by an increase in film production cost.

Gross Profit. As a result of the foregoing, our gross profit decreased to US\$30.5 million in 2014 from US\$35.1 million in 2013, while our gross margin decreased slightly to 72.2% in 2014 from 72.6% in 2013. The gross margin of our online business increased from 78.4% in 2013 to 80.4% in 2014, while the gross margin of our offline business decreased from 56.8% in 2013 to 41.8% in 2014.

[Table of Contents](#)

Operating Expenses. Our operating expenses slightly increased by 1.8% to US\$32.4 million in 2014 from US\$31.8 million in 2013. The increase in our operating expenses was primarily due to the increase in product development expenses and general and administrative expenses as well as the decrease in other operating income.

- **Product Development Expenses.** Our product development expenses increased by 4.0% from US\$13.9 million in 2013 to US\$14.4 million in 2014. The increase was primarily attributable to an increase in payroll expenses and toy design fees, partially offset by a decrease in rental expenses.
- **Sales and Marketing Expenses.** Our sales and marketing expenses slightly decreased by 1.5% from US\$9.4 million in 2013 to US\$9.3 million in 2014. The decrease was primarily attributable to decreases in payroll and advertising and promotion expenses, partially offset by an increase in film promotion cost.
- **General and Administrative Expenses.** Our general and administrative expenses increased by 3.1% from US\$13.1 million in 2013 to US\$13.5 million in 2014. The increase was primarily due to an increase in payroll expenses and provision for bad debt and unrecoverable prepayments, partially offset by a decrease in professional service fees and share-based compensation expenses.
- **Impairment loss on acquired intangible assets.** We incurred impairment loss on acquired intangible assets of US\$0.1 million in 2014 incurred by writing off the remaining term of an underperforming game, Magic Haqi II, as compared to US\$1.0 million in 2013 incurred by writing off the remaining term of two underperforming games, Wizard 101 and Speed Hunter.
- **Other Operating Income.** We had other operating income of US\$5.0 million in 2014, a decrease of 12.1% from US\$5.7 million in 2013. Other operating income primarily consists of government subsidies and revenue recognized upon expiration of prepaid cards.

Income Tax Benefit (Expense). We had income tax benefit of US\$2.2 million in 2014, compared to an income tax expense of approximately US\$1.4 million in 2013. The change was primarily because we accrued US\$1.5 million of deferred tax liabilities on the undistributed earnings of our VIEs and VIE subsidiaries in 2013. In 2014, we reversed the deferred tax liabilities of US\$1.5 million after we completed our analysis on a feasible method, which we could ultimately execute if necessary to repatriate the undistributed earnings of VIEs without significant tax costs.

Interest Income, Net. Our net interest income was US\$2.9 million in 2013 and 2014, respectively.

Other Income (Expenses), Net. We had other expenses of US\$0.5 million in 2014, compared with other income of US\$0.8 million in 2013, because of the exchange loss of our offshore RMB as RMB depreciated against US dollar in year 2014.

Impairment loss on Investment in Equity Investees. We incurred impairment loss on investment in an equity investee of US\$1.4 million in 2014 primarily due to the deteriorating operating and financial performance of our investment in Voozclub, as compared to impairment loss of US\$0.4 million in 2013 primarily due to the deteriorating operating and financial performance of our investment in Chuangyou.

Share of Profit (loss) in Equity Method Investments, net of gain (loss) on disposals. We incurred share of loss in equity investment of US\$0.4 million in 2014, compared with share of profit in equity investment of US\$0.2 million in 2013. The change was mainly due to the losses of our equity method investment Jiangxi Haomi significantly increased comparing with 2013.

Net Income. As a result of the foregoing, we had a net profit of US\$1.0 million in 2014, compared with our net income of US\$5.4 million in 2013.

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

Net Revenues. Our net revenues increased by 20.3% from US\$40.2 million in 2012 to US\$48.4 million in 2013. This increase was primarily attributable to the increase in both online business revenues and offline business revenues.

Online Business. Net revenues generated from the online business increased by 9.8% from US\$32.2 million in 2012 to US\$35.3 million in 2013. The increase was primarily driven by continued revenue growth of our core virtual worlds, as well as contribution from several newly launched franchises.

Offline Business. Net revenues generated from our offline business increased by 62.0% to US\$13.0 million in 2013 from approximately US\$8.0 million in 2012. This increase was primarily attributable to revenue contribution from our toy sales and box office sharing of our film *Seer III: Universal Force*.

Cost of Revenues. Our cost of revenues increased from US\$10.0 million in 2012 to US\$13.3 million in 2013, primarily due to the increased costs resulting from the growth of both online and offline businesses.

Online Business. Cost of revenues relating to our online business increased by 10.0% to US\$7.6 million in 2013 from US\$6.9 million in 2012. This increase was primarily due to an increase in bandwidth costs, fees related to our operation of certain third-party developed virtual worlds and amortization costs associated with game licensing fees.

Offline Business. Cost of revenues relating to our offline business increased by 84.4% to US\$5.6 million in 2013 from approximately US\$3.0 million in 2012. This increase was primarily due to an increase in toy costs resulting from our expansion of our toy sales.

Gross Profit. As a result of the foregoing, our gross profit increased to US\$35.1 million in 2013 from US\$30.2 million in 2012, while our gross margin decreased to 72.6% in 2013 from 75.1% in 2012, as a result of the revenue contribution from toy business, which generates lower gross margin as compared to our online business and other offline business.

Operating Expenses. Our operating expenses increased by 18.3% to US\$31.8 million in 2013 from US\$26.8 million in 2012. The increase in our operating expenses was primarily due to the increase in general and administrative expenses and impairment loss on acquired intangible assets, and to a lesser extent, an increase in product development expenses.

- **Product Development Expenses.** Our product development expenses increased by 12.7% from US\$12.3 million in 2012 to US\$13.9 million in 2013. The increase was primarily attributable to an increase in personnel-related expenses associated with an increase in salary and in performance related bonuses to retain our research and development talent, partially offset by a decrease in depreciation costs and share-based compensation.
- **Sales and Marketing Expenses.** Our sales and marketing expenses decreased by 5.2% from US\$10.0 million in 2012 to US\$9.4 million in 2013. The decrease was primarily attributable to the decreased advertising expenses, partially offset by an increase in payroll expenses and promotion expenses.
- **General and Administrative Expenses.** Our general and administrative expenses increased by 29.9% from US\$10.1 million in 2012 to US\$13.1 million in 2013. The increase was primarily due to the increased indirect tax costs related to intercompany transactions, an increase in payroll expense, and to a lesser extent, an increase in provision in accounts receivable.

[Table of Contents](#)

- **Impairment loss on acquired intangible assets.** We incurred impairment loss on acquired intangible assets of US\$1.0 million in 2013 primarily incurred by writing off the remaining term of two underperforming games, Wizard 101 and Speed Hunter.
- **Other Operating Income.** We had other operating income of US\$5.7 million in 2013, an increase of 3.6% from US\$5.5 million in 2012. Other operating income primarily consists of government subsidies and revenue recognized upon expiration of prepaid cards.

Income Tax Benefit/(Expense). We had income tax expense of US\$1.4 million in 2013, compared to an income tax benefit of approximately US\$0.9 million in 2012. The change was primarily due the accrual of deferred tax liabilities on the undistributed earnings of our VIEs and VIE subsidiaries in 2013, whereas in the prior year they were in cumulative loss positions.

Interest Income, Net. Our net interest income increased to approximately US\$2.9 million in 2013 from approximately US\$2.6 million in 2012 primarily.

Other Income (Expenses), Net. Our other income decreased to US\$0.8 million in 2013 from approximately US\$0.9 million in 2012.

Impairment loss on Investment in an Equity Investee. We incurred impairment loss on investment in an equity investee of US\$0.4 million in 2013 primarily due to the deteriorating operating and financial performance of our investment in Chuangyou.

Share of Profit in Equity Method Investments, net of gain (loss) on disposals. We incurred share of profit in equity investment of US\$0.2 million in 2013, compared with US\$1.1 million in 2012. The change was mainly due to our most recent equity method investments in entities which are loss-making as they are in the early stage of research and development.

Net Income. As a result of the foregoing, our net income decreased from US\$8.9 million in 2012 to US\$5.4 million in 2013.

B. *Liquidity and Capital Resources*

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

	For the Years Ended December 31,		
	2012	2013	2014
	(US\$ in thousands)		
Net cash provided by operating activities	7,162	9,936	2,401
Net cash used in investing activities	(7,731)	(14,771)	(3,777)
Net cash used in financing activities	(1,667)	(1,098)	(9,592)
Effect of exchange rate changes	128	1,613	(109)
Net decrease in cash and cash equivalents	(2,108)	(4,320)	(11,077)
Cash and cash equivalents, beginning of the period	120,679	118,571	114,251
Cash and cash equivalents, end of the period	118,571	114,251	103,174

To date, we have financed our operations primarily through cash from operations and proceeds from our initial public offering. We did not have any short-term or long-term bank borrowings outstanding as of December 31, 2012, 2013 and 2014. As of December 31, 2012, 2013 and 2014, we had US\$118.6 million, US\$114.3 million and US\$103.2 million in cash and cash equivalents, respectively, among which US\$51.5 million, US\$44.9 million and US\$27.8 million were held outside the PRC, respectively. Our cash and cash equivalents held outside the PRC primarily originated from our initial public offering, and as of December 31, 2014, the proceeds were used as follows: (i) US\$0.6 million

[Table of Contents](#)

were used to subscribe for the newly issued shares of Taiwan Taomee through Joy Children in the fourth quarter of 2011; (ii) US\$6.2 million were used to acquire 8.02% equity interest in Gamespedia in second half of 2012; (iii) US\$5.3 million were used to pay increased legal, accounting and other operational expenses and costs we incurred as a public company; (iv) US\$6.4 million were used to pay a cash dividend declared in November 2010 to our shareholders in July 2011 and August 2011; (v) US\$1.4 million were used to acquire a minority equity interest in Voozclub in January 2013; (vi) US\$3.0 million invested in a short-term money market investment in the second quarter of 2013 and disposed in the second quarter of 2014; (vii) US\$2.0 million were used to acquire a minority equity interest in a Beijing-based pre-school education service provider in September 2013, (viii) US\$0.2 million were used to acquire a minority equity interest in a New York City company that develops mobile applications, animation and products for pre-school children in December 2013, (ix) US\$14.7 million were used to repurchase from the open market during the period from December 2011 to December 2014 a total of 2,940,370 ADSs under our share repurchase program approved by the Board in November 2011 and extended in September 2012 and November 2014, and a new share repurchase plan approved by the board on March 28, 2014 and extended in March 2015, and (x) US\$9.7 million were used to increase register capital for Shanghai Shengran. We will continue to use the IPO proceeds primarily for the purposes described in the "Use of Proceeds" section of our Form F-1 in accordance with our business plans and on an as-needed basis.

Our cash and cash equivalents as of December 31, 2012, 2013 and 2014 are listed in the table below:

	Held in US\$ (in thousands)				Held in RMB (in thousands)				US\$ (in thousands)
	Cash located inside the PRC(1)				Cash located inside the PRC(1)				Total translated to US\$
	Cash located outside the PRC	Held by non-VIEs	Held by VIEs(2)	Total	Cash located outside the PRC	Held by non-VIEs	Held by VIEs(2)	Total	
December 31, 2014	8,365	5,362	—	13,727	120,687	370,661	57,820	549,168	103,174
December 31, 2013	17,122	103	—	17,225	168,453	347,554	74,482	590,489	114,251
December 31, 2012	19,541	103	—	19,644	198,699	323,809	97,214	619,722	118,571

(1) Subject to currency conversion control.

(2) Including VIE subsidiaries.

Cash located in the PRC, which are held by our VIEs (including VIEs' subsidiaries) and non-VIE entities, can be transferred to our subsidiaries outside of China through dividend payments, subject to PRC government's control of currency conversion. Such transfer will incur cost in the form of PRC withholding tax. See "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—We principally rely on dividends and other distributions on equity paid by our PRC subsidiary to fund any cash and financing requirements we may have, and any limitation on the ability of our PRC subsidiary to make payments to us, or the tax implications of making payments to us, could have a material adverse effect on our ability to conduct our business.", "—Restrictions on currency exchange may limit our ability to receive and use our revenues effectively", and "—Governmental control of currency conversion may affect the value of your investment."

The decrease of the cash and cash equivalents from 2013 to 2014 was primarily due to the repurchase of US\$10.3 million our ADS on open market as well as the prepayment for land use rights and land pre-development service fees of US\$1.5 million. The decrease in cash provided by operating activities from 2013 to 2014 was primarily attributable to the decrease in revenues generated from both our online and offline businesses.

We did not declare any dividend in 2012, 2013 and 2014.

[Table of Contents](#)

On January 26, 2015, we declared a special one-time cash dividend of US\$0.0325 per ordinary share, or US\$0.65 per ADS, each representing 20 ordinary shares. The total amount of cash distributed for the special dividend was US\$24.6 million, which has been paid in full by February 17, 2015.

We are a holding company, and we rely principally on dividends and other distributions from our subsidiary in China for our cash requirements. We receive economic benefits generated from our significant VIE, Shanghai Taomee, through various contractual arrangements entered into by Shanghai Shengran, our PRC subsidiary, with Shanghai Taomee. Such contractual arrangements include business operation agreement, commercial cooperation agreement and equity interest pledge agreement with Shanghai Taomee. Under these contractual arrangements, Shanghai Taomee will pay to Shanghai Shengran its earnings in RMB in the form of services fees. Under China's existing foreign exchange regulations, our PRC subsidiary is able to make payments of current accounts, like dividends to its offshore holding companies, in foreign currencies, without prior approval from the SAFE, after complying with certain procedural requirements. See "Item 3. Key Information—Risk Factors—Risks Related to Doing Business in China—Governmental control of currency conversion may affect the value of your investment" and "Item 3. Key Information—Risk Factors—Risks Related to Doing Business in China—We may be subject to penalties, including restriction on our ability to inject capital into our PRC subsidiary and our PRC subsidiary's ability to distribute profits to us, if our PRC resident shareholders or beneficial owners fail to comply with relevant PRC foreign exchange rules."

In addition, current PRC regulations permit our subsidiary to pay dividends to us only out of its accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. Each of our subsidiaries, VIEs and VIEs' subsidiaries in China is required to set aside at least 10% of its after tax profits, as determined on a calendar year basis and in accordance with PRC GAAP, if any, to fund a statutory reserve until such reserve reaches 50% of its registered capital. The registered capital of Shanghai Taomee and Shanghai Shengran are RMB10.0 million (US\$1.4 million) and RMB77.1 million (US\$12.2 million), respectively. As of the date of this annual report, Shanghai Taomee and Shanghai Shengran have made allocations to the statutory reserve fund in compliance with the applicable PRC laws and regulations. Shanghai Taomee didn't make any allocations for the year ended December 31, 2014 because its statutory reserves have reached 50% of its registered capital, the maximum amount required under the PRC regulations. Shanghai Shengran made allocations of RMB1.9 million (US\$0.3 million) for the year ended December 31, 2014. These reserves are not distributable as cash dividends.

We determine the amount of statutory reserves to be set aside each year in accordance with PRC regulations based the amount of accumulated profits of our subsidiaries, VIEs and VIEs' subsidiaries in China as determined under PRC GAAP. The differences in the amount of accumulated profits under PRC GAAP and the amount of retained earnings in our financial statements, prepared and presented in accordance with U.S. GAAP, relate to the different methods of revenue recognition and accounting for share-based compensation under PRC GAAP and U.S. GAAP.

We believe that our current levels of cash balances and cash flows from operations will be sufficient to meet our anticipated cash needs to fund our operations for at least the next 12 months. However, we may need additional cash resources in the future if we experience adverse business conditions or other developments or if we find and wish to pursue opportunities for investment, acquisitions, strategic cooperation or other similar actions. For example, our land development for our future office buildings may require bank debt to partially fund the development.

Operating Activities

Our net cash provided by operating activities in 2014 was approximately US\$2.4 million. This is based on our net income of US\$0.9 million in 2014, positively adjusted by US\$2.2 million increase in share-based compensation, US\$2.2 million increase in depreciation and amortization, US\$1.4 million

[Table of Contents](#)

increase in long-term investment impairment, US\$1.3 million increase in advance from customers as well as US\$1.1 million increase in allowance for doubtful accounts and long-term prepayments. This was partially offset by US\$2.8 million increase in deferred income tax benefit, US\$1.9 million increase in other assets, US\$1.5 million decrease in accrued expenses and other current liabilities and, to a less extent, by adjustment of accounts payable, prepayments and other current assets, as well as deferred revenues.

Our net cash provided by operating activities in 2013 was approximately US\$9.9 million. This is based on our net income of US\$5.4 million in 2013, positively adjusted by a US\$2.2 million increase in depreciation and amortization, US\$2.1 million increase in share-based compensation, US\$1.7 million increase in allowance for doubtful accounts as well as impairment of intangible assets and long-term investment. This was partially offset by US\$1.5 million increase in amounts due from related parties, US\$1.2 million decrease in advance from customers, US\$1.1 million decrease in accounts payable, US\$0.9 million increase in other assets, and, to a less extent, by adjustment of accrued expenses and other current liabilities, accounts receivable, income tax payable and deferred revenue.

Our net cash provided by operating activities in 2012 was approximately US\$7.2 million. This is based on our net income of US\$8.9 million in 2012, positively adjusted by a US\$2.3 million increase in share-based compensation and US\$0.6 million dividends received from Elyn Corporation and Joy Children. This was partly offset primarily by a US\$2.2 million adjustment in income tax recoverable, as well as a US\$2.1 million decrease in advance from customers, a US\$0.9 million decrease in deferred revenue and a US\$0.9 million decrease in accounts receivable which are attributable to the decrease of our revenues of 2012 compared to the revenue of 2011, and, to a lesser extent, by adjustment of accrued expenses, accounts payables, deferred income tax, prepayments and other assets.

Investing Activities

Our net cash used in investing activities in 2014 was approximately US\$3.8 million, primarily due to US\$4.7 million paid to acquire equity investees, US\$1.5 million paid as prepayment for land use rights and land pre-development service fees, US\$0.8 million for the purchase of property and equipment for our ordinary course of businesses as well as US\$0.3 million paid to purchase intangible assets. This was partially offset by proceeds of US\$3.0 million from disposal of short-term investments and proceeds of US\$0.3 million from sale of an equity investment.

Our net cash used in investing activities in 2013 was approximately US\$14.8 million, primarily due to US\$6.5 million paid to acquire equity investees, US\$3.0 million paid to purchase short-term investment, US\$3.0 million paid as prepayments for land use right and building purchase, US\$1.4 million paid for the purchase of property and equipment for our ordinary course of businesses, as well as US\$0.9 million paid to purchase intangible assets such as exclusive licensing right of Avata Star and Speed Hunter.

Our net cash used in investing activities in 2012 was approximately US\$7.7 million, primarily due to US\$7.0 million paid to acquire equity investees, including the purchase of 8.02% equity interest in Gamespedia, US\$1.4 million for the purchase of intangible assets such as Animals franchise and additional three franchises for our future pipeline from Voozclub, and the exclusive licensing right of two online games from our related parties, and to a lesser extent, US\$0.3 million paid for the purchase of property and equipment for our ordinary course of business. This was partly offset by US\$1.0 million proceeds from the sale of all our equity interest in Shenzhen Ruigao.

Financing Activities

Our net cash used in financing activities in 2014 was approximately US\$9.6 million, resulting from US\$10.3 million used in repurchase of ordinary shares, and was offset by the proceeds of US\$0.6 million received from exercise of share options.

[Table of Contents](#)

Our net cash used in financing activities in 2013 was approximately US\$1.1 million, resulting from US\$2.1 million used in repurchase of ordinary shares, and was offset by the proceeds of US\$1.0 million received from exercise of share options.

Our net cash used in financing activities in 2012 was approximately US\$1.7 million, resulting from US\$1.7 million used in repurchase of ordinary shares and US\$0.3 million as issuance costs of our ordinary shares, and was offset by US\$0.3 million received from exercise of share options.

Capital Expenditures

We had capital expenditures of US\$1.7 million, US\$5.3 million and US\$2.5 million for 2012, 2013 and 2014, respectively. Our capital expenditures were used primarily for (i) purchase of computer hardware and equipment, (ii) purchase of intangible assets, (iii) purchase of franchises and online game licensing rights for our pipeline, and (iv) prepayments as deposits for obtaining land use rights and building ownership. Actual future capital expenditures may differ from the amounts indicated above.

Restricted Net Assets

Pursuant to laws applicable to entities incorporated in the PRC, our subsidiaries, VIEs and VIEs' subsidiaries in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires annual appropriation of 10% of after tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserve fund reaches 50% of their registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserve funds can only be used for specific purposes of enterprise expansion and staff bonus and welfare and are not distributable as cash dividends and amounted to US\$2.3 million as of December 31, 2014. In addition, due to restrictions on the distribution of registered capital from our PRC subsidiaries, the PRC subsidiaries' registered capital of US\$42.0 million as of December 31, 2014, were considered restricted. As a result of these PRC laws and regulations, as of December 31, 2014, approximately US\$44.3 million, were not available for distribution to the Company by its PRC subsidiaries in the form of dividends, loans or advances.

C. Research and Development, Patents and Licenses, etc.

We have created a proprietary engine for powering our virtual worlds. Our scalable hardware infrastructure allows us to cost-effectively accommodate rapid growth in user base and traffic. The advanced modular architecture of our technology platform allows us to quickly update the content of our virtual worlds with new features, shorten development cycles and rapidly roll out new virtual worlds and other services. The layering of more advanced features and functionalities afford us opportunities to increase the monetization of our user base. Our reliable account and virtual currency management system and integrated prepaid card and online payment systems also allow us to analyze user spending patterns and quickly monetize any new virtual worlds and services. Our research and development team possesses extensive experience in Flash and HTML5 technologies and is credited with the creation of innovative and advanced features, such as the continuous side-scrolling action scenes that deliver a superior and highly engaging user experience and add monetization values. Our technology platform also features a scalable data warehouse and advanced data and integrated data analytical functions that help us measure the popularity of themes, features and virtual items. This helps our product development team understand user preferences and develop content that enhances user experience and creates better monetization potential.

In each of the three years ended December 31, 2012, 2013 and 2014, our research and development expenditures, including share-based compensation expenses for research and development

staff, were US\$12.3 million, US\$13.9 million and US\$14.4 million, representing 30.6%, 28.7% and 34.2% of our total net revenues for 2012, 2013 and 2014, respectively. Our research and development expenses consist primarily of payroll expenses, share-based compensation expenses and rental expenses. We have expensed all of the development costs for the research and development of products.

Intellectual Property

We regard our copyrights, trademarks, trade secrets and similar intellectual property as important to our success, and rely on trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, suppliers and others to protect our proprietary rights. All of our research and development personnel have entered into confidentiality and proprietary information agreements or contract clauses with us. These agreements address intellectual property protection issues and require our employees to assign to us all of the inventions, designs, and technologies they develop during their employment with us.

As of December 31, 2014, we had received approval for 376 and 7 trademark registrations in China and Taiwan respectively and are in the process of applying for registration of 70 trademarks in China. In addition, we have obtained 105 copyright registrations for software we developed, 177 copyright registrations for Mole's World and Seer animation series and 416 copyright registrations for artworks which were produced by our employees and owned by us. We also registered 38 domain names, including www.61.com, our primary operation website, and www.taomee.com, our corporate information website.

Under the contractual arrangements we enter into with producers of film and television series, we either wholly own or jointly own the intellectual property rights for newly created characters in the television series and films we help develop.

While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. This is particularly the case in China where the laws may not protect our proprietary rights as fully as in the United States. Infringement or misappropriation of our intellectual property could materially harm our business.

D. *Trend Information*

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the year ended December 31, 2014 that are reasonably likely to have a material adverse effect on our net revenues, income, profitability, liquidity or capital resources, or that would cause the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

E. *Off-Balance Sheet Arrangements*

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

F. Contractual Obligations

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

	Payments Due by Period				Total
	Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 years	
	(US\$ in thousands)				
Operating lease obligations	819	122	—	—	941
Total	819	122	—	—	941

Our operating lease obligations related to lease agreements for our corporate offices and Internet data centers.

In December 2014, Shanghai Xinsheng was granted a two-year right from a third party to develop a web game and a mobile ARPG game based on "Fairy Tail", a famous Japanese IP derived from manga series. License fee and minimum guarantee for each game was \$0.5 million and \$0.4 million, respectively and the total amount of license fees and minimum guarantees was \$1.8 million. We made payments of \$1.0 million license fees and \$0.4 million minimum guarantees in February 2015.

In December 2014, we entered into a land use right transfer agreement with Songjiang Planning and Land Administration Bureau of Shanghai Municipality to purchase the land use right of the above mentioned two parcels lands for considerations of RMB11.0 million (US\$1.8 million) and RMB10.4 million (US\$1.7 million), respectively. Prepayments of RMB2.2 million (US\$0.4 million) and RMB2.1 million (US\$0.3 million) were paid in December 2014 and the rest of considerations were paid in January 2015.

Under the land use right transfer agreement in connection with the First Parcel, we agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach sales revenues of RMB259.2 million (US\$41.8 million), (ii) the relevant annual tax expenses will be no less than RMB14.6 million (US\$2.4 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by January 26, 2020. In addition, we also committed to pay a project completion security deposit of RMB2.2 million (US\$0.4 million), adhering us to certain project commencement, completion and operation milestones on specific dates. Should we fail to meet these requirements and depending on the severity of breach, we may be subject to liabilities for breach including forfeiture of a portion or all of our deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Under the land use right transfer agreement in connection with the Second Parcel, we agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach revenues of RMB244.3 million (US\$39.4 million), (ii) the relevant annual tax expenses will be no less than RMB13.8 million (US\$2.2 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by February 11, 2020. In addition, we also committed to pay a project completion security deposit of RMB2.1 million (US\$0.3 million), adhering us to certain project commencement, completion and operation milestones on specific dates. Should we fail to meet these requirements and depending on the severity of breach, we may be subject to liabilities for breach including forfeiture of a portion or all of our deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Separate from the project completion security deposits, if we fail to comply with the terms of the land use right transfer agreements (and depending on the severity of breach), we may be subject to liabilities for the breach including the forfeiture of the land use rights by the PRC government.

We did not have any other long-term debt obligations, capital lease obligations, purchase obligations or other long-term liabilities as of December 31, 2014.

G. *Safe Harbor*

This annual report contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to us. These statements involve known and unknown risks, uncertainties and other factors, including those listed under "Risk Factors," which may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements.

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

- our business strategies and initiatives as well as our business plans;
- our future business development, results of operations and financial condition;
- expected changes in our revenues and certain cost or expense items;
- our expectations with respect to increased revenue growth and our ability to sustain profitability;
- our services and products under development or planning;
- our ability to attract users and further enhance our brand recognition; and
- trends and competition in the children's entertainment and media market and industry, including those for online entertainment.

This annual report also contains data related to the children's online entertainment industry in China, including projections that are based on a number of assumptions. These market data, including the public data from EntGroup.cn include projections that are based on a number of assumptions. The children's entertainment and media market and children's product market in China may not grow at the rates suggested by the market data, or at all. The failure of the markets to grow at the projected rates may have a material adverse effect on our business and the market price of our ADSs. In addition, the rapidly changing nature of the children's online entertainment industry in China subjects any projections or estimates relating to the growth prospects or future condition of our market to significant uncertainties. If any one or more of the assumptions underlying the market data turns out to be incorrect, our actual results may differ from the projections based on these assumptions.

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

You should not rely upon forward-looking statements as predictions of future events. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

The following table sets forth information regarding our directors and executive officers as of the date of this annual report.

Directors and Executive Officers	Age	Position/Title
Jason Liqing Zeng	45	Chairman and Director
Benson Haibing Wang	35	Co-Founder, Director and Chief Executive Officer
Roc Yunpeng Cheng	38	Co-Founder, Director and President
Crow Zhen Wei	40	Co-Founder and Director
JP Gan	44	Independent Director
Shengwen Rong	47	Independent Director
Ted Lai	44	Independent Director
Changtian Wang	50	Independent Director
George Kuan	42	Independent Director
Sam Lawn	38	Chief Financial Officer

Mr. Jason Liqing Zeng has served as our chairman and director since October 2008. Mr. Zeng founded Shenzhen Decent Investment Limited, an investment company which focuses on high-technology investment, in May 2007 and has served as the chairman since its inception. Previously, Mr. Zeng co-founded Tencent Holdings Limited, an Internet service company in China listed on the Hong Kong Stock Exchange, and served as its chief operating officer from 1999 to 2007. From 1993 to 1999, Mr. Zeng served as a manager in the Shenzhen Branch of China Telecom Corporation Limited, a company engaging in information service and wired telecommunications and broadband services in China and listed on the Hong Kong Stock Exchange and the New York Stock Exchange. Mr. Zeng is also an independent director of A8 Digital Music Holdings Limited, an integrated digital music company listed on the Hong Kong Stock Exchange, a director of Shenzhen Ruigao, a director of Chuangyou, a director of Shenzhen Taole Network Technology Co., Ltd, a director of Shenzhen Kuaibo Technology Co., Ltd. and a director of several private companies. Mr. Zeng received his EMBA degree from China Europe International Business School in China in 2007 and his bachelor's degree in computer communication from Xi'an Electronic Technology University in 1993.

Mr. Benson Haibing Wang is one of the founders and the creative architect of many of our franchises. Mr. Wang is also our chief executive officer and has served as our director since October 2008. Prior to co-founding our company, Mr. Wang worked as a project manager at Tencent Technology (Shenzhen) Company Limited, a subsidiary of Tencent Holdings Limited, from 2004 to 2007. Mr. Wang is also a director of Gamespedia Holdings Limited, Chuangyou, Shanghai Jushou Wireless Technology Co., Ltd. and Shanghai Weiju, respectively. Mr. Wang has approximately ten years of experience in the development of online products in China and has formulated our current strategy and led our rapid growth. Mr. Wang received his bachelor's degree in electrical engineering and his master's degree in computer science from Huazhong University of Science and Technology in 2001 and 2004, respectively.

Mr. Roc Yunpeng Cheng is one of our founders and our president. Mr. Cheng has served as our director since October 2008. Prior to co-founding our company, Mr. Cheng worked as an assistant general manager of the advertising department of Tencent Technology (Shenzhen) Company Limited from 2001 to 2007, primarily responsible for advertising business in East and South China. Mr. Cheng was a sales manager in the Shenzhen Branch of International Network Communications (Shanghai) Co., Ltd., a company engaging in Internet portal and related business, from 1999 to 2001. Ms. Cheng is also a director of Shanghai Taoyue Information Technology Co., Ltd., an online game development company, a director of Jiangxi Haomi Network Technology Co., Ltd., a company which develops family entertainment and education application on mobile and multi-screen platforms in China and Shanghai Weiju, a Hi-tech toy design and R&D company. Mr. Cheng has approximately

[Table of Contents](#)

15 years of experience in marketing and operations. Mr. Cheng received his bachelor's degree in materials engineering from Harbin Institute of Technology in 1999.

Mr. Crow Zhen Wei is one of our founders. Mr. Wei has served as our director since October 2008 and as our chief technology officer from October 2008 to February 2014. Prior to co-founding our company, Mr. Wei worked as a software engineer at Novell China Inc., a company engaging in infrastructure software business, from 2006 to 2007. Mr. Wei was a system architecture designer and project manager at Tencent Technology (Shenzhen) Company Limited from 2004 to 2006. Prior to that, Mr. Wei was a software engineer at Huawei Technologies Co., Ltd., a China-based telecom solutions provider, from July 2003 to December 2003. Mr. Wei has approximately 11 years of experience in software and Internet technology. Mr. Wei received his bachelor's degree in chemistry and his master's degree in computer science from University of Science and Technology of China in 1999 and 2003, respectively.

Mr. JP Gan has served as our director since May 2009 and is currently our independent director. Mr. Gan has been serving as a managing director and a member of the investment committee of Qiming Venture Partners, a private equity firm affiliated to the Qiming Funds, since 2007. From 2005 to 2006, Mr. Gan was the chief financial officer of Kongzhong Corporation, a Nasdaq listed wireless Internet company. Prior to joining Kongzhong, Mr. Gan was a director of the Carlyle Group responsible for venture capital investments in the Greater China region from 2000 to 2005. Mr. Gan worked at the investment banking division of Merrill Lynch, in Hong Kong from 1999 to 2000, and worked at PricewaterhouseCoopers LLP in the United States from 1994 to 1997. Currently, Mr. Gan is also a director of Ctrip.com International Limited and Jiayuan.com International Ltd., both of which are NASDAQ-listed companies, a director of Playgame Sdn. Bhd, or Playgame, an affiliate of us, and a director of several private companies. Mr. Gan obtained his Masters of Business Administration from the University of Chicago Booth School of Business and his bachelor's degree in business administration from the University of Iowa.

Mr. Shengwen Rong has served as our independent director since June 2011. From February 2012 to December 2014, Mr. Rong was the chief financial officer of UCWeb Inc., a leading provider of mobile Internet software technology and application services, which was acquired by Alibaba Group Holdings Limited (NYSE: BABA) in June 2014. From April 2010 to January 2012, Mr. Rong was the chief financial officer of Country Style Cooking Restaurant Chain Co., Ltd, a NYSE-listed company. Prior to that, Mr. Rong had been the chief financial officer of two privately held education companies in China since April 2008. From 2000 to 2008, Mr. Rong held multiple financial management positions at Google, Inc. Solectron Corp., and Siebel Systems. Mr. Rong also worked at PricewaterhouseCoopers as an auditor both in its Chicago and Beijing offices. Mr. Rong obtained a bachelor's degree in economics from Renmin University of China in 1991, a master's degree in professional accountancy from West Virginia University in 1996 and an MBA from the Booth School of Business at the University of Chicago in 2000. Mr. Rong is a certified public accountant in the United States.

Mr. Ted Lai has served as our independent director since June 2012. Mr. Lai is currently CEO of Zoodles, a leading kids' educational mobile app company backed by HTC. Mr. Lai is also the co-founder and steering committee member of Angel Vest, a China based angel investor organization. Previously, Mr. Lai served as executive vice president for Asia of BBC Worldwide, responsible for strategic development across the Asia region, driving growth through new brand, product and service initiatives. Before joining BBC, Mr. Lai spent more than a decade working for Time Warner, including as senior vice president of Warner Bros. International TV. Previously, Mr. Lai was a business development and product management executive in the digital media industry, having worked in several high-profile companies, including idealab's FreePC from inception to merger and initial public offering. Mr. Lai also developed strategic plans for theme parks and location-based entertainment centers for the Walt Disney Company. Mr. Lai earned his MBA at Harvard Business School and master's and bachelor's degrees in engineering at Stanford University.

[Table of Contents](#)

Mr. Changtian Wang has served as our independent director since June 2012. Mr. Wang is the chairman and chief executive officer of Beijing Enlight Media Co., Ltd., a company listed on the Shenzhen Stock Exchange. Mr. Wang has more than twenty years' experience in media industry. Before founding Beijing Enlight Media Co., Ltd., Mr. Wang worked for some television channels and newspapers in China, such as Beijing Television. Mr. Wang is also director of JinHua Changfeng Information and Technology Co., Ltd., a Zhejiang-based instant messaging and internet value-added service provider, and is also the chairman or director of several companies which are affiliates or subsidiaries of Beijing Enlight Media Co., Ltd. Mr. Wang earned his bachelor's degree in journalism from Fudan University.

Mr. George Kuan has served as our independent director since June 2012. Mr. Kuan is currently in a sales leadership role at Nike Inc. Greater China. Prior to joining Nike Inc. Greater China, Mr. Kuan worked at several well-known multinational corporations, including Coca-Cola (China) Beverages, Ltd., SAP, Oracle Corporation and BMC Software Inc. Mr. Kuan earned his bachelor's degree in business administration in finance from the University of Houston in 1996, his master of science in management and systems from New York University in 2004, and his Ph.D. in philosophy from the International School of Management in 2011.

Mr. Sam Lawn has been our chief financial officer since April 2014. Prior to joining us, Mr. Lawn held a senior executive position at RenRen Inc. (NYSE: RENN) and served as the head of investor relations from 2011 to 2013. From 2009 to 2011, Mr. Lawn served as a research equity analyst at Oppenheimer and covered Internet, online gaming, and media companies in the Chinese ADR market. From 2008 to 2009, he worked as the senior director of business development of Lucky Dragon Group, a global supplier of fashion accessories listed on the Taiwan Stock Exchange. From 2004 to 2008, Mr. Lawn co-founded and served as president of Leap Inc. From 2003 to 2004, he was an operations manager for Universal Distribution Company. From 2001 to 2003, Mr. Lawn worked as a programming business analyst for Accenture Corp., a global management consulting firm. Mr. Lawn received his bachelor's degree in Operations Management Information Systems from Santa Clara University.

B. Compensation of Directors and Executive Officers

In 2014, we paid an aggregate of approximately RMB5.5 million (US\$0.9 million) in cash to our executive officers, and US\$120,000 in cash to our independent directors. For options granted to our executive officers, see "—Share Incentive Plans."

We have neither set aside nor accrued any amount of cash to provide pension, retirement or other similar benefits to our officers and directors. Our PRC subsidiaries, VIE and VIEs' subsidiaries are required by law to make contributions equal to certain percentages of each employee's salary for his or her retirement benefit, medical insurance benefits, housing funds, unemployment and other statutory benefit. Our PRC subsidiary contributed an aggregate of RMB0.2 million (US\$0.03 million) for retirement and similar benefits for our officers and directors in 2014.

Share Incentive Plans

2009 Stock Option Plan

We have adopted our 2009 Stock Option Plan, or the 2009 Plan, to promote our success and to increase shareholder value by providing an additional means, through the grant of awards, to attract, motivate, retain and reward selected employees and other eligible persons. The maximum number of shares which may be issued pursuant to all awards under the 2009 Plan is 45,000,000. As of December 31, 2014, options to purchase an aggregate of 6,548,240 ordinary shares and 1,600,000 restricted shares were outstanding under the 2009 Plan.

Types of Awards. The 2009 Plan permits the grant of several kinds of awards, including among others, options, restricted shares and restricted share units.

[Table of Contents](#)

Plan Administration. Our board of directors, or one or more committees designated by our board of directors, will administer the 2009 Plan. The administrator will determine the terms and conditions of each grant, including, without limitation, the eligibility of the persons, whether and to what extent awards are granted, the grant price, the number of awards, the forms of the award agreements, limited amendment of terms of any outstanding award, the construction and interpretation of the 2009 Plan and any award agreements, and such other action not inconsistent with the terms of the 2009 Plan as the administrator deems appropriate.

Award Agreements. Options and other awards granted under the 2009 Plan are evidenced by a written award agreement that sets forth the material terms and conditions for each grant.

Eligibility. We may grant awards to employees and directors of our company and consultants.

Term of the Option and Stock Appreciation Rights. The term of each option and stock appreciation rights granted will not exceed ten years.

Vesting Schedule. In general, the option agreements specify the vesting schedules.

Amendment and Termination of the 2009 Plan. Unless terminated earlier, the 2009 Plan will continue in effect for a term of ten years from the date of its approval by the board of directors. Our board of directors has the authority to amend, modify, suspend, or terminate the 2009 Plan subject to shareholder approval to the extent required by applicable laws or if such amendment would lessen the shareholder approval requirements. However, no such action may impair the rights of any award recipient unless agreed by the recipient in written.

2010 Share Incentive Plan

We have adopted our 2010 Share Incentive Plan, or the 2010 Plan. The maximum number of shares which may be issued pursuant to all awards under the 2010 Plan is 55,000,000. As of December 31, 2014, options to purchase an aggregate of 10,970,000 ordinary shares and 6,683,016 restricted shares under the 2010 Plan were outstanding.

Types of Awards. The 2010 Plan permits the grant of several kinds of awards, including among others, options, restricted shares, restricted share units and share appreciation rights.

Plan Administration. The compensation committee of our board of directors will administer the 2010 Plan, and may delegate its administrative authority to a committee of one or more members of our board or one or more of our officers, subject to certain restrictions. Among other things, the compensation committee will designate the eligible individuals who may receive awards, and determine the types and number of awards to be granted and terms and conditions of each award grant. The compensation committee has the sole power and discretion to cancel, forfeit or surrender an outstanding award.

Award Agreements. Options and other awards granted under the 2010 Plan will be evidenced by a written award agreement that sets forth the material terms and conditions for each grant.

Eligibility. We may grant awards to the employees, consultants rendering bona fide services to us or our affiliated entities designated by our board, as well as our directors, provided that awards cannot be granted to consultants or non-employee directors who are resident of any country in the European Union, and any other country which pursuant to applicable laws does not allow grants to non-employees.

Term of the Option and Stock Appreciation Rights. The term of each option and stock appreciation rights granted will not exceed ten years, and the compensation committee may extend the term subject to certain limitation under relevant applicable regulations.

[Table of Contents](#)

Acceleration of Awards upon Corporate Transactions. The compensation committee may, in its sole discretion, upon or in anticipation of a corporate transaction, accelerate awards, purchase the awards from the holder or replace the awards.

Vesting Schedule. In general, the compensation committee determines, or the option agreements specify the vesting schedules.

Amendment and Termination of the 2010 Plan. The compensation committee may at any time amend, modify or terminate the 2010 Plan subject to shareholder approval to the extent required by laws. Additionally, shareholder approval will be specifically required to increase the number of shares available under the 2010 Plan, or to permit the compensation committee to extend the term or the exercise period of an option or share appreciation right beyond ten years, or if amendments result in material increases in benefits or a change in eligibility requirements. Any amendment, modification or termination of the 2010 Plan must not impair any rights or obligations under awards already granted without consent of the holder of such awards. Unless terminated earlier, the 2010 Plan will expire and no further awards may be granted after the tenth anniversary of the shareholders' approval of the 2010 Plan.

2012 Share Incentive Plan

We have adopted our 2012 Share Incentive Plan, or the 2012 Plan. The maximum number of shares which may be issued pursuant to all awards under the 2012 Plan is 30,000,000. As of December 31, 2014, nil options to purchase an aggregate of ordinary shares and 1,060,000 restricted shares under the 2012 Plan were outstanding.

Types of Awards. The 2012 Plan permits the grant of several kinds of awards, including among others, options, restricted shares, restricted share units and share appreciation rights.

Plan Administration. The compensation committee of our board of directors will administer the 2012 Plan, and may delegate its administrative authority to a committee of one or more members of our board or one or more of our officers, subject to certain restrictions. Among other things, the compensation committee will designate the eligible individuals who may receive awards, and determine the types and number of awards to be granted and terms and conditions of each award grant. The compensation committee has the sole power and discretion to cancel, forfeit or surrender an outstanding award.

Award Agreements. Options and other awards granted under the 2012 Plan will be evidenced by a written award agreement that sets forth the material terms and conditions for each grant.

Eligibility. We may grant awards to the employees, consultants rendering bona fide services to us or our affiliated entities designated by our board, as well as our directors, provided that awards cannot be granted to consultants or non-employee directors who are resident of any country in the European Union, and any other country which pursuant to applicable laws does not allow grants to non-employees.

Term of the Option and Stock Appreciation Rights. The term of each option and stock appreciation rights granted will not exceed ten years, and the compensation committee may extend the term subject to certain limitation under relevant applicable regulations.

Acceleration of Awards upon Corporate Transactions. The compensation committee may, in its sole discretion, upon or in anticipation of a corporate transaction, accelerate awards, purchase the awards from the holder or replace the awards.

Vesting Schedule. In general, the compensation committee determines, or the option agreements specify the vesting schedules.

[Table of Contents](#)

Amendment and Termination of the 2012 Plan. The compensation committee may at any time amend, modify or terminate the 2012 Plan subject to shareholder approval to the extent required by laws. Additionally, shareholder approval will be specifically required to increase the number of shares available under the 2012 Plan, or to permit the compensation committee to extend the term or the exercise period of an option or share appreciation right beyond ten years, or if amendments result in material increases in benefits or a change in eligibility requirements. Any amendment, modification or termination of the 2012 Plan must not impair any rights or obligations under awards already granted without consent of the holder of such awards. Unless terminated earlier, the 2012 Plan will expire and no further awards may be granted after the tenth anniversary of the shareholders' approval of the 2012 Plan.

The table below sets forth, as of December 31, 2014, the option and restricted share grants made to our directors and executive officers and other individuals as a group, under our share incentive plans:

Name	Ordinary Shares Underlying Outstanding Options/ Restricted Shares	Exercise Price/ Purchase Price (US\$/Share)	Grant Date/ Award Date	Expiration Date
Benson				
Haibing Wang	*	0.07	June 7, 2010	June 7, 2020
	*	0.00002	November 5, 2013	November 5, 2023
Roc Yunpeng Cheng	*	0.07	June 7, 2010	June 7, 2020
	*	0.00002	November 5, 2013	November 5, 2023
Sam Lawn Shengwen Rong	*	0.00002	April 22, 2014	April 22, 2024
	*	0.45	May 24, 2011	May 24, 2021
	*	0.00002	July 1, 2014	July 1, 2024
Ted Lai	*	0.1960	July 20, 2012	July 20, 2022
Changtian Wang	*	0.1960	July 20, 2012	July 20, 2022
George Kuan	*	0.1960	July 20, 2012	July 20, 2022
JP Gan	*	0.1960	July 20, 2012	July 20, 2022
Directors and executive officers as a group	3,930,600	0.07	June 7, 2010	June 7, 2020
	3,600,000	0.1960	July 20, 2012	July 20, 2022
	1,200,000	0.00002	November 5, 2013	November 5, 2023
	1,000,000	0.00002	April 22, 2014	April 22, 2024
	60,000	0.00002	July 1, 2014	July 1, 2024
Other individuals as a group	1,368,260	0.04	June 24, 2009	June 24, 2019
	1,617,380	0.07	June 7, 2010	June 7, 2020
	913,756	0.36/nil	January 4, 2011	January 4, 2021
	133,340	nil	May 24, 2011	May 24, 2021
	6,695,000	0.2395	July 16, 2012	July 16, 2022
	4,815,000	0.00002	September 4, 2013	September 4, 2023
			December 11, 2013	December 11, 2023
	295,920	0.00002		
	1,600,000	0.00002	March 18, 2014	March 18, 2024

* Ordinary shares underlying the share options held by such person comprise less than 1% of our outstanding ordinary shares.

[Table of Contents](#)

On February 28, 2012, our compensation committee approved a share option exchange program that offered our eligible directors and employees the right to exchange vested and unvested outstanding share options to purchase our ordinary shares granted under the 2010 Share Incentive Plan between January 2011 to May 2011 for our restricted shares at the ratio of 3:1. The exchange ratio was determined based on the fair value of replacement restricted shares so that the fair value of the replacement restricted shares to be issued upon exchange would be approximately equivalent to the fair value of the share options surrendered by an individual. These replacement restricted shares are subject to substantially the same vesting schedule as the options that were validly tendered in the exchange offer. A total of 102 directors and employees accepted the offer, and tendered options to purchase an aggregate of 28,790,000 ordinary shares, including 14,090,000 shares granted on January 4, 2011 and 14,700,000 shares granted on May 24, 2011, in exchange for an aggregate of 9,596,718 restricted shares at a ratio of 3:1, which were granted on March 30, 2012. The exchange of the share option for restricted shares was accounted for as a modification of share-based award, which involves a cancellation of the original award and an issuance of a new award, with no incremental compensation cost recognized as the fair value of the restricted shares was not more than the fair value of the options given up on the date of exchange. This exchange program is expected to provide additional incentive and retention value. The replacement restricted shares to our directors, officers and employees as listed below:

Name	Number of Restricted Shares Granted	Date of Grant of Restricted Shares	Date of Grant of Cancelled Option
Shengwen Rong	*	March 30, 2012	May 24, 2011
Directors and executive officers as a group	*	March 30, 2012	January 4, 2011/ May 24, 2011
Other individuals as a group	*	March 30, 2012	January 4, 2011/ May 24, 2011

* Beneficially own less than 1.0% of our outstanding ordinary shares.

C. *Board Practices*

Board of Directors

Our board of directors consists of nine members. A director is not required to hold any shares in the company by way of qualification. A director who is in any way, whether directly or indirectly, interested in a contract or proposed contract with our company is required to declare the nature of his interest at a meeting of our directors. A director may vote with respect to any contract or proposed contract or arrangement notwithstanding that he may be interested therein and if he does so his vote shall be counted and he may be counted in the quorum at any meeting of the directors at which any such contract or proposed contract or arrangement is considered. The directors may exercise all the powers of our company to borrow money, and to mortgage or charge its undertaking, property and uncalled capital or any part thereof, and to issue debentures or other securities whenever money is borrowed or as security for any debt, liability or obligation of the company or of any third-party. None of our non-executive directors has a service contract with us that provides for benefits upon termination of employment.

Committees of the Board of Directors

We have established three committees under the board of directors: the audit committee, the compensation committee and the corporate governance and nominating committee, and adopt a charter for each of the committees. Each committee's members and functions are described below.

Audit Committee

Our audit committee consists of Mr. Shengwen Rong, Mr. Ted Lai and Mr. George Kuan. Mr. Rong, Mr. Lai and Mr. Kuan satisfy the "independence" requirements of Section 303A of the Corporate Governance Rule of the New York Stock Exchange and Rule 10A-3 under the Securities Exchange Act of 1934, as amended. Mr. Rong is the chairman of our audit committee and meets the criteria of an audit committee financial expert as set forth under the applicable rules of the SEC. Mr. Rong, Mr. Lai and Mr. Kuan all have extensive knowledge and experience applying U.S. GAAP. From April 2010 to January 2012, Mr. Rong was the chief financial officer of Country Style Cooking Restaurant Chain Co., Ltd, a NYSE-listed company which prepares and presents its consolidated financial statements in accordance with U.S. GAAP, and also had experience applying U.S. GAAP at his previous positions at Google, Inc., Solectron Corp., and Siebel Systems. Prior to that, Mr. Rong worked at PricewaterhouseCoopers LLP in the United States and Beijing. Mr. Rong is a certified public accountant in the United States. Mr. Kuan has served in various finance and accounting roles at BMC Software Inc., including serving as the regional finance manager based in Australia and the country controller at BMC Japan. In BMC Software Inc., Mr. Kuan was a member of the corporate accounting team responsible for operating expenses management control. In BMC Japan, Mr. Kuan served in the corporate accounting team responsible for revenue recognition accounting practice, in accordance with GAAP software policy. Mr. Lai has experience of reviewing company financial statements related to his work with AngelVest, as well as with BBC Worldwide, Time Warner and the Walt Disney Company.

The audit committee oversees our accounting and financial reporting processes and the audits of the financial statements of our company. The audit committee is responsible for, among other things:

- selecting our independent registered public accounting firm and pre-approving all auditing and non-auditing services permitted to be performed by our independent registered public accounting firm;
- reviewing with the independent registered public accounting firm any audit problems or difficulties and management's response;
- reviewing and approving all proposed related-party transactions, as defined in Item 404 of Regulation S-K under the Securities Act;
- discussing the annual audited financial statements with management and our independent registered public accounting firm;
- annually reviewing and reassessing the adequacy of our audit committee charter;
- meeting separately and periodically with management and our independent registered public accounting firms;
- reporting regularly to the full board of directors; and
- such other matters that are specifically delegated to our audit committee by our board of directors from time to time.

Compensation Committee

Our compensation committee consists of Mr. JP Gan, Mr. Ted Lai and Mr. George Kuan. Mr. Gan, Mr. Tai and Mr. Kuan satisfy the "independence" requirements of Section 303A of the Corporate Governance Rule of the New York Stock Exchange. Mr. Gan is the chairman of our compensation committee. Our compensation committee assists the board of directors in reviewing and approving the compensation structure of our directors and executive officers, including all forms of compensation to be provided to our directors and executive officers. Our chief executive officer may

not be present at any committee meeting during which his compensation is deliberated. The compensation committee is responsible for, among other things:

- reviewing and recommending to the board with respect to the total compensation package for our four most senior executives;
- approving and overseeing the total compensation package for our executives other than the four most senior executives;
- reviewing and making recommendations to the board of directors with respect to the compensation of our directors;
- reviewing periodically and approving any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pension and welfare benefit plans; and
- retaining or obtaining the advice of a compensation consultant, legal counsel or other adviser in the compensation committee's sole discretion,

Corporate Governance and Nominating Committee

Our corporate governance and nominating committee consists of Mr. Changtian Wang, Mr. JP Gan and Mr. Shengwen Rong. Mr. Wang, Mr. Gan and Mr. Rong satisfy the "independence" requirements of Section 303A of the Corporate Governance Rule of the New York Stock Exchange. Mr. Wang is the chairman of our corporate governance and nominating committee. The corporate governance and nominating committee assists our board of directors in identifying individuals qualified to become our directors and in determining the composition of the board and its committees. The corporate governance and nominating committee is responsible for, among other things:

- identifying and recommending nominees for election or re-election to our board of directors, or for appointment to fill any vacancy;
- reviewing annually with our board of directors its current composition in light of the characteristics of independence, age, skills, experience and availability of service to us;
- identifying and recommending to our board the directors to serve as members of committees;
- advising the board periodically with respect to significant developments in the law and practice of corporate governance as well as our compliance with applicable laws and regulations, and making recommendations to our board of directors on all matters of corporate governance and on any corrective action to be taken; and
- monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

Duties of Directors

Under Cayman Islands law, our directors owe to us fiduciary duties, including a duty of loyalty, a duty to act honestly, and a duty to act in what they consider in good faith and to be in our best interests. Our directors also owe to our company a duty to act with skill and care. It was previously considered that a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. However, English and commonwealth courts have moved towards an objective standard with regard to the required skill and care and these authorities are likely to be followed in the Cayman Islands. In fulfilling their duty of care to us, our directors must ensure compliance with our memorandum and articles of association as may be amended from time to time. Our company has a right to seek damages against any director who breaches a duty owed to us.

Terms of Directors and Officers

Pursuant to our memorandum and articles of association, our board of directors are designated into three classes, namely Class A directors, Class B directors and Class C directors, who shall retire from office and be eligible for re-election at the first, second and third annual general meeting after our initial public offering, respectively. Mr. Roc Yunpeng Cheng, Mr. Ted Lai and Mr. Changtian Wang have been designated as Class A directors. Mr. Crow Zhen Wei, Mr. Shengwen Rong and Mr. George Kuan have been designated as Class B directors. Mr. Jason Liqing Zeng, Mr. Benson Haibing Wang and Mr. JP Gan have been designated as Class C directors. At each subsequent annual general meeting after the third annual general meeting after our initial offering, one-third of our directors for the time being (or, if their number is not a multiple of three (3), the number nearest to but not greater than one-third) shall retire from office by rotation, and each such retiring director shall be eligible for re-election. Every director shall be subject to retirement by rotation at least once every three years. A director may be removed from office at any time by an ordinary resolution of our shareholders. In addition, the office of a director shall be vacated if the director (i) dies, becomes bankrupt or makes any arrangement or composition with his creditors, (ii) is found to be or becomes of unsound mind, (iii) resigns his office by notice in writing to our company, (iv) without special leave of absence from our board of directors, is absent from three consecutive meetings of the board and the board resolves that his office be vacated, or (v) if he is otherwise removed from office pursuant to our memorandum and articles of association or the Companies Law or other laws of the Cayman Islands.

Officers are appointed by and serve at the discretion of our board of directors.

Employment Agreements

We have entered into employment agreements with each of our executive officers. Under these agreements, each of our executive officers is employed for a three-year period or five-year period. We may terminate an executive officer's employment for cause, at any time, without notice or remuneration, for certain acts of the officer, including but not limited to serious or persistent breach or non-observance of the employment terms or a conviction of a criminal offence. An executive officer may terminate his/her employment at any time with one-month prior written notice. Furthermore, we may terminate the employment at any time without cause upon advance written notice and certain amount of compensation payment.

Each executive officer has agreed to hold, both during and after the employment agreement expires or is earlier terminated, in strict confidence and not to use, except for our benefit, any confidential information of our company. In addition, the majority of our executive officers have agreed to be bound by non-competition restrictions which are set forth in his or her employment agreement.

Board Observer

We have granted Saban Media Ventures, an affiliate of Saban Capital Group, a non-voting observer seat on our board of directors for a period of eighteen months after the closing of the initial public offering, and our board of directors further renewed such period for another eighteen months to June 9, 2014. Mr. Sumeet Jaisinghani has been designated by Saban as our board observer since July 2011. Mr. Jaisinghani is the Managing Director of Saban Capital Group (Asia), responsible for Saban's principal investment activities in Asia, and is head of the firm's Singapore office. In addition, Mr. Jaisinghani is a member of the Board of Directors of Partner Communications and Celestial Tiger Entertainment (CTE), and played a key role in Saban's investments in Bezeq Telecommunications, Partner, Media Nusantara Citra, MNC Sky Vision, CTE and Taomee.

[Table of Contents](#)**D. Employees**

We had 640, 623 and 626 employees as of December 31, 2012, 2013 and 2014, respectively. The following table sets forth the number of our employees categorized by areas of operations as of December 31, 2014:

Function	Number of Employees	Percentage of total
Online operations	91	14.5%
Offline operations	30	4.8%
Product development	386	61.7%
Sales and marketing	50	8.0%
General and administrative	69	11.0%
Total	626	100.0%

Our success depends on our ability to attract, retain and motivate qualified personnel. We believe we offer our employees competitive compensation packages, and we have generally been able to attract and retain qualified personnel and maintain a stable core management team. For a description of the employment agreement we signed with some members of our senior management, see "Item. 6. Directors, Senior Management and Employees—C. Board Practices—Employment Agreements."

Substantially all of our employees are based in the PRC. In accordance with PRC laws, we participate in employee benefit plans organized by municipal and provincial governments, including pension, work-related injury benefits, maternity insurance, medical insurance, unemployment benefit and housing fund plans. We are required under PRC laws to make contributions to the employee benefit plans at specified percentages of the salaries, bonuses and certain allowances of our employees, up to a maximum amount specified by the local government. A labor union of our employees was established to represent employees with respect to labor disputes and other employee matters. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes or disputes with the labor department of the PRC government since our inception.

E. Share Ownership

The following table sets forth information with respect to the beneficial ownership of our ordinary shares as of the date of this annual report, by:

- each of our directors and executive officers; and
- each person known to us to own beneficially more than 5% of our ordinary shares.

The total number of ordinary shares outstanding as of December 31, 2014 is 757,684,760, including ordinary shares represented by ADSs. As of December 31, 2014, we had 6,596,410 ordinary shares which were legally issued according to our share incentive plans, but were not deemed issued or outstanding from accounting perspective.

For each person and group included in the following table, percentage of beneficial ownership is calculated by dividing the number of shares beneficially owned by such person or group (which includes ordinary shares underlying share options held by such person or group that are exercisable within 60 days after the date of this annual report) by the sum of (i) the number of ordinary shares outstanding as of the date of this annual report, (ii) the number of ordinary shares underlying share options held by such person or group that are exercisable within 60 days after the date of this annual report, and (iii) the number of non-vested equity shares held by such person or group that will vest within 60 days after the date of this annual report.

[Table of Contents](#)

Except as otherwise noted, the business address of each person listed in the table is c/o Taomee Holdings Limited, 16/F, Building No. A-2, No. 1528 Gumei Road, Xuhui District, Shanghai 200233, People's Republic of China.

	Ordinary Shares Beneficially Owned	
	Number	%
Directors and Executive Officers:		
Jason Liqing Zeng(1)	167,568,540	22.1
Benson Haibing Wang(2)	87,548,012	11.5
Roc Yunpeng Cheng(3)	74,478,613	9.8
Crow Zhen Wei(4)	69,211,233	9.1
JP Gan(5)	120,987,660	16.0
Shengwen Rong(6)	*	*
Ted Lai(7)	*	*
Changtian Wang(8)	*	*
George Kuan(9)	*	*
Sam Lawn(10)	*	*
All Directors and Executive Officers as a Group(11)	521,864,878	68.8
Principal Shareholders:		
Frontier Technology Holdings Limited(12)	135,000,000	17.8
Speednext Industrial Limited (13)	32,568,540	4.3
Qiming Venture Partners II, L.P.(14)	109,231,900	14.4
Qiming Venture Partners II-C, L.P.(15)	9,566,340	1.3
Qiming Managing Directors Fund II, L.P.(16)	1,589,420	0.2
Joy Union Holdings Limited(17)	86,392,592	11.4
Universys Holdings Ltd.(18)	69,211,233	9.1
Charming China Limited(19)	71,392,593	9.4

* Less than 1%

- (1) Includes 6,750,000 ADSs representing 135,000,000 ordinary shares held by Frontier Technology Holdings Limited and 1,628,427 ADSs representing 32,568,540 ordinary shares held by Speednext Industrial Limited, a British Virgin Islands company wholly-owned by Mr. Zeng.
- (2) Represents 12 ordinary shares and 86,392,580 ordinary shares represented by 4,319,629 ADSs held by Joy Union Holdings Limited, a British Virgin Islands company wholly owned by Mr. Wang, and 155,420 ordinary shares directly held by Mr. Wang and 1,000,000 ordinary shares issuable upon exercise of options within 60 days of the date of this annual report held by Mr. Wang.
- (3) Represents 13 ordinary shares and 71,392,580 ordinary shares represented by 3,569,629 ADSs held by Charming China Limited, a British Virgin Islands company wholly owned by Mr. Cheng, and 155,420 ordinary shares directly held by Mr. Cheng and 2,930,600 ordinary shares issuable upon exercise of options within 60 days of the date of this annual report held by Mr. Cheng.
- (4) Represents 13 ordinary shares and 69,211,220 ordinary shares represented by 3,460,561 ADSs held by Universys Holdings Ltd., a British Virgin Islands company wholly owned by Mr. Wei.
- (5) Represents 109,231,900 ordinary shares held by Qiming Venture Partners II, L.P., 9,566,340 ordinary shares held by Qiming Venture Partners II-C, L.P., 1,589,420 ordinary shares held by Qiming Managing Directors Fund II, L.P., and ordinary shares issuable upon exercise of

options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by Mr. Gan. Mr. Gan is a managing director of and participates on the investment committee of Qiming Corporate GP II, Ltd. The business address of Mr. Gan is c/o Qiming Corporate GP II, Ltd., 11400 SE Sixth Street, Suite 100 Bellevue, Washington 98004, USA.

- (6) Represents ordinary shares issuable upon exercise of options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by Mr. Rong.
- (7) Represents ordinary shares issuable upon exercise of options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by Mr. Lai.
- (8) Represents ordinary shares issuable upon exercise of options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by Mr. Wang.
- (9) Represents ordinary shares issuable upon exercise of options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by Mr. Kuan.
- (10) Represents ordinary shares issuable upon exercise of options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by Mr. Lawn.
- (11) Represents ordinary shares held by all of our directors and executive officers as a group and ordinary shares issuable upon exercise of options and the non-vested equity shares that will vest within 60 days of the date of this annual report held by all of our directors and executive officers as a group.
- (12) Represents 6,750,000 ADSs representing 135,000,000 ordinary shares held by Frontier Technology Holdings Limited, a British Virgin Islands company wholly owned by Mr. Jason Liqing Zeng. The registered address for Frontier Technology Holdings Limited is Trinity Chambers, P.O. Box 4301, Road Town, Tortola, British Virgin Islands.
- (13) Represents 1,628,427 ADSs representing 32,568,540 ordinary shares held by Speednext Industrial Limited, a British Virgin Islands company wholly owned by Mr. Jason Liqing Zeng. The registered address of Speednext Industrial Limited is Offshore Incorporations Limited, P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands.
- (14) Represents 109,231,900 ordinary shares held by Qiming Venture Partners II, L.P. The general partner of both Qiming Venture Partners II, L.P. and Qiming Venture Partners II-C, L.P. is Qiming GP II, L.P., a Cayman Islands exempted limited partnership, whose general partner is Qiming Corporate GP II, Ltd., a Cayman Islands limited company which is also the general partner of Qiming Managing Directors Fund II, L.P. Voting and investment power of the shares held by the Qiming Funds is exercised by the investment committee of Qiming Corporate GP II, Ltd., which consists of Duane Kuang, Gary Rieschel, JP Gan and Robert Headley. Each of Duane Kuang, Gary Rieschel, JP Gan and Robert Headley disclaims beneficial ownership of the ordinary shares, except to the extent of such person's own pecuniary interest therein. The business address of each of the Qiming Funds, Qiming GP II, L.P. and Qiming Corporate GP II, Ltd. is 11400 SE Sixth Street, Suite 100 Bellevue, Washington 98004, USA.
- (15) Represents 9,566,340 ordinary shares held by Qiming Venture Partners II-C, L.P. See also note (14) to this table above.
- (16) Represents 1,589,420 ordinary shares held by Qiming Managing Directors Fund II, L.P. See also note (14) to this table above.
- (17) Represents 12 ordinary shares and 86,392,580 ordinary shares represented by 4,319,629 ADSs held by Joy Union Holdings Limited, a British Virgin Islands company wholly owned by

Mr. Benson Haibing Wang. The registered address for Joy Union Holdings Limited is Trinity Chambers, P.O. Box 4301, Road Town, Tortola, British Virgin Islands.

- (18) Represents 13 ordinary shares and 74,492,580 ordinary shares represented by 3,724,629 ADSs held by Universys Holdings Ltd., a British Virgin Islands company wholly owned by Mr. Crow Zhen Wei. The registered address for Universys Holdings Ltd. is Trinity Chambers, P.O. Box 4301, Road Town, Tortola, British Virgin Islands.
- (19) Represents 13 ordinary shares and 71,392,580 ordinary shares represented by 3,569,629 ADSs held by Charming China Limited, a British Virgin Islands company wholly owned by Mr. Roc Yunpeng Cheng. The registered address for Charming China Limited is Trinity Chambers, P.O. Box 4301, Road Town, Tortola, British Virgin Islands.

As of the date of this annual report, to our knowledge, 634,784,722 ordinary shares were held by two record holders in the United States, including JPMorgan Chase Bank N.A., the depository of our ADS program. The number of beneficial owners of our ADSs in the United States is likely to be much larger than the number of record holders of our ordinary shares in the United States. None of our existing shareholders has different voting rights from other shareholders. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

See "Item 6. Directors, Senior Management and Employees—E. Share Ownership."

B. Related Party Transactions

Contractual Arrangements

PRC laws currently restrict foreign ownership of online virtual world businesses. To comply with PRC laws, we conduct our online virtual world business through contractual arrangements with Shanghai Taomee and its shareholders. See "Item 4. Information on the Company—C. Organizational Structure" for a description of these contractual arrangements.

As part of our contractual arrangements with Shanghai Taomee and certain of its shareholders, Mr. Jason Liqing Zeng, our chairman, Mr. Benson Haibing Wang, our co-founder, director and chief executive officer, Mr. Crow Zhen Wei, our co-founder, director and chief technology officer, Mr. Roc Yunpeng Cheng, our co-founder, director and president and Mr. Bin Wang, Shanghai Shengran entered into a loan agreement with these five persons, under which Shanghai Shengran lent an interest-free loan of RMB2.5 million (US\$0.4 million) to these persons, solely for their respective contributions to the increased capital of Shanghai Taomee, our significant VIE.

Transactions with Certain Officers, Shareholders and Affiliates and Key Management Personnel

In June 2009, and May 2012, Shanghai Taomee entered into two agreements with ParaEngine to co-develop 3-D online virtual worlds for children. For the years ended December 31, 2012, 2013 and 2014, we paid US\$203,444, US\$193,559 and US\$121,230 in royalty, and US\$200,000, nil and nil licensing fees to Shenzhen ParaEngine, respectively. As of December 31, 2014, we had approximately US\$4,700 royalty fee due to Shenzhen ParaEngine.

In June 2011, Shanghai Shengran entered into an agreement with Taiwan Taomee for the license to Taiwan Taomee of certain operating rights of an online game developed and owned by Shanghai Shengran. Shanghai Shengran also entered into agreement with Taiwan Taomee for the license of certain offline products which are derived from the online game images. In 2012, 2013 and 2014 Shanghai Shengran further licensed Taiwan Taomee additional two, three and one online games,

[Table of Contents](#)

respectively. In addition, Shanghai Shengran granted Taiwan Taomee an exclusive sublicense right to utilize a licensed brand to design and distribute licensed products, including mobile applications, animation, books, products) in Taiwan in 2014. For the years ended December 31, 2012, 2013 and 2014 revenues generated from Taiwan Taomee were US\$127,644, US\$767,267 and US\$442,902 for online licensing and US\$175,500, US\$130,808 and US\$99,536 for offline licensing. As of December 31, 2014, we had an amount due from Taiwan Taomee of US\$19,140, and an amount due to Taiwan Taomee of US\$298,146.

On February 25, 2011, we entered into an agreement to effectively sell a 10.5% equity interest in Elyn Corporation that had been indirectly held by a related party on our behalf. Of the 10.5% equity interest in Elyn Corporation, 9.14% was sold to Qiming Funds, which are our existing shareholders and 1.36% was sold to an investor, an independent third party who was not affiliated with us or the Series A shareholders, for a consideration of approximately US\$3.4 million and US\$0.5 million in cash, respectively, at the same price per share. In addition, the nominee shareholding agreement was terminated with the related party and we currently hold 29.5% equity in Elyn Corporation directly.

On August 12, 2011, our equity interest in Elyn Corporation was diluted from 29.5% to 28.8% as a result of Elyn Corporation's issuing shares to its employees.

In November 2011, Taiwan Taomee went through reorganization and contemporaneously issued new ordinary shares to existing shareholders and certain employees. As a result of such transactions, our equity interest in Taiwan Taomee was changed from 28.8% interest held through Elyn Corporation to a 27.6% effective interest which was held through (1) 29.50% in Elyn Corporation, which held 72.09% of Taiwan Taomee, and (2) 28.77% in Joy Children Technology Co., Ltd., or Joy Children, a shell company with no operations, which owned 21.86% of Taiwan Taomee after the reorganization. The change in equity interest reflected a dilution resulting from shares issued to Taiwan Taomee's employees, which were accounted for by Taiwan Taomee as stock compensation. In addition, we paid total consideration of US\$668,992 in cash for the newly issued shares of Taiwan Taomee through Joy Children, which was recorded as an increase in equity method investment.

In July 2012, our aggregated equity interest through Elyn and Joy Children in Taiwan Taomee was diluted from 27.6% to 27.1%, i.e. 29.50% in Elyn, which holds 70.88% of Taiwan Taomee, and 28.77% in Joy Children, which holds 21.49% of Taiwan Taomee. The dilution was mainly due to the issue of new ordinary shares by Taiwan Taomee from capital surplus and appropriations of 2011 earnings to certain existing shareholders and employees.

In June 2013, as part of a restructuring of Taiwan Taomee, our equity interest in Taiwan Taomee was held through Playgame, and Elyn was liquidated. Our aggregated equity interest in Taiwan Taomee was not changed. In September 2013, Playgame transferred 3% of Taiwan Taomee's shares to Taiwan Taomee's underwriters upon its initial public offering in Taiwan Emerging Stock Market. As a result, Playgame's equity interest in Taiwan Taomee was diluted from 70.88% to 67.87%, resulting in a gain from investment of approximately US\$287,790 recognized in the year 2013, reported within share of profit in equity method investees in the consolidated statements of operations.

Our equity in profit in 2012, 2013 and 2014 was US\$506,644, US\$500,388 and US\$27,041 of Elyn Corporation (or Playgame, as applicable) and US\$191,381, US\$96,869 and US\$9,347 of Joy Children, respectively, and was recognized as share of profit in equity investment in the consolidated statements of operations.

In November 2011, Shanghai Taomee entered into an agreement with Shenzhen Taole for the license to Shanghai Taomee of certain operating rights of an online game. For the years ended December 31, 2012, 2013 and 2014, Shanghai Taomee has paid \$8,969, \$6,067 and \$889 royalties, respectively. As of December 31, 2014, there was no royalty fee due to Shenzhen Taole.

[Table of Contents](#)

In July 2012, Shanghai Taomee entered into an operating agreement with Guangzhou Chuangyou Information Technology Co., Ltd., or Chuangyou, for the license to Shanghai Taomee of certain operating rights of an online game developed and owned by Chuangyou. For the years ended December 31, 2012, 2013 and 2014, Shanghai Taomee has paid nil, US\$9,787 and US\$10,329 royalties and US\$150,000, US\$50,000 and nil licensing fee to Chuangyou, respectively. As of December 31, 2014, Shanghai Taomee had had US\$10,651 as online royalty fee and US\$14,708 as offline licensing fee due to Chuangyou.

In November 2012, Shanghai Shengran provided a RMB480,000 (US\$76,366) interest-free loan to Chuangyou. Chuangyou paid off the loan in December 2012.

In July, August and December 2013, Guangdong Taomee entered into four cooperation agreements at an aggregate consideration of RMB0.7 million (US\$0.1 million) with Shanghai Weiju, under which Guangdong Taomee outsourced Shanghai Weiju to develop a website for a toy, a homepage and a distributor management software for Guangdong Taomee. For the years ended December 31, 2013 and 2014, Guangdong Taomee has paid nil and RMB472,000 (US\$77,137) service fees to Shanghai Weiju, respectively. As of December 31, 2014, we had RMB188,000 (US\$30,724) as service fees due to Shanghai Weiju.

In the first quarter of 2013 and the second quarter of 2014, Shanghai Animation entered into agreements with Enlight Media to jointly invest in the production and distribution of the Group's feature film, *Seer III: Universal Force* and *Seer IV: Magic Stone Wars*, respectively. *Seer III* and *Seer IV* were released in July 2013 and 2014, respectively, in mainland China. Enlight Media was also entitled to share a certain percentage of film licensing revenues under the agreements. For the years ended December 31, 2013 and 2014, film investment from Enlight Media were RMB3.9 million (US\$639,669) and RMB4.0 million (US\$653,702) and revenues generated from Enlight Media were RMB13,299,454 (US\$2,169,865) and RMB11,746,083 (US\$1,919,608) as box office revenue sharing. As of December 31, 2014, we had an amount due from Enlight Media of RMB15,746,083 (US\$2,573,310) and an amount due to Enlight Media of RMB386,050 (US\$63,090).

Employment Agreement

See "Item 6. Directors, Senior Management and Employees—C. Board Practices—Employment Agreements."

Share Incentives

See "Item 6. Directors, Senior Management and Employees—B. Compensation of Directors and Executive Officers—Share Incentive Plan."

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

We have appended consolidated financial statements filed as part of this annual report.

Legal Proceedings

We are accused by Xi'an Jiayunshe Digital Entertainment Distribution Ltd. for Shanghai Taomee's unauthorized broadcast of four series of TV cartoons on v.61.com on December 31, 2014, and the

accused compensation amount was RMB200,000 (US\$32,2347) with all litigation expenses. We are still in the process of evidence exchanging.

Except the legal proceeding as foregoing, we are not currently a party to any material litigation or other legal proceeding and are not aware of any pending or threatened litigation or other legal proceeding that may have a material adverse impact on our business or operations.

Dividend Policy

Subject to our memorandum and articles of association and the laws of Cayman Islands, our board of directors has complete discretion over whether to pay dividends on our ordinary shares. Our shareholders may by ordinary resolution declare a dividend, but no dividend may exceed the amount recommended by our directors. If our board of directors decides to pay dividends on our ordinary shares, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that the board of directors may deem relevant.

We did not declare any dividend in 2012, 2013 and 2014.

On January 26, 2015, we declared a special one-time cash dividend of US\$0.0325 per ordinary share, or US\$0.65 per ADS, each representing 20 ordinary shares. The total amount of cash distributed for the special dividend was US\$24.6 million which has been paid in full by February 17, 2015.

We intend to retain most, if not all, of our available funds and any future earnings to operate and expand our business. If we pay any dividends, the depositary will pay our ADS holders the dividends it receives on our ordinary shares, after deducting its fees and expenses as provided in the deposit agreement. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

We are a holding company incorporated in the Cayman Islands. We rely principally on dividends from our subsidiary in China for our cash requirements, including any payment of dividends to our shareholders. Current PRC regulations permit our PRC subsidiary to pay dividends to us only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. In addition, each of our subsidiaries, VIEs and VIEs' subsidiaries in China is required to set aside a certain amount of its after-tax profits each year, if any, to fund certain statutory reserves. These reserves are not distributable as cash dividends. Furthermore, if our subsidiaries, VIEs and VIEs' subsidiaries in China incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us.

B. Significant Changes

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

We completed the initial public offering of 7,187,500 ADSs, each representing 20 ordinary shares of par value US\$0.00002 per share, on June 10, 2011. On June 8, 2011, we listed our ADSs on the NYSE under the ticker symbol "TAOM".

[Table of Contents](#)

The following table provides the high and low trading prices for our ADSs on the NYSE for the periods shown.

	Sales Price	
	High	Low
Annual Highs and Lows		
Fiscal Year ended December 31, 2011 (from June 8, 2011)	17.90	3.95
Fiscal Year ended December 31, 2012	6.50	3.15
Fiscal Year ended December 31, 2013	6.98	3.54
Fiscal Year ended December 31, 2014	8.90	2.90
Quarterly Highs and Lows		
First Quarter ended March 31, 2013	5.29	3.54
Second Quarter ended June 30, 2013	5.10	3.69
Third Quarter ended September 30, 2013	6.98	3.92
Fourth Quarter ended December 31, 2013	6.44	4.73
First Quarter ended March 31, 2014	8.90	5.06
Second Quarter ended June 30, 2014	6.28	4.30
Third Quarter ended September 30, 2014	5.53	4.15
Fourth Quarter ended December 31, 2014	4.72	2.90
First Quarter ended March 31, 2015		
Monthly Highs and Lows		
October 2014	4.72	3.97
November 2014	4.36	3.84
December 2014	4.14	2.90
January 2015	4.18	3.01
February 2015	4.19	3.20
March 2015	3.36	2.65
April 2015 (through April 13, 2015)	3.30	2.15

B. *Plan of Distribution*

Not applicable.

C. *Markets*

Our ADSs, each representing 20 ordinary shares, have been listed on the NYSE since June 8, 2011. Our ADSs are traded under the symbol "TAOM."

D. *Selling Shareholders*

Not applicable.

E. *Dilution*

Not applicable.

F. *Expenses of the Issue*

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We are a Cayman Islands company and our affairs are governed by our memorandum and articles of association, as amended and restated from time to time, and the Companies Law (2013 Revision) of the Cayman Islands, which is referred to as the Companies Law below, and the common law of the Cayman Islands. We incorporate by reference into this annual report the description of our third amended and restated memorandum and articles of association contained in our F-1 registration statement (File No. 333-174293) originally filed with the SEC on May 18, 2011.

C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in "Item 4. Information on the Company" or elsewhere in this annual report on Form 20-F.

D. Exchange Controls

See "Item 4. Information on the Company—B. Business Overview—Regulations Related to Our Business—Regulation related to Foreign Currency Exchange and Dividend Distribution."

E. Taxation

The following summary of the material Cayman Islands, PRC and United States federal income tax consequences of an investment in our ADSs or ordinary shares is based upon laws and relevant interpretations thereof in effect as of the date of this annual report, all of which are subject to change. This summary does not deal with all possible tax consequences relating to an investment in our ADSs or ordinary shares, such as the tax consequences under state, local and other tax laws.

Cayman Islands Taxation

According to Maples and Calder, our Cayman Islands counsel, the Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty or withholding tax applicable to us or to any holder of our ADSs and ordinary shares. There are no other taxes likely to be material to us levied by the Government of the Cayman Islands except for stamp duties which may be applicable on instruments executed in, or after execution brought within the jurisdiction of the Cayman Islands. No stamp duty is payable in the Cayman Islands on transfers of shares of Cayman Islands companies, except those which hold interests in land in the Cayman Islands. The Cayman Islands is not party to any double tax treaties which are applicable to payments made by or to our company. There are no exchange control regulations or currency restrictions in the Cayman Islands.

People's Republic of China Taxation

If the PRC tax authorities determine that our Cayman Islands holding company is a "resident enterprise" for PRC enterprise income tax purposes, a withholding tax of 10% for our non-PRC enterprise shareholders or potentially 20% for non-PRC individual shareholders may be imposed on dividends they receive from us and a 10% (20% in the case of non-PRC individual shareholders) income tax may be imposed on gains they recognize from transferring our shares or ADSs. See "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—We may be

classified as a "resident enterprise" for PRC enterprise income tax purposes, which could result in our global income becoming subject to 25% PRC enterprise income tax" and "Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—If we are classified as a "resident enterprise" for PRC enterprise income tax purposes, you may be subject to PRC withholding tax on dividends from us and to PRC income tax on gain realized on the transfer of our ADSs or ordinary shares."

United States Federal Income Taxation

The following discussion describes the material U.S. federal income tax consequences to U.S. Holders (as defined below) under current law of an investment in the ADSs or ordinary shares. This discussion applies only to U.S. Holders that hold the ADSs or ordinary shares as capital assets within the meaning of Section 1221 of the United States Internal Revenue Code of 1986, as amended (generally, property held for investment), and that have the U.S. dollar as their functional currency. The effects of other U.S. federal tax laws, such as estate and gift tax laws, and any applicable state, local or non-U.S. tax laws are not discussed. This discussion is based on the tax laws of the United States as of the date of this annual report and on U.S. Treasury regulations in effect or, in some cases, proposed, as of the date of this annual report, as well as judicial and administrative interpretations thereof available on or before such date. All of the foregoing authorities are subject to change, which change could apply retroactively and could affect the tax consequences described below. We have not sought and will not seek any rulings from the U.S. Internal Revenue Service regarding the matters discussed below. There can be no assurance the U.S. Internal Revenue Service or a court will not take a contrary position to that discussed below regarding the tax consequences of the ownership and disposition of the ADSs or ordinary shares.

The following discussion does not address all U.S. federal income tax consequences relevant to a U.S. Holder's particular circumstances, including the impact of the Medicare contribution tax on net investment income. In addition, it does not address consequences relevant to U.S. Holders subject to special rules, including, without limitation:

- banks, insurance companies and other financial institutions;
- regulated investment companies;
- real estate investment trusts;
- broker, dealers or traders in securities;
- "controlled foreign corporations," "passive foreign investment companies," and corporations that accumulate earnings to avoid U.S. federal income tax;
- U.S. expatriates and former citizens or long-term residents of the United States;
- tax-exempt organizations or governmental entities;
- persons subject to alternative minimum tax;
- persons holding ADSs or ordinary shares as part of a straddle, hedging, conversion or integrated transaction;
- persons that actually or constructively own 10% or more of the total combined voting power of all classes of our voting stock;
- persons deemed to sell ADSs or ordinary shares under the constructive sale provisions of the United States Internal Revenue Code of 1986, as amended;
- persons who acquired ADSs or ordinary shares pursuant to the exercise of any employee share option or otherwise as compensation; or

- partnerships or pass-through entities, or persons holding ADSs or ordinary shares through such entities.

INVESTORS ARE URGED TO CONSULT THEIR TAX ADVISORS REGARDING THE APPLICATION OF THE U.S. FEDERAL TAX RULES TO THEIR PARTICULAR CIRCUMSTANCES AS WELL AS THE STATE, LOCAL, NON-U.S. AND OTHER TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF ADSs OR ORDINARY SHARES.

For purposes of the discussion below of the U.S. federal income tax consequences to "U.S. Holders," you are a U.S. Holder if you are a beneficial owner of ADSs or ordinary shares and you are, for U.S. federal income tax purposes,

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States, any State thereof or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust that (1) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons for all substantial decisions or (2) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If you are a partner in a partnership (or other entity taxable as a partnership for U.S. federal income tax purposes) that holds ADSs or ordinary shares, your tax treatment will generally depend on your status and the activities of the partnership. If you are a partner in such a partnership, you should consult your tax advisor.

The discussion below assumes the representations contained in the deposit agreement are true and the obligations in the deposit agreement and any related agreement have been and will be complied with in accordance with their terms. If you own ADSs, you should be treated as the owner of the underlying ordinary shares represented by those ADSs for U.S. federal income tax purposes.

The U.S. Treasury has expressed concerns that intermediaries in the chain of ownership between the holder of a depositary share and the issuer of the security underlying the depositary share may be taking actions that are inconsistent with the beneficial ownership of the underlying security (which may include, for example, pre-releasing ADSs to persons that do not have the beneficial ownership of the securities underlying the ADSs). Accordingly, the creditability of any PRC taxes, or the availability of the reduced tax rate for any dividends received by certain non-corporate U.S. Holders, including individual U.S. Holders (discussed below), could be affected by actions taken by intermediaries in the chain of ownership between the holders of ADSs and our company if as a result of such actions the holders of ADSs are not properly treated as beneficial owners of underlying ordinary shares.

Passive Foreign Investment Company

Based on the market price of our ADSs and the composition of our income and assets, we believe we were a PFIC for U.S. federal income tax purposes for our taxable year ended December 31, 2014. A non-U.S. corporation will be a PFIC for U.S. federal income tax purposes for any taxable year if either:

- at least 75% of its gross income for such year is passive income; or
- at least 50% of the value of its assets (based on an average of the quarterly values of the assets) during such year is attributable to assets that produce passive income or are held for the production of passive income.

[Table of Contents](#)

For this purpose, passive income generally includes dividends, interest, royalties and rents (other than royalties and rents derived in the active conduct of a trade or business and not derived from a related person). In addition, we will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, at least 25% (by value) of the stock.

A separate determination must be made after the close of each taxable year as to whether we were a PFIC for that year. Because the value of our assets for purposes of the PFIC test will generally be determined, in part, by reference to the market price of our ADSs and ordinary shares, our PFIC status will depend in large part on the market price of the ADSs and ordinary shares, which may fluctuate significantly.

If we were treated as a PFIC for our taxable year ended December 31, 2014 and you held ADSs or ordinary shares during such year, we generally will continue to be treated as a PFIC with respect to you for all succeeding years during which you hold ADSs or ordinary shares, unless we cease to be a PFIC and you make a "deemed sale" election with respect to the ADSs or ordinary shares. If such election is made, you will be deemed to have sold ADSs or ordinary shares you hold at their fair market value on the last day of the last taxable year in which we were a PFIC and any gain from such deemed sale would be subject to the rules described in the following two paragraphs. After the deemed sale election, your ADSs or ordinary shares with respect to which the deemed sale election was made will not be treated as shares in a PFIC unless we subsequently become a PFIC.

For each taxable year we are treated as a PFIC with respect to you, you will be subject to special tax rules with respect to any "excess distribution" you receive and any gain you recognize from a sale or other disposition (including a pledge) of the ADSs or ordinary shares, unless you make a "mark-to-market" election as discussed below. Distributions you receive in a taxable year that are greater than 125% of the average annual distributions you received during the shorter of the three preceding taxable years or your holding period for the ADSs or ordinary shares will be treated as an excess distribution. Under these special tax rules:

- the excess distribution or recognized gain will be allocated ratably over your holding period for the ADSs or ordinary shares;
- the amount allocated to the current taxable year, and any taxable years in your holding period prior to the first taxable year in which we were a PFIC, will be treated as ordinary income; and
- the amount allocated to each other taxable year will be subject to the highest tax rate in effect for individuals or corporations, as applicable, for each such year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

The tax liability for amounts allocated to taxable years prior to the year of disposition or excess distribution cannot be offset by any net operating losses for such years, and gains (but not losses) realized on the sale or other disposition of the ADSs or ordinary shares cannot be treated as capital, even if you hold the ADSs or ordinary shares as capital assets.

If we are treated as a PFIC with respect to you for any taxable year, to the extent any of our subsidiaries are also PFICs or we make direct or indirect equity method investments in other entities that are PFICs, you may be deemed to own shares in such lower-tier PFICs that are directly or indirectly owned by us in that proportion which the value of the ADSs or ordinary shares you own bears to the value of all of our ADSs or ordinary shares, as applicable, and you may be subject to the adverse tax consequences described in the preceding two paragraphs with respect to the shares of such lower-tier PFICs that you are deemed to own. You should consult your tax advisors regarding the application of the PFIC rules to any of our subsidiaries.

[Table of Contents](#)

A U.S. Holder of "marketable stock" in a PFIC may make a mark-to-market election for such stock to elect out of the PFIC rules described above regarding excess distributions and recognized gains. For this purpose, "marketable stock" is stock that is regularly traded on a qualified exchange or other market, as defined in applicable U.S. Treasury regulations. Our ADSs, but not our ordinary shares, are listed on the New York Stock Exchange, which is a qualified exchange or other market for these purposes. Consequently, if the ADSs are listed on the New York Stock Exchange and are regularly traded, and you are a holder of ADSs, we expect the mark-to-market election would be available to you.

If you make a mark-to-market election for the ADSs, you will include in income for each year we are a PFIC an amount equal to the excess, if any, of the fair market value of the ADSs as of the close of your taxable year over your adjusted basis in such ADSs. You will be allowed an ordinary deduction for the excess, if any, of the adjusted basis of the ADSs over their fair market value as of the close of the taxable year. However, deductions will be allowable only to the extent of any net mark-to-market gains on the ADSs included in your income for prior taxable years. Amounts included in your income under a mark-to-market election, as well as gain on the actual sale or other disposition of the ADSs, will be treated as ordinary income. Ordinary loss treatment will also apply to the deductible portion of any mark-to-market loss on the ADSs, as well as to any loss realized on the actual sale or other disposition of the ADSs, to the extent the amount of such loss does not exceed the net mark-to-market gains previously included for such ADSs. Your basis in the ADSs will be adjusted to reflect any such income or loss amounts. If you make a mark-to-market election, any distributions we make would generally be subject to the rules discussed below under "Taxation of Dividends and Other Distributions on the ADSs or Ordinary Shares," except the lower tax rate applicable to qualified dividend income would not apply. Because a mark-to-market election cannot be made for equity interests in any lower-tier PFICs that we own, a U.S. Holder may continue to be subject to the PFIC rules with respect to its indirect interest in any investments held by us that are treated as an equity interest in a PFIC for U.S. federal income tax purposes. You should consult your tax advisors as to the availability and desirability of a mark-to-market election, as well as the impact of such election on interests in any lower-tier PFICs.

Alternatively, if a non-U.S. corporation is a PFIC, a holder of shares in that corporation may avoid taxation under the PFIC rules described above regarding excess distributions and recognized gains by making a "qualified electing fund" election to include in income its share of the corporation's income on a current basis. However, you may make a qualified electing fund election with respect to your ADSs or ordinary shares only if we agree to furnish you annually with certain tax information, and we currently do not intend to prepare or provide such information.

Unless otherwise provided by the U.S. Treasury, each U.S. Holder of a PFIC is required to file an annual report containing such information as the U.S. Treasury may require. Since we believe we were a PFIC for our taxable year ended December 31, 2014, you should consult your tax advisor regarding any reporting requirements that may apply to you.

You are strongly urged to consult your tax advisor regarding the application of the PFIC rules to your investment in the ADSs or ordinary shares.

Taxation of Dividends and Other Distributions on the ADSs or Ordinary Shares

Subject to the PFIC rules discussed above, the gross amount of any distributions we make to you with respect to the ADSs or ordinary shares (including the amount of any taxes withheld therefrom) generally will be includible in your gross income as dividend income on the date of receipt by the depository, in the case of ADSs, or on the date of receipt by you, in the case of ordinary shares, but only to the extent the distribution is paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Any such dividends will not be eligible for the

dividends-received deduction allowed to corporations in respect of certain dividends received from U.S. corporations. To the extent the amount of the distribution exceeds our current and accumulated earnings and profits (as determined under U.S. federal income tax principles), such excess amount will be treated first as a tax-free return of your tax basis in your ADSs or ordinary shares, and then, to the extent such excess amount exceeds your tax basis in your ADSs or ordinary shares, as capital gain. We currently do not and we do not intend to calculate our earnings and profits under U.S. federal income tax principles. Therefore, you should expect any distribution we make to you will be reported as a dividend even if such distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above.

With respect to certain non-corporate U.S. Holders, including individual U.S. Holders, any dividends may be taxed at the lower capital gains rates applicable to "qualified dividend income," provided (1) either (a) our ADSs or ordinary shares, as applicable, are readily tradable on an established securities market in the United States, or (b) we are eligible for the benefits of a qualifying income tax treaty with the United States that includes an exchange of information program, (2) we were neither a PFIC nor treated as such with respect to you for the taxable year in which the dividend was paid and the preceding taxable year (discussed below), and (3) certain holding period requirements are met. Under U.S. Internal Revenue Service authority, ADSs are considered for purposes of clause (1) above to be readily tradable on an established securities market in the United States if they are listed on the New York Stock Exchange, as our ADSs (but not our ordinary shares) are. Based on existing guidance, it is not entirely clear whether dividends you receive with respect to the ordinary shares may qualify as qualified dividend income because the ordinary shares are not themselves listed on a U.S. exchange. In addition, as discussed above in "—Passive Foreign Investment Company," we believe we were a PFIC for our taxable year ended December 31, 2014. If we are treated as a "resident enterprise" for PRC tax purposes under the PRC EIT Law, we may be eligible for the benefits of the income tax treaty between the United States and the PRC. You should consult your tax advisors regarding the availability of the lower tax rates applicable to qualified dividend income for any dividends we pay with respect to the ADSs or ordinary shares, as well as the effect of any change in applicable law after the date of this annual report.

Any dividends we pay with respect to the ADSs or ordinary shares will constitute foreign source income for foreign tax credit limitation purposes. If any such dividends are taxed as qualified dividend income (as discussed above), the amount of the dividend taken into account for purposes of calculating the foreign tax credit limitation will in general be limited to the gross amount of the dividend, multiplied by the reduced tax rate applicable to qualified dividend income and divided by the highest tax rate normally applicable to dividends. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, any dividends we pay with respect to the ADSs or ordinary shares will generally constitute "passive category income" but could, in the case of certain U.S. Holders, constitute "general category income."

If PRC withholding taxes apply to any dividends paid to you with respect to our ADSs or ordinary shares (see "Item 5. Operating and Financial Review and Prospects—A. Operating Results—Taxation—China"), the amount of the dividend would include the withheld PRC taxes and, subject to certain conditions and limitations, such PRC withholding taxes would be treated as foreign taxes eligible for credit against your U.S. federal income tax liability. The rules relating to the determination of the foreign tax credit are complex, and you should consult your tax advisors regarding the availability of a foreign tax credit in your particular circumstances.

Taxation of Disposition of ADSs or Ordinary Shares

Subject to the PFIC rules discussed above, you will recognize taxable gain or loss on any sale, exchange or other taxable disposition of ADSs or ordinary shares equal to the difference between the amount realized for the ADSs or ordinary shares and your tax basis in the ADSs or ordinary shares.

[Table of Contents](#)

The gain or loss generally will be capital gain or loss. If you are a non-corporate U.S. Holder, including an individual U.S. Holder, that has held the ADSs or ordinary shares for more than one year, you may be eligible for reduced U.S. federal income tax rates. The deductibility of capital losses is subject to limitations. Any gain or loss you recognize on a disposition of ADSs or ordinary shares will generally be treated as U.S. source income or loss for foreign tax credit limitation purposes. However, if we are treated as a "resident enterprise" for PRC tax purposes, we may be eligible for the benefits of the income tax treaty between the United States and the PRC. In such event, if PRC tax were to be imposed on any gain from the disposition of the ADSs or ordinary shares (see "Item 5. Operating and Financial Review and Prospects—A. Operating Results—Taxation—China"), a U.S. Holder that is eligible for the benefits of the income tax treaty between the United States and the PRC may elect to treat the gain as PRC source income for foreign tax credit purposes, in which case, subject to certain conditions and limitations, such PRC tax would be eligible for credit against the holder's U.S. federal income tax liability. You should consult your tax advisors regarding the proper treatment of gain or loss in your particular circumstances, including the effects of any applicable income tax treaties.

Information Reporting and Backup Withholding

Any dividend payments with respect to ADSs or ordinary shares and proceeds from the sale, exchange or other taxable disposition of ADSs or ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service and backup withholding, unless the U.S. Holder is an exempt recipient. Backup withholding will not apply, however, to a U.S. Holder that furnishes a correct taxpayer identification number and makes any other required certification on U.S. Internal Revenue Service Form W-9. U.S. Holders that are exempt from backup withholding may be required to complete U.S. Internal Revenue Service Form W-9 to avoid possible erroneous backup withholding. U.S. Holders should consult their tax advisors regarding the application of the information reporting and backup withholding rules.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against your U.S. federal income tax liability, and you may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the U.S. Internal Revenue Service and furnishing any required information in a timely manner.

Additional Reporting Requirements

Certain U.S. Holders who are individuals are required to report information relating to an interest in our ADSs or ordinary shares, subject to certain exceptions (including an exception for ADSs and ordinary shares held in accounts maintained by certain financial institutions). U.S. Holders should consult their tax advisors regarding the effect, if any, of these rules on their ownership and disposition of the ADSs or ordinary shares.

F. Dividends and Paying Agents

Not Applicable.

G. Statement by Experts

Not Applicable.

H. Documents on Display

We previously filed with the SEC our registration statement on Form F-1 (Registration Number 333-174293), as amended and prospectus under the Securities Act of 1933, with respect to our ordinary shares represented by the ADSs. We also filed with the SEC a related registration statement on Form F-6 (Registration Number 333-174441) with respect to the ADSs. We have also filed with the

[Table of Contents](#)

SEC our registration statements on Form S-8 (Registration Number 333-176920 and 333-183651) with respect to our securities to be issued under our 2009 Stock Option Plan, 2010 Share Incentive Plan and 2012 Share Incentive Plan.

We are subject to periodic reporting and other informational requirements of the Exchange Act as applicable to foreign private issuers. Accordingly, we are required to file reports, including annual reports on Form 20-F, and other information with the SEC. All documents filed by us with the SEC can be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. You can request copies of these documents, upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. The SEC also maintains a web site at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system.

As a foreign private issuer, we are exempt from the rules of the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and our executive officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements with the SEC as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act.

We intend to furnish JPMorgan Chase Bank, N.A., the depositary of our ADSs, with all notices of shareholders' meeting and other reports and communications that are made generally available to our shareholders. The depositary will make such notices, reports and communications available to holders of ADSs and, upon our written request, will mail to all record holders of ADSs the information contained in any notice of a shareholders' meeting received by the depositary from us.

In accordance with NYSE Rules 203.01, we will post this annual report on Form 20-F on our website at <http://ir.taomee.com/>. In addition, we will provide hard copies of our annual report free of charge to shareholders and ADS holders upon request.

I. *Subsidiary Information*

For a listing of our subsidiaries, see "Item 4—Information on the Company—C. Organizational Structure," as well as Exhibit 8.1 filed herewith.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

Our revenues and purchases are generally denominated in Renminbi. Our assets and liabilities are also denominated in Renminbi, except for cash held in other currencies, which included approximately US\$13.7 million as of December 31, 2014. As a result, fluctuations in the exchange rates between the U.S. dollar and Renminbi will affect our results of operations and financial condition. Such fluctuations will also affect us with respect to the translation of the net proceeds that we will receive from the initial public offering into Renminbi. The Renminbi's exchange rate with the U.S. dollar is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under this policy, the Renminbi was permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. For almost two years after reaching a high against the U.S. dollar in July 2008, the Renminbi traded within a narrow band against the U.S. dollar. As a consequence, the Renminbi fluctuated sharply since July 2008 against other freely traded currencies, in tandem with the U.S. dollar. In June 2010, the PRC government announced that it would increase the Renminbi exchange rate flexibility and since that time the Renminbi has gradually

appreciated against the U.S. dollar. However, it remains unclear how this flexibility might be implemented. There remains significant international pressure on the PRC government to adopt a more flexible currency policy, which could result in greater fluctuation of the Renminbi against the U.S. dollar.

To the extent that we need to convert U.S. dollars that we have on hand or receive from future financing activities into the Renminbi for our operations or other uses within the PRC, appreciation of the Renminbi against the U.S. dollar would have an adverse effect on the Renminbi amount we would receive from the conversion. On the other hand, a decline in the value of the Renminbi against the U.S. dollar could reduce the U.S. dollar equivalent amounts of our financial results, the value of your investment in our company and the dividends we may pay in the future, if any, all of which may have a material adverse effect on the prices of ADSs. As of December 31, 2014, we had U.S. dollar-denominated cash balances of US\$13.7 million. Assuming we had converted the US\$13.7 million into the Renminbi at the exchange rate of US\$1.00 for RMB6.2046 as of December 31, 2014, this cash balance would have been RMB85.0 million. Assuming a 5% appreciation of the RMB against the U.S. dollar, this cash balance would have decreased to RMB81.0 million as of December 31, 2014.

Interest Rate Risk

Our exposure to interest rate risk primarily relates to finance income generated by excess cash invested in demand deposits with original maturities of three months or less. We have not used any derivative financial instruments to manage our interest risk exposure. We have not been exposed, nor do we anticipate being exposed, to material risks due to changes in interest rates. However, our future finance income may be lower than expected due to changes in market interest rates.

Inflation Risk

In recent years, inflation has not had a material impact on our results of operations. According to the National Bureau of Statistics of China, the change in China's Consumer Price Index increased by 2.6% in 2012, 2.6% in 2013 and 2.0% in 2014. If inflation rises, it may materially and adversely affect our business.

Credit Risk

As of December 31, 2012, 2013 and 2014, substantially all of our cash and cash equivalents were held by financial institutions that we believe to have high credit quality. Therefore, we believe we are not exposed to unusual risks. We have not experienced any losses on deposits of cash and cash equivalents. Due to the limited availability of online payment systems in China and the limited access children have to online payment channels, users pay for our online business primarily through purchase of our prepaid cards, which distributed through a network of third-party distributors. Our top three distributors contributed to 9.8%, 8.9% and 7.2% in 2012, 7.4%, 6.4% and 6.0% in 2013 and 6.9%, 6.0% and 5.8% in 2014. We collect payment from distributors upon delivery of the prepaid cards, which helps reduce our accounts receivable related to our online business. Accounts receivables generated from offline business are primarily resulted from sharing of box-office revenues and licensing royalties. We made nil, US\$0.3 and US\$0.3 allowance for doubtful accounts in 2012, 2013 and 2014, respectively.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

A. *Debt Securities*

Not applicable.

[Table of Contents](#)

B. *Warrants and Rights*

Not applicable.

C. *Other Securities*

Not applicable.

D. *American Depositary Shares*

Fees and Charges Our ADS holders May Have to Pay

ADS holders will be required to pay the following service fees to the depository:

Service	Fee
• Issuance of ADSs	Up to US\$0.05 per ADS issued
• Cancellation of ADSs	Up to US\$0.05 per ADS canceled
• Distribution of cash dividends or other cash distributions	Up to US\$0.05 per ADS held
• Distribution of ADSs pursuant to stock dividends, free stock distributions or exercise of rights	Up to US\$0.05 per ADS held
• Distribution of securities other than ADSs or rights to purchase additional ADSs	Up to US\$0.05 per ADS held
• Depositary services	Up to US\$0.05 per ADS held on the applicable record date(s) established by the depository
• Transfer of ADSs	US\$1.50 per certificate presented for transfer

The depository may charge each person to whom ADSs are issued, including, without limitation, issuances against deposits of shares, issuances in respect of share distributions, rights and other distributions, issuances pursuant to a stock dividend or stock split declared by us or issuances pursuant to a merger, exchange of securities or any other transaction or event affecting the ADSs or deposited securities, and each person surrendering ADSs for withdrawal of deposited securities or whose ADRs are cancelled or reduced for any other reason, \$5.00 for each 100 ADSs (or any portion thereof) issued, delivered, reduced, cancelled or surrendered, as the case may be. The depository may sell (by public or private sale) sufficient securities and property received in respect of a share distribution, rights and/or other distribution prior to such deposit to pay such charge.

The following additional charges shall be incurred by the ADR holders, by any party depositing or withdrawing shares or by any party surrendering ADSs or to whom ADSs are issued (including, without limitation, issuance pursuant to a stock dividend or stock split declared by us or an exchange of stock regarding the ADRs or the deposited securities or a distribution of ADSs), whichever is applicable:

- a fee of up to US\$1.50 per ADR or ADRs for transfers of certificated or direct registration ADRs;
- a fee of up to US\$0.05 per ADS for any cash distribution made pursuant to the deposit agreement;
- a fee of up to US\$0.05 per ADS per calendar year (or portion thereof) for services performed by the depository in administering the ADRs (which fee may be charged on a periodic basis during each calendar year and shall be assessed against holders of ADRs as of the record date or record dates set by the depository during each calendar year and shall be payable in the manner described in the next succeeding provision);

[Table of Contents](#)

- reimbursement of such fees, charges and expenses as are incurred by the depositary and/or any of the depositary's agents (including, without limitation, the custodian and expenses incurred on behalf of holders in connection with compliance with foreign exchange control regulations or any law or regulation relating to foreign investment) in connection with the servicing of the shares or other deposited securities, the delivery of deposited securities or otherwise in connection with the depositary's or its custodian's compliance with applicable law, rule or regulation (which charge shall be assessed on a proportionate basis against holders as of the record date or dates set by the depositary and shall be payable at the sole discretion of the depositary by billing such holders or by deducting such charge from one or more cash dividends or other cash distributions);
- a fee for the distribution of securities (or the sale of securities in connection with a distribution), such fee being in an amount equal to the fee for the execution and delivery of ADSs which would have been charged as a result of the deposit of such securities (treating all such securities as if they were shares) but which securities or the net cash proceeds from the sale thereof are instead distributed by the depositary to those holders entitled thereto;
- stock transfer or other taxes and other governmental charges;
- cable, telex and facsimile transmission and delivery charges incurred at your request in connection with the deposit or delivery of shares;
- transfer or registration fees for the registration of transfer of deposited securities on any applicable register in connection with the deposit or withdrawal of deposited securities; and
- expenses of the depositary in connection with the conversion of foreign currency into U.S. dollars.

We will pay all other charges and expenses of the depositary and any agent of the depositary (except the custodian) pursuant to agreements from time to time between us and the depositary. The charges described above may be amended from time to time by agreement between us and the depositary.

Our depositary has agreed to reimburse us for certain expenses we incur that are related to establishment and maintenance of the ADR program, including investor relations expenses and exchange application and listing fees. Neither the depositary nor we can determine the exact amount to be made available to us because (i) the number of ADSs that will be issued and outstanding, (ii) the level of fees to be charged to holders of ADSs and (iii) our reimbursable expenses related to the ADR program are not known at this time. The depositary collects its fees for issuance and cancellation of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions, or by directly billing investors, or by charging the book-entry system accounts of participants acting for them. The depositary will generally set off the amounts owing from distributions made to holders of ADSs. If, however, no distribution exists and payment owing is not timely received by the depositary, the depositary may refuse to provide any further services to holders that have not paid those fees and expenses owing until such fees and expenses have been paid.

At the discretion of the depositary, all fees and charges owing under the deposit agreement are due in advance and/or when declared owing by the depositary.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not Applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

A.—D. Material Modifications to the Rights of Security Holders

None. See "Item 10. Additional Information" for a description of the rights of securities holders, which remain unchanged.

E. Use of Proceeds

The following "Use of Proceeds" information relates to our registration statement on Form F-1 (file No. 333-174293) filed with the Securities and Exchange Commission on May 18, 2011 for our initial public offering of 7,187,500 ADSs, representing 143,750,000 ordinary shares, and the underwriters' exercise of their option to purchase an additional 525,224 ADSs, representing 10,504,480 ordinary shares, which registration statement was declared effective by the Securities and Exchange Commission on June 10, 2011.

We received net proceeds from the initial public offering (including over-allotment) of approximately US\$62.2 million after deducting the underwriting discounts and commissions and the estimated offering expenses payable by us. As of December 31, 2014, the proceeds were used as follows:

(i) US\$0.6 million were used to subscribe for the newly issued shares of Taiwan Taomee through Joy Children in the fourth quarter of 2011; (ii) US\$6.2 million were used to acquire 8.02% equity interest in Gamespedia in second half of 2012; (iii) US\$5.3 million were used to pay increased legal, accounting and other operational expenses and costs we incurred as a public company; (iv) US\$6.4 million were used to pay a cash dividend declared in November 2010 to our shareholders in July 2011 and August 2011; (v) US\$1.4 million were used to acquire a minority equity interest in Voozclub in January 2013; (vi) US\$3.0 million were used to invest in a short-term money market investment in the second quarter of 2013; (vii) US\$2.0 million were used to acquire a minority equity interest in a Beijing-based pre-school education service provider in September 2013, (viii) US\$0.2 million were used to acquire a minority equity interest in a New York City company that develops mobile applications, animation and products for pre-school children in December 2013; (ix) US\$14.7 million were used to repurchase our ADSs from the open market during the period from December 2011 to December 2014 a total of 2,940,370 ADSs under our share repurchase program approved by the Board in November 2011 and extended in September 2012 and November 2014 and a new share repurchase plan approved by the board on March 28, 2014; and (x) US\$9.7 million were used to increase register capital for Shanghai Shengran. We will continue to use the IPO proceeds primarily for the purposes described in the "Use of Proceeds" section of our Form F-1 in accordance with our business plans and on an as-needed basis.

Proceeds from our initial public offering that have yet to be applied have been invested in bank deposits. Credit Suisse Securities (USA) LLC and Deutsche Bank Securities Inc were the managing underwriters for our initial public offering.

ITEM 15. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, has performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined

in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report, as required by Rule 13a-15(b) under the Exchange Act.

Based upon that evaluation, our chief executive officer and chief financial officer have concluded that, as of December 31, 2014, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with generally accepted accounting principles, and includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that a company's receipts and expenditures are being made only in accordance with authorizations of a company's management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on the consolidated financial statements.

Due to its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation, and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

As required by Section 404 of the Sarbanes-Oxley Act and related rules as promulgated by the SEC, our management assessed the effectiveness of the internal control over financial reporting as of December 31, 2014 using criteria established in Internal Control—Integrated Framework issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, our management has concluded that the internal control over financial reporting was effective as of December 31, 2014.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. AUDIT COMMITTEE FINANCIAL EXPERT

Mr. Shengwen Rong qualifies as an "audit committee financial expert" as defined in Item 16A of Form 20-F. Mr. Rong satisfies the independence requirements under the standards set forth in

Section 303A of the Corporate Governance Rules of the New York Stock Exchange and Rule 10A-3 under the Securities Exchange Act of 1934, as amended.

ITEM 16B. CODE OF ETHICS

Our board of directors adopted a code of business conduct and ethics that applies to our directors, officers and employees. We have filed our code of business conduct and ethics as Exhibit 99.1 of our registration statement on Form F-1 (file No. 333-174293) filed with the Securities and Exchange Commission on May 18, 2011, and have filed the amended code of business conduct and ethics as Exhibit 11.1 of our annual report on Form 20-F (file No. 001-35190) filed with the Securities and Exchange Commission on April 18, 2012. We have posted a copy of our code of business conduct and ethics on our investor relations website at <http://ir.taomee.com/phoenix.zhtml?c=243417&p=irol-sec>. We hereby undertake to provide to any person without charge, upon a written request, a copy of our code of business conduct and ethics.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Deloitte Touche Tohmatsu Certified Public Accountants LLP our principal external auditors, for the periods indicated.

	<u>2013</u>	<u>2014</u>
	<u>(US\$ in thousands)</u>	
Audit fees(1)	680	480
Audit-related fees(2)	36	37
Tax fees(3)	30	15

- (1) "Audit fees" means the aggregate fees billed for professional services rendered in connection with the audit or review of our financial statements.
- (2) "Audit-related fees" represents aggregate fees billed for professional services rendered in connection with the assurance and related services.
- (3) "Tax fees" represents the aggregated fees billed for professional services rendered in connection with tax compliance, tax advice and tax planning.

The policy of our audit committee is to pre-approve all audit and non-audit services provided by Deloitte Touche Tohmatsu Certified Public Accountants LLP including audit services, audit-related services, tax services and other services as described above for the fiscal year ended December 31, 2014, other than those for de minimus services which are approved by our audit committee prior to the completion of the audit.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not Applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.

On November 28, 2011, we announced a share repurchase plan approved by our board of directors on November 22, 2011, or Share Repurchase Plan A, to repurchase our ADSs, through open market purchase or privately negotiated transactions, up to US\$10 million over a period of 12 months. On September 28, 2012 and November 26, 2013, respectively, our board of directors approved the extension of the Share Repurchase Plan A for another 12 months from November 23, 2012 to November 23, 2013, and from November 24, 2013 to November 23, 2014, respectively, to repurchase

[Table of Contents](#)

our ADSs up to the remaining balance of the US\$10 million. On March 28, 2014, we completed the Share Repurchase Plan A. On March 28, 2014, we announced a new share repurchase plan, or Share Repurchase Plan B, to repurchase up to US\$10 million worth of outstanding ADSs over a 12-month period. On March 21, 2015, we extended the Share Repurchase Plan B for an additional year from March 29, 2015 to March 28, 2016.

Under the two share repurchase programs, we repurchased a total of 58,807,400 ordinary shares, representing approximately 7.7% of our outstanding shares as of December 31, 2014, at an average price of \$5.0 per share. The table below is a summary of the ADSs repurchased by us in the fiscal year of 2014:

Period	Total Number of ADSs Purchased(1)	Average Price Paid Per ADS(2)	Total Number of ADSs Purchased as Part of Publicly Announced Plans	Approximate Dollar Value of ADSs that May Yet Be Purchased Under the Plans
Share Repurchase Plan A				
January 2, 2014 to January 31, 2014	616,360	US\$ 5.34	1,680,537	US\$ 2,336,301
February 3, 2014 to February 28, 2014	169,969	US\$ 6.38	1,850,506	US\$ 1,251,433
March 3, 2014 to March 31, 2014	204,483	US\$ 6.12	2,054,989	nil
Total	990,812	US\$ 5.68	2,054,989	nil
Share Repurchase Plan B				
March 3, 2014 to March 31, 2014	64,724	US\$ 5.98	64,724	US\$ 9,612,780
April 1, 2014 to April 30, 2014	427,504	US\$ 5.90	492,228	US\$ 7,089,988
May 1, 2014 to May 30, 2014	131,196	US\$ 5.06	623,424	US\$ 6,426,645
June 2, 2014 to June 26, 2014	123,750	US\$ 4.96	747,174	US\$ 5,812,961
Oct 10, 2014 to Oct 31, 2014	24,053	US\$ 4.11	771,227	US\$ 5,714,157
Nov 5, 2014 to Nov 28, 2014	30,200	US\$ 4.07	801,427	US\$ 5,591,117
Dec 1, 2014 to Dec 31, 2014	83,954	US\$ 3.43	885,381	US\$ 5,303,523
Total	1,876,193	US\$ 5.50	885,381	US\$ 5,303,523

(1) All the ADSs were purchased in the open market.

(2) Each ADS represents 20 ordinary share. Average price includes service charge and commission occurred during the repurchase.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not Applicable.

ITEM 16G. CORPORATE GOVERNANCE

We are incorporated in the Cayman Islands and our corporate governance practices are governed by applicable Cayman Islands law. As a foreign private issuer with shares listed on the NYSE, we are subject to corporate governance requirements imposed by the NYSE. Under Section 303A of the NYSE's Listed Company Manual, NYSE listed non-US companies may, in general, follow their home country corporate governance practices in lieu of some of the NYSE corporate governance requirements. We are committed to a high standard of corporate governance. We believe that there are no significant differences between our corporate governance practices and those of U.S. domestic companies under the listing standards of the New York Stock Exchange.

ITEM 16H. MINE SAFETY DISCLOSURE

Not Applicable.

PART III**ITEM 17. FINANCIAL STATEMENTS**

We have elected to provide financial statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

The consolidate financial statements of Taomee Holdings Limited and its subsidiaries are included at the end of this annual report.

ITEM 19. EXHIBITS

<u>Exhibit Number</u>	<u>Description of Document</u>
1.1	Form of Third Amended and Restated Memorandum and Articles of Association of the Registrant, which became effective upon the completion of the initial public offering. (incorporated by reference to Exhibit 3.2 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
2.1	Registrant's Specimen American Depositary Receipt (incorporated by reference to Exhibit 99.A of our registration statement on Form F-6 (File No. 333-174441) filed with the Commission on May 24, 2011)
2.2	Registrant's Specimen Certificate for Ordinary Shares (incorporated by reference to Exhibit 4.2 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 31, 2011)
2.3	Form of Deposit Agreement among the Registrant, the depositary and holder of the American Depositary Receipts (incorporated by reference to Exhibit 99.A of our registration statement on Form F-6 (File No. 333-174441) filed with the Commission on May 24, 2011)
4.1	Shareholder's Agreement, dated as of May 6, 2009, among the Registrant, the then shareholders of the Registrant and certain other parties listed thereunder. (incorporated by reference to Exhibit 4.4 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.2	2009 Stock Option Plan (incorporated by reference to Exhibit 10.1 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.3	2010 Share Incentive Plan (incorporated by reference to Exhibit 10.2 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.4	2012 Share Incentive Plan (incorporated by reference to Exhibit 10.1 of our registration statement on Form S-8 (File No. 333-183651), filed with the Commission on August 31, 2012)
4.5	Form of Indemnification Agreement with the Registrant's directors and officers (incorporated by reference to Exhibit 10.3 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.6†	Form of Employment Agreements with the Registrant's senior executives.(incorporated by reference to Exhibit 10.4 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011 and May 24, 2011)

[Table of Contents](#)

Exhibit Number	Description of Document
4.7	English Translation of Loan Agreement, dated as of June 12, 2009, among Mr. Jason Liqing Zeng, Mr. Bin Wang, Mr. Benson Haibing Wang, Mr. Roc Yunpeng Cheng, Mr. Crow Zhen Wei and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 10.5 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.8	English Translation of Proxy Agreement, dated as of December 31, 2009, among Mr. Jason Liqing Zeng, Mr. Bin Wang, Mr. Benson Haibing Wang, Mr. Roc Yunpeng Cheng, Mr. Crow Zhen Wei, Mr. Yuliang Feng, Shanghai Taomee Network Technology Co., Ltd. and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 10.6 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.9	English Translation of Option Agreement, dated as of December 31, 2009, among Mr. Jason Liqing Zeng, Mr. Bin Wang, Mr. Benson Haibing Wang, Mr. Roc Yunpeng Cheng, Mr. Crow Zhen Wei, Mr. Yuliang Feng and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 10.7 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.10	English Translation of Business Operation Agreement, dated as of December 31, 2009, among Mr. Jason Liqing Zeng, Mr. Bin Wang, Mr. Benson Haibing Wang, Mr. Roc Yunpeng Cheng, Mr. Crow Zhen Wei, Mr. Yuliang Feng, Shanghai Taomee Network Technology Co., Ltd. and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 10.8 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.11	English Translation of Commercial Cooperation Agreement between Shanghai Taomee Network Technology Co., Ltd. and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 10.9 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.12	English Translation of Equity Interest Pledge Agreement, dated as of March 17, 2010 among Mr. Jason Liqing Zeng, Mr. Bin Wang, Mr. Benson Haibing Wang, Mr. Roc Yunpeng Cheng, Mr. Crow Zhen Wei, Mr. Yuliang Feng, Shanghai Taomee Network Technology Co., Ltd. and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 10.10 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.13	Form of Director Agreement with independent directors of the Registrant (incorporated by reference to Exhibit 10.20 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.14	Registration Rights Addendum, dated as of May 4, 2011, between Taomee Holdings Limited and Saban Media Ventures LLC. (incorporated by reference to Exhibit 10.21 of our registration statement on Form F-1 (File No. 333-174293), as amended, initially filed with the Commission on May 18, 2011)
4.15	English Translation of Building Lease Contract, undated, between M&G Chenguang Holding Group Co., Ltd. and Shanghai Taomee Network Technology Co., Ltd. (incorporated by reference to Exhibit 4.17 of our annual report on Form 20-F (File No. 001-35190), filed with the Commission on April 17, 2013)

[Table of Contents](#)

Exhibit Number	Description of Document
4.16	English Translation of Building Lease Contract, undated, between M&G Chenguang Holding Group Co., Ltd. and Shanghai Shengran Information Technology Co., Ltd. (incorporated by reference to Exhibit 4.18 of our annual report on Form 20-F (File No. 001-35190), filed with the Commission on April 17, 2013)
4.17*	English Translation of Termination of Building Lease Contract, undated, between M&G Chenguang Holding Group Co., Ltd. and Shanghai Taomee Animation Co., Ltd.
4.18*	English Translation of Termination of Building Lease Contract, undated, between M&G Chenguang Holding Group Co., Ltd. and Shanghai Shengran Information Technology Co., Ltd.
4.19*	English Translation of Building Lease Contract, undated, between M&G Chenguang Holding Group Co., Ltd. and Shanghai Xinsheng Information Technology Co., Ltd
4.20*	English Translation of Building Lease Contract, undated, between M&G Chenguang Holding Group Co., Ltd. and Shanghai Taomee Animation Co., Ltd
4.21	English Translation of Form Regional Agency Sales Cooperation Agreement of Internet Physical Cards between the Company and third-party distributor (incorporated by reference to Exhibit 4.21 of our annual report on Form 20-F (File No. 001-35190), filed with the Commission on April 17, 2013)
4.22	English Translation of Form Regional Agency Sales Cooperation Agreement of Internet Visual Cards between the Company and third-party distributor (incorporated by reference to Exhibit 4.22 of our annual report on Form 20-F (File No. 001-35190), filed with the Commission on April 17, 2013)
4.23*	Joint Investment Contract for Seer IV the Movie, undated, between Shanghai Taomee Animation Co., Ltd. and Beijing Enlight Pictures Co., Ltd.
4.24*	Contract on Transfer of Right to use State-owned Contruction Land in Shanghai Municipality (Hu Song Gui Tu (214) Chu Rang He Tong No.56 (1.0 version), dated December 19, 2014, between Songjiang Planning and Land Administration Bureau of Shanghai Municipality and Shanghai Taomee Software Development Co., Ltd
4.25*	Contract on Transfer of Right to use State-owned Contruction Land in Shanghai Municipality (Hu Song Gui Tu (214) Chu Rang He Tong No. 37 (1.0 version), dated December 3, 2014, between Songjiang Planning and Land Administration Bureau of Shanghai Municipality and Shanghai Taomee Software Development Co., Ltd
8.1*	Subsidiaries of the Registrant
11.1	Code of Business Conduct and Ethics of the Registrant, as amended (incorporated by reference to Exhibit 11.1 of our annual report on Form 20-F (File No. 001-35190), filed with the Commission on April 18, 2012)
12.1*	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2*	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1*	CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2*	CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1*	Consent of Allbright Law Offices
15.2*	Consent of Deloitte Touche Tohmatsu Certified Public Accountants LLP
15.3*	Consent of Maples and Calder
101.INS*	XBRL Instance Document.

[Table of Contents](#)

Exhibit Number	Description of Document
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

* Filed with this annual report on Form 20-F.

† Order for confidential treatment of portions of this document has been granted by the Commission pursuant to Rule 406 of the Securities Act.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing its annual report on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

TAOMEE HOLDINGS LIMITED

By: /s/ BENSON HAIBING WANG

Name: Benson Haibing Wang
Title: Chief Executive Officer

Date: April 15, 2015

TAOMEE HOLDINGS LIMITED
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

	<u>Page</u>
Report of independent registered public accounting firm	F-2
Consolidated balance sheets as of December 31, 2013 and 2014	F-3
Consolidated statements of operations for the years ended December 31, 2012, 2013 and 2014	F-4
Consolidated statements of comprehensive income for the years ended December 31, 2012, 2013 and 2014	F-5
Consolidated statements of changes in equity for the years ended December 31, 2012, 2013 and 2014	F-6
Consolidated statements of cash flows for the years ended December 31, 2012, 2013 and 2014	F-7
Notes to the consolidated financial statements	F-8
Additional Information—Financial Statement Schedule I	F-51

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF
TAOMEE HOLDINGS LIMITED

We have audited the accompanying consolidated balance sheets of Taomee Holdings Limited (the "Company"), its subsidiaries and its variable interest entities (the "Group") as of December 31, 2013 and 2014, and the related consolidated statements of operations, comprehensive income, changes in equity, and cash flows for each of the three years in the period ended December 31, 2014 and related financial statement schedule included in Schedule I. These financial statements and financial statement schedule are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule 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. The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, 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 the Group as of December 31, 2013 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects, the information set forth therein.

/s/ DELOITTE TOUCHE TOHMATSU CERTIFIED PUBLIC ACCOUNTANTS LLP

Shanghai, China
April 15, 2015

TAOMEET HOLDINGS LIMITED
CONSOLIDATED BALANCE SHEETS

(In US dollars, except share and per share data, unless otherwise stated)

	As of December 31,	
	2013	2014
Assets		
Current assets:		
Cash and cash equivalents	\$114,250,772	\$103,173,555
Short-term investment	2,992,343	—
Accounts receivable, net	2,387,747	2,499,084
Inventory	196,757	238,055
Prepaid income tax	402,460	797,711
Due from related parties	2,242,382	2,592,450
Prepayments and other current assets	2,904,695	4,128,248
Deferred tax assets—current	4,166,088	5,872,817
Total current assets	129,543,244	119,301,920
Investment in equity investees	14,047,509	16,138,860
Property and equipment, net	1,840,419	1,813,660
Prepayments for land use rights and building	3,008,520	2,162,445
Acquired intangible assets	1,252,572	1,113,495
Other assets	1,496,242	1,331,363
Total assets	\$151,188,506	\$141,861,743
Liabilities and equity		
Current liabilities:		
Accounts payable (including accounts payable of the consolidated VIEs without recourse to Taomee Holdings Limited of 1,538,665 and 730,535 as of December 31, 2013 and 2014, respectively)	\$ 1,549,908	\$ 786,446
Due to related parties (including due to related parties of the consolidated VIEs without recourse to Taomee Holdings Limited of 22,957 and 163,748 as of December 31, 2013 and 2014, respectively)	369,983	422,019
Advance from customers (including advance from customers of the consolidated VIEs without recourse to Taomee Holdings Limited of 6,184,953 and 5,860,035 as of December 31, 2013 and 2014, respectively)	6,960,857	8,236,080
Deferred revenue (including deferred revenue of the consolidated VIEs without recourse to Taomee Holdings Limited of 12,340,821 and 11,768,665 as of December 31, 2013 and 2014, respectively)	12,340,821	11,768,665
Accrued expenses and other current liabilities (including accrued expenses and other current liabilities of the consolidated VIEs without recourse to Taomee Holdings Limited of 1,680,767 and 1,452,119 as of December 31, 2013 and 2014, respectively)	6,279,858	4,814,555
Deferred tax liabilities—current (including deferred tax liabilities of the consolidated VIEs without recourse to Taomee Holdings Limited of 1,758,134 and 386,092 as of December 31, 2013 and 2014, respectively)	1,758,134	698,800
Total current liabilities	29,259,561	26,726,565
Commitments and contingencies (Note 12)		
Equity:		
Taomee Holdings Limited shareholders' equity		
Ordinary shares (\$0.00002 par value; 875,000,000 shares authorized; 741,126,859 and 751,088,350 shares issued; 735,913,039 and 708,350,670 shares outstanding as of December 31, 2013 and 2014, respectively)	14,823	15,022
Treasury stock (at cost)	(1,198,904)	(11,521,316)
Additional paid-in capital	73,757,483	76,308,327
Accumulated other comprehensive income	4,342,755	4,188,419
Retained earnings	44,853,977	45,860,434
Taomee Holdings Limited shareholders' equity	121,770,134	114,850,886
Noncontrolling interests	158,811	284,292
Total equity	121,928,945	115,135,178
Total liabilities and equity	\$151,188,506	\$141,861,743

The accompanying notes are an integral part of these consolidated financial statements.

TAOMEET HOLDINGS LIMITED

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014**

(In US dollars, except share and per share data, unless otherwise stated)

	For the years ended December 31,		
	2012	2013	2014
Revenues:			
Online business, net	\$ 32,169,495	\$ 35,330,152	\$ 33,292,449
Offline business, net	8,038,739	13,023,535	8,896,702
Total net revenues	40,208,234	48,353,687	42,189,151
Cost of revenues:			
Online business	(6,949,772)	(7,643,598)	(6,534,883)
Offline business	(3,048,618)	(5,620,619)	(5,182,265)
Total cost of revenues	(9,998,390)	(13,264,217)	(11,717,148)
Gross profit	30,209,844	35,089,470	30,472,003
Operating income (expenses):			
Product development expenses	(12,317,528)	(13,885,922)	(14,445,618)
Sales and marketing expenses	(9,966,282)	(9,446,025)	(9,304,028)
General and administrative expenses	(10,077,739)	(13,095,086)	(13,506,506)
Impairment loss on acquired intangible assets	—	(1,046,173)	(115,753)
Other operating income	5,511,806	5,708,455	5,020,065
Total operating expenses	(26,849,743)	(31,764,751)	(32,351,840)
Income (loss) from operations	3,360,101	3,324,719	(1,879,837)
Interest income	2,646,967	2,931,511	2,914,372
Other income (expenses), net	858,869	770,807	(453,379)
Impairment loss on investment in equity investees	—	(370,407)	(1,400,000)
Income (loss) before income taxes and share of profit (loss) in equity method investments, net of gain (loss) on disposals	6,865,937	6,656,630	(818,844)
Income tax benefit (expense):			
Current	1,279,003	(788,724)	(600,073)
Deferred	(424,099)	(630,339)	2,762,885
Total income tax benefit (expense)	854,904	(1,419,063)	2,162,812
Income before share of profit (loss) in equity method investments, net of gain (loss) on disposals	7,720,841	5,237,567	1,343,968
Share of profit (loss) in equity method investees, net of gain (loss) on disposals	1,139,650	207,766	(432,874)
Net income	8,860,491	5,445,333	911,094
Net income (loss) attributable to noncontrolling interest	(1,376)	4,073	(95,363)
Net income attributable to Taomee Holdings Limited	\$ 8,861,867	\$ 5,441,260	\$ 1,006,457
Earnings per share:			
Basic	\$ 0.01	\$ 0.01	\$ 0.001
Diluted	\$ 0.01	\$ 0.01	\$ 0.001
Weighted average number of shares used in calculating earnings per share:			
Basic	731,303,362	733,333,891	712,973,565
Diluted	753,533,499	746,532,112	719,852,640

The accompanying notes are an integral part of these consolidated financial statements.

TAOMEE HOLDINGS LIMITED**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014****(In US dollars, except share and per share data, unless otherwise stated)**

	For the years ended December 31,		
	2012	2013	2014
Net income	\$ 8,860,491	\$ 5,445,333	\$ 911,094
Other comprehensive income, net of tax of nil			
Foreign currency translation adjustments	189,354	1,787,185	(154,336)
Comprehensive income	9,049,845	7,232,518	756,758
Comprehensive income (loss) attributable to noncontrolling interest	(1,376)	4,073	(95,363)
Comprehensive income attributable to Taomee Holdings Limited	9,051,221	7,228,445	852,121

TAOMEET HOLDINGS LIMITED
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share and per share data, unless otherwise stated)

	Taomeet Holdings Limited Shareholders' equity									
	Ordinary shares		Treasury stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total Taomeet Holdings Limited equity	Noncontrolling interests	Total shareholders' equity
	Shares	Amount	Shares	Amount						
Balance as of January 1, 2012	730,900,680	\$ 14,618	2,473,160	\$ (562,502)	\$70,782,370	\$30,550,850	2,366,216	\$103,151,552	\$ —	\$ 103,151,552
Repurchase of shares	—	—	9,237,880	(1,754,792)	—	—	—	(1,754,792)	—	(1,754,792)
Cancellation of repurchased shares	(7,472,100)	(149)	(7,472,100)	1,569,935	(1,569,786)	—	—	—	—	—
Issuance of ordinary shares upon exercise of options and vesting of restricted shares	13,220,152	264	—	—	550,966	—	—	551,230	—	551,230
Share-based compensation	—	—	—	—	2,252,552	—	—	2,252,552	—	2,252,552
Reversal of accrued IPO costs	—	—	—	—	421,181	—	—	421,181	—	421,181
Noncontrolling interest for establishment of Guangdong Taomeet	—	—	—	—	—	—	—	—	78,979	78,979
Net income (loss)	—	—	—	—	—	8,861,867	—	8,861,867	(1,376)	8,860,491
Foreign currency translation adjustment	—	—	—	—	—	—	189,354	189,354	—	189,354
Balance as of December 31, 2012	736,648,732	\$ 14,733	4,238,940	\$ (747,359)	\$72,437,283	\$39,412,717	2,555,570	\$113,672,944	\$ 77,603	\$ 113,750,547
Repurchase of shares	—	—	9,572,500	(2,056,771)	—	—	—	(2,056,771)	—	(2,056,771)
Cancellation of repurchased shares	(8,597,620)	(172)	(8,597,620)	1,605,226	(1,605,054)	—	—	—	—	—
Issuance of ordinary shares upon exercise of options and vesting of restricted shares	13,075,747	262	—	—	859,944	—	—	860,206	—	860,206
Share-based compensation	—	—	—	—	2,142,445	—	—	2,142,445	—	2,142,445
Noncontrolling interest on establishment of Guangdong Taomeet (Note 17)	—	—	—	—	(77,135)	—	—	(77,135)	77,135	—
Net income	—	—	—	—	—	5,441,260	—	5,441,260	4,073	5,445,333
Foreign currency translation adjustment	—	—	—	—	—	—	1,787,185	1,787,185	—	1,787,185
Balance as of December 31, 2013	741,126,859	\$ 14,823	5,213,820	\$ (1,198,904)	\$73,757,483	\$44,853,977	4,342,755	\$121,770,134	\$ 158,811	\$ 121,928,945
Repurchase of shares	—	—	37,523,860	(10,322,412)	—	—	—	(10,322,412)	—	(10,322,412)
Issuance of ordinary shares upon exercise of options and vesting of restricted shares	9,961,491	199	—	—	461,749	—	—	461,948	—	461,948
Share-based compensation	—	—	—	—	2,228,431	—	—	2,228,431	—	2,228,431
Noncontrolling interest on establishment of Guangdong Taomeet (Note 17)	—	—	—	—	(60,051)	—	—	(60,051)	60,051	—

Noncontrolling interest for capital injection of Shanghai Xinsheng (Note 17)	—	—	—	—	13,421	—	—	13,421	40,918	54,339
Noncontrolling interest on establishment of Shanghai Jushou (Note 17)	—	—	—	—	(92,706)	—	—	(92,706)	119,875	27,169
Net income (loss)	—	—	—	—	—	1,006,457	—	1,006,457	(95,363)	911,094
Foreign currency translation adjustment	—	—	—	—	—	—	(154,336)	(154,336)	—	(154,336)
Balance as of December 31, 2014	<u>751,088,350</u>	<u>\$ 15,022</u>	<u>42,737,680</u>	<u>\$(11,521,316)</u>	<u>\$76,308,327</u>	<u>\$45,860,434</u>	<u>\$ 4,188,419</u>	<u>\$114,850,886</u>	<u>\$ 284,292</u>	<u>\$ 115,135,178</u>

The accompanying notes are an integral part of these consolidated financial statements.

TAOMEE HOLDINGS LIMITED

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014**

(In US dollars, except share and per share data, unless otherwise stated)

	For the years ended December 31,		
	2012	2013	2014
Operating activities:			
Net income	\$ 8,860,491	\$ 5,445,333	\$ 911,094
Adjustments to reconcile net income to net cash provided by operating activities:			
Share-based compensation	2,252,552	2,142,445	2,228,431
Depreciation and amortization	2,629,532	2,234,816	2,245,918
Share of loss (profit) in equity method investees, net of gain (loss) on disposals	(1,139,650)	(207,766)	432,874
Deferred income taxes	424,099	630,339	(2,762,885)
Loss on disposal of property and equipment	3,891	62,811	12,490
Allowance for doubtful receivables and long-term prepayments	—	313,851	1,086,939
Gain on disposal of short-term investment	—	—	(15,043)
Impairment on acquired intangible assets	—	1,046,173	115,753
Impairment on investment in equity investees	—	370,407	1,400,000
Changes in assets and liabilities:			
Accounts receivable	(948,526)	(330,538)	(383,076)
Inventories	(41,316)	(155,441)	(41,298)
Due from related parties	16,608	(1,499,362)	(350,068)
Prepayments and other current assets	(232,860)	(775,819)	860,118
Other assets	(565,770)	(921,629)	(1,873,111)
Accounts payable	212,806	1,115,282	(763,462)
Income taxes payable	(2,237,032)	(352,504)	(395,251)
Due to related parties	76,613	280,255	52,036
Advance from customers	(2,081,132)	(1,181,320)	1,275,223
Deferred revenue	(851,429)	279,311	(572,156)
Accrued expenses and other current liabilities	160,218	858,830	(1,465,303)
Return on investment in equity investees	623,120	581,238	401,387
Net cash provided by operating activities	7,162,215	9,936,712	2,400,610
Investing activities:			
Purchases of short-term investment	—	(2,992,343)	—
Purchases of property and equipment	(336,612)	(1,432,161)	(751,731)
Purchases of intangible assets	(1,398,020)	(853,939)	(250,000)
Prepayments for land use rights and building	—	(2,963,461)	(1,456,856)
Lending of loans receivable	(79,548)	—	—
Lending to a related party	(76,366)	—	—
Collection of amounts due from related party	76,366	—	—
Cash paid to acquire equity investees	(6,957,520)	(6,529,154)	(4,649,967)
Proceeds from sale of equity method investees	1,041,124	—	324,355
Disposal of short-term investment	—	—	3,007,386
Net cash used in investing activities	(7,730,576)	(14,771,058)	(3,776,813)
Financing activities:			
Issuance cost of ordinary shares	(340,713)	—	—
Proceeds from exercise of share options	275,825	1,046,021	648,663
Capital contribution from noncontrolling interest	78,979	—	81,508
Repurchase of ordinary shares	(1,681,520)	(2,144,386)	(10,322,412)
Net cash used in financing activities	(1,667,429)	(1,098,365)	(9,592,241)
Effect of exchange rate changes on cash and cash equivalents	127,564	1,612,811	(108,773)
Net decrease in cash and cash equivalents	(2,108,226)	(4,319,900)	(11,077,217)
Cash and cash equivalents, beginning of the year	120,678,898	118,570,672	114,250,772
Cash and cash equivalents, end of the year	\$ 118,570,672	\$ 114,250,772	\$ 103,173,555
Supplemental disclosure of cash flow information:			
Income taxes paid	\$ 950,028	\$ 1,528,394	\$ 1,504,209
Supplemental schedule of non-cash investing and financing activities:			
Purchases of property and equipment included in accrued expenses	\$ —	\$ —	\$ 19,802
Repurchases of ordinary shares included in accrued expenses	\$ 87,615	\$ —	\$ —

The accompanying notes are an integral part of these consolidated financial statements.

TAOMEET HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES

Taomee Holdings Limited (the "Company"), all of its subsidiaries and consolidated variable interest entities ("VIEs") are collectively referred to as the "Group". The Group is principally engaged in the development and operation of online virtual worlds, mobile games and applications and other online services, the provision of related offline operations by licensing the Group's proprietary cartoon figures to merchandisers and book publishers as well as producing films and trading interactive toys. The Group's principal operations and geographic market are in the People's Republic of China ("PRC").

The subsidiaries and consolidated VIEs of the Company as of December 31, 2014 are as follows:

<u>Name of subsidiaries and consolidated VIEs</u>	<u>Percentage of ownership</u>	<u>Date of incorporation or combination</u>	<u>Place of incorporation</u>
Taomee Holdings (HK) Limited ("Taomee Hong Kong")	100%	November 27, 2008	Hong Kong
Shanghai Shengran Information Technology Co., Ltd. ("Shanghai Shengran")	100%	June 12, 2009	PRC
Shanghai Taomee Network Technology Co., Ltd. ("Shanghai Taomee")	VIE	October 8, 2007	PRC
Shanghai Qidong Information Technology Co., Ltd. ("Shanghai Qidong")	VIE	March 4, 2009	PRC
Shanghai Taomee Animation Co., Ltd. ("Shanghai Animation")	VIE	November 11, 2010	PRC
Guangdong Taomee Animation Technology Co., Ltd. ("Guangdong Taomee")	VIE	June 1, 2012	PRC
Shanghai Xinsheng Information Technology Co., Ltd. ("Shanghai Xinsheng")	93%	October 31, 2012	PRC
Shanghai Taomee Wireless Technology Co., Ltd. ("Shanghai Wireless")	99%	May 6, 2013	PRC
Shanghai Taomee Software Development Co., Ltd. ("Shanghai Software")	99%	October 29, 2013	PRC
Shanghai Taomee Property Service Co., Ltd. ("Shanghai Property Service")	99%	November 1, 2013	PRC
Shanghai Jushou Wireless Technology Co., Ltd. ("Shanghai Jushou")	VIE	July 3, 2014	PRC

The Group conducts its business primarily through two consolidated VIEs Shanghai Taomee and Shanghai Qidong. Shanghai Animation, Guangdong Taomee and Shanghai Jushou were incorporated under Shanghai Taomee and were consolidated since their respective date of incorporation.

The Company, through its wholly owned subsidiary Shanghai Shengran, entered into a series of contractual arrangements with the VIEs and the shareholders, pursuant to which the Company is entitled to receive effectively all economic benefits generated from the shareholders' equity interests in the VIEs. These contractual arrangements include:

- (i) a Proxy Agreement, under which each shareholder of the VIEs has assigned Shanghai Shengran all rights as a shareholder of the VIEs including voting rights. The Proxy Agreement is valid infinitely and is only subject to be terminated by Shanghai Shengran;

TAOMEE HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES (Continued)

- (ii) an Option Agreement, under which the shareholders of the VIEs granted Shanghai Shengran an irrevocable and exclusive option to purchase all or a portion of their equity interests in the VIEs when and to the extent permitted by PRC law. The Option Agreement will terminate when the equity interests in the VIEs are legally transferred to Shanghai Shengran;
- (iii) a Business Operation Agreement, under which the shareholders of the VIEs have agreed that Shanghai Shengran shall direct the day-to-day operational and financial activities of the VIEs including electing directors and officers and hiring personnel, that the VIEs will not conduct any transactions which might substantially affect their assets and business operations without the prior written consent of Shanghai Shengran, and that the shareholders will unconditionally transfer to Shanghai Shengran, for no consideration, all dividends or other proceeds received from the VIEs in their capacity as shareholders;
- (iv) a Commercial Cooperation Agreement between the VIEs and Shanghai Shengran, under which Shanghai Shengran is engaged by the VIEs as the exclusive provider of software services, technology support, and marketing services for a service fee. By virtue of the governance rights Shanghai Shengran maintains over the VIEs, through the terms of the other agreements noted above, the Company is able unilaterally renew, extend or amend the service agreements at its discretion;
- (v) an Equity Interest Pledge Agreement, under which the shareholders pledged all of their equity interests in the VIEs to Shanghai Shengran as collateral to secure their obligations under the agreement, and all benefits derived from the equity interests in the VIEs shall be the guarantee for the VIEs' debt. The Equity Interest Pledge Agreement is continuously effective until the full performance of the contractual obligations or the full repayment of the guaranteed liabilities as described in such agreement; and
- (vi) a Loan Agreement, under which Shanghai Shengran shall provide interest-free loans of up to a total of RMB2.5 million (equivalent to \$366,129) to PRC citizens Mr. WANG Haibing, Mr. WEI Zhen, Mr. CHENG Yunpeng, Mr. ZENG Liqing and Mr. WANG Bin (collectively referred to as the "five shareholders") for their respective capital contributions in the VIEs. The loans have an unspecified term and will remain outstanding for the duration of Shanghai Shengran or until such time that Shanghai Shengran elects to terminate the agreement (which is at Shanghai Shengran's sole discretion) at which point the loans are payable on demand. The five shareholders of the VIEs may not prepay all or any portion of the loans without Shanghai Shengran's prior written request.

Under the above agreements, the shareholders of the VIEs irrevocably granted Shanghai Shengran the power to exercise all voting rights to which they were entitled. In addition, Shanghai Shengran has the option to acquire all of the equity interests in the VIEs, to the extent permitted by the then-effective PRC laws and regulations, for nominal consideration. Shanghai Shengran is entitled to receive service fees for certain services to be provided to the VIEs.

These contractual agreements are designed to provide the Company control of the VIEs. The Option Agreement and Proxy Agreement provide Shanghai Shengran effective control over the VIEs, while the Equity Interest Pledge Agreement secures the shareholders' obligations under these agreements. Because the Company, through its wholly owned subsidiary Shanghai Shengran has (1) the

TAOMEE HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES (Continued)

power to direct the activities of the VIEs that affect the Company's economic performance and (2) the right to receive benefits from the VIEs, it has been deemed to be the primary beneficiary of the VIEs and has a result consolidated the respective VIEs since the date of execution of such agreements. The call option on subsidiary shares under the Option Agreement and the guarantee of VIEs' debt under the Equity Interest Pledge Agreement have not been accounted for in the consolidated financial statements since they are agreements between a parent and a consolidated subsidiary. The service fees under the Commercial Cooperation Agreement are eliminated upon consolidation.

In arriving at the conclusion that the Company is the primary beneficiary of the VIEs, the Company relied on the determination that the Company's rights under the terms of the Option Agreement provide it with a substantive kick out right, subject to applicable PRC law. The Company also believes that the minimum amount of consideration permitted by the applicable PRC law to exercise the option does not represent a financial barrier or disincentive for the Company to currently exercise its rights under the Option Agreement.

The Company has concluded that these contractual arrangements are legally binding and the Company exercises control over the VIEs. The Group's current ownership structure, as well as the contractual arrangements that Shanghai Shengran entered into with the consolidated VIEs and their shareholders are in compliance with all existing PRC laws and regulations. However, the aforementioned contractual arrangements with the VIEs and their respective shareholders are subject to risks and uncertainties:

- The VIEs and their respective shareholders may have or develop interests that conflict with the Company's interests, which may lead them to pursue opportunities in violation of or to refuse to renew the aforementioned contractual arrangements.
- The VIEs or their shareholders may be deemed to be in violation of PRC laws and regulations or could fail to obtain the proper operating licenses. As a result, the PRC government could:
 - 1) Confiscate incomes of the VIEs, impose fines or other requirements with which the Company's PRC subsidiaries may not be able to comply;
 - 2) Revoke the business or operating licenses of the Company's PRC subsidiaries;
 - 3) Require a restructuring of the current VIE structure, or require the VIEs or the Company to mandate a change in ownership structure or operations of the VIEs or the Company, or discontinue all or any portion of their business;
 - 4) Discontinue or restrict the operations of any related-party transactions among the Company's PRC subsidiaries;
 - 5) Limit the Group's business expansion in China through contractual arrangements;
 - 6) Restrict or prohibit the Company's use of the proceeds from any additional public offering to finance the Company's business and operations in China.
- The aforementioned contractual agreements may not be as effective as direct ownership in providing control over the VIEs. The Group may incur substantial costs and resources to enforce such arrangements if the shareholders of the VIEs fail to perform their respective obligations under the contractual arrangements.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES (Continued)

- Although the aforementioned contractual agreements are enforceable, they may be difficult to enforce given the uncertainties in the PRC legal system.

If these adverse circumstances were to occur, the Company may lose the ability to exert effective control over the VIEs and its shareholders, and it may lose the ability to receive economic benefits from the VIEs. As a result, the Company may not be able to consolidate the VIEs into its consolidated financial statements. The Company, however, does not believe such actions would result in the liquidation or dissolution of the Company, the WFOE or the VIEs.

The aforementioned shareholders collectively own all of the equity interests in the VIEs and together own a majority of the Company's shares as of December 31, 2014. The Company cannot assure that, when conflicts of interest arise, the shareholders 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 may encounter in their capacity as owners of record and directors of the VIEs, on the one hand, and as beneficial owners and directors of the Company, on the other hand. The Company believes the shareholders will not act contrary to any of the contractual arrangements and the Option Agreement entitles the Company to remove the shareholders as beneficial shareholders of the VIEs should any of them act in a way that is detrimental to the Company. The Company relies on the shareholders 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, the Company would have to rely on legal proceedings, which could result in disruption of its business, and there would likely be substantial uncertainty as to the outcome of any such legal proceedings.

Nonetheless, the Company believes that its ability to direct the activities of the VIEs that most significantly impact their economic performance and the VIE arrangements are not affected by current PRC laws and regulations. Accordingly, the VIEs continue to be consolidated by the Company, as the primary beneficiary.

However, there may be changes and other developments in the PRC laws and regulations or their interpretation could affect the Company's ability to control the VIEs and preclude the Company from consolidating the VIEs in the future.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES (Continued)

Summary financial information of the Group's VIEs included in the accompanying consolidated financial statements (after eliminating all intercompany transactions and balances, except for cash flow information which was before eliminating intercompany transactions and balances) is as follows:

	December 31,	
	2013	2014
Assets		
Current assets:		
Cash and cash equivalents	12,216,436	9,449,326
Accounts receivable, net	1,849,786	1,243,350
Inventory	196,757	238,055
Income tax recoverable	585,861	219,374
Due from related party	2,169,866	2,575,248
Prepayments and other current assets	1,614,931	1,276,264
Deferred tax assets—current	3,489,805	4,004,672
Total current assets	22,123,442	19,006,289
Investment in equity investees	2,326,793	6,183,197
Property and equipment, net	1,163,086	1,160,380
Acquired intangible asset	1,030,702	730,152
Other assets	376,926	947,525
Total assets	27,020,949	28,027,543
Liabilities		
Accounts payable	1,538,665	730,535
Due to related parties	22,957	163,748
Advance from customers	6,184,953	5,860,035
Deferred revenue	12,340,821	11,768,665
Accrued expenses and other current liabilities	1,680,767	1,452,119
Deferred tax liabilities—current	1,758,134	386,092
Total liabilities	23,526,297	20,361,194

The Company earns service fees from the VIEs which are eliminated upon consolidation. For the years ended December 31, 2012, 2013 and 2014, the service fees payable by the VIEs to Shanghai Shengran were RMB102 million (US\$16.2 million), RMB118 million (US\$19.1 million) and RMB91 million (US\$14.8 million). The service fees outstanding and payable to the WFOE from the VIEs were RMB0.3 million (US\$0.05 million) and RMB0.6 million (US\$0.1 million) as of December 31, 2013 and 2014, respectively.

	For the year ended December 31,		
	2012	2013	2014
Net revenues	\$ 33,535,368	\$ 40,985,710	\$ 35,363,951
Net income	\$ 20,773,883	\$ 21,586,325	\$ 18,979,696

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES (Continued)

	For the year ended December 31,		
	2012	2013	2014
Net cash provided by (used in) operating activities	(1,468,141)	1,741,060	1,250,010
Net cash used in investing activities	(318,549)	(4,991,080)	(4,044,290)
Net cash provided by financing activities	78,979	—	27,170
Net decrease in cash and cash equivalent	(1,707,711)	(3,250,020)	(2,767,110)

The VIEs contributed an aggregate of 83.4%, 84.8% and 83.8% of the consolidated net revenues for the year ended December 31, 2012, 2013 and 2014, respectively. The Company's operations not conducted through contractual arrangements with the VIEs primarily consist of its merchandise licensing and book royalty business as well as mobile game development. As of the fiscal years ended December 31, 2013 and 2014, the VIEs accounted for an aggregate of 17.9% and 19.8%, respectively, of the consolidated total assets, and 80.4% and 76.2%, respectively, of the consolidated total liabilities. The assets not associated with the VIEs primarily consist of cash and cash equivalents.

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 interest that require the Company or its subsidiaries to provide financial support to the VIEs. However, if the VIEs were to require financial support, the Company or its subsidiaries may, at its option and subject to statutory limits and restrictions, provide financial support to the VIEs through loans.

Relevant PRC laws and regulations restrict the VIEs from transferring a portion of its net assets, equivalent to the balance of its statutory reserve and its share capital, to the Company in the form of loans and advances or cash dividends. Please refer to Note 11 for disclosure of restricted net assets.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

(1) Basis of presentation

The consolidated financial statements of the Group have been prepared in accordance with the accounting principles generally accepted in the United States of America ("US GAAP"). Significant accounting policies followed by the Group in the preparation of the accompanying consolidated financial statements are summarized below.

(2) Basis of consolidation

The consolidated financial statements include the financial statements of the Group, its subsidiaries and VIEs. All intercompany transactions and balances are eliminated upon consolidation.

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

TAOMEE HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

US GAAP provides guidance on the identification and financial reporting for entities over which control is achieved through means other than voting interests, which requires certain VIEs to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Through the contractual arrangements between the Company and the VIEs, the Company controls the operating activities and holds all the beneficial interests of the VIEs and has been determined to be the primary beneficiary of the VIEs. The Company has concluded that such contractual arrangements are legally enforceable (see footnote 1 for related risks and uncertainties).

(3) Use of estimates

The preparation of the consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affected the reported amount of the assets and liabilities, the disclosure of assets and liabilities at the date of the financial statements, and the reported revenues and expenses during the reported periods. Actual results may differ from those estimates. Significant accounting estimates reflected in the Group's consolidated financial statements mainly include allowance for doubtful accounts, the useful life of in-game items, useful life and impairment for property and equipment and intangible asset, impairment of cost method investment and equity method investments, assumptions related to the valuation of share-based compensation and related forfeiture rates, consolidation of VIEs, assumptions applied in the classification of equity investments and realization of deferred tax assets. Such accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements, and actual results could differ materially from these estimates.

(4) Cash and cash equivalents

Cash and cash equivalents represent cash on hand and demand deposits, which are unrestricted as to withdrawal or use, and which have original maturities of three months or less when purchased.

(5) Short-term investment

Investments in debt or equity securities are accounted for based on the nature of the products invested, and the Group's intent and ability to hold the investments to maturity. In 2013, the Group invested in a short-term money market investment whose return is linked to a short term interest rate with interest income accrued on a daily basis. The instrument does not have a stated maturity but can be traded daily at par value plus accrued interest, subject to certain normal market conditions. In 2014, the Group disposed this short-term investment in full and a gain of \$15,043 was recognized as interest income in the earnings.

(6) Accounts receivable, net

Accounts receivable mainly consists of receivables from the distribution of films, receivables from third party online payment channels, royalties due from corporate customers and revenue sharing from mobile game publishers, and is recorded net of allowance for doubtful accounts. The Group determines the allowance for doubtful accounts when facts and circumstances indicate that the receivable is unlikely to be collected. Allowance for doubtful accounts are charged to general administrative expenses. The Group recorded nil and \$0.3 million allowance for doubtful accounts as of December 31,

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

2012 and 2013, respectively. In the year 2014, the Group made additional bad debt provision of \$0.3 million and later wrote off accounts receivable and related full allowance for doubtful accounts of \$0.6 million from the settlements agreed with counterparties.

(7) Inventory

Inventory primarily consists of toys. Inventories are stated at the lower of cost or market and the cost of merchandise inventory is determined using the weighted average cost method. The Group records valuation adjustments to write-down the inventories if the cost of specific inventory items on hand exceeds the amount expected to be realized from the ultimate sale or disposal of the inventory. The Group recorded no inventory write-downs in the periods presented.

(8) Investment in equity investees

The Group uses the equity method to account for an equity investment over which it has significant influence but does not own a majority equity interest or otherwise control. The Group records equity method adjustments in share of earnings and losses. Equity method adjustments include the Group's proportionate share of investee income or loss, adjustments to recognize certain differences between the Group's carrying value and its equity in net assets of the investee at the date of investment, impairments, and other adjustments required by the equity method. Dividends received are recorded as a reduction of carrying amount of the investment. Cumulative distributions that do not exceed the Group's cumulative equity in earnings of the investee are considered as a return on investment and classified as cash inflows from operating activities. Cumulative distributions in excess of the Group's cumulative equity in the investee's earnings are considered as a return of investment and classified as cash inflows from investing activities. Equity method investments only include non-marketable investments. For equity investments over which the Group does not have significant influence or control, the cost method of accounting is used.

The Group assesses its equity investments for other-than-temporary impairment by considering factors as well as all relevant and available information including, but not limited to, current economic and market conditions, the operating performance of the investees including current earnings trends, the technological feasibility of the investee's products and technologies, the general market conditions in the investee's industry or geographic area, factors related to the investee's ability to remain in business, such as the investee's liquidity, debt ratios, and cash burn rate and other company-specific information including recent financing rounds.

The Group recorded nil, \$0.4 million and \$1.4 million (refer to Note 5 and Note 16) in impairment losses on equity investees as of December 31, 2012, 2013 and 2014, respectively.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

(9) Property and equipment, net

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

	Estimated useful lives
Leasehold improvements	Lesser of the lease term or their estimated useful lives
Computers and office equipment	3-5 years
Software	Lesser of 5 years or the contracted term of use
Vehicles	4 years

(10) Impairment of long-lived assets

The Group evaluates its long-lived assets with definite useful life, including property and equipment and acquired intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. When these events occur, the Group measures impairment by comparing the carrying amount of the assets to the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the future undiscounted cash flow is less than the carrying amount of the assets, the Group would recognize an impairment loss equal to the excess of the carrying amount over the fair value of the assets. There were nil, \$1.0 million and nil impairment charge recognized for the years ended December 31, 2012, 2013 and 2014, respectively.

The Group tests the intangible asset with indefinite useful life for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. If the carrying amount of the intangible asset exceeds its fair value, the Group recognizes an impairment loss in an amount equal to that excess.

(11) Acquired intangible assets

Upfront licensing fees

Upfront licensing fees paid to third party licensors are capitalized when paid and amortized on a straight-line basis over the shorter of the estimated economic life of the intangible assets or license period, ranging from three to seven years. Amortization of acquired game licenses commences upon the commercial launch of the related online game. As of December 31, 2013 and 2014, the carrying values of these acquired upfront licensing fees were \$1.1 million and \$1.0 million, and the accumulated amortization was \$0.2 million and \$0.4 million, respectively.

The less than satisfactory performance of certain games indicated that the carrying amounts of acquired intangible assets may not be recoverable. The Group tested the long-lived assets and goodwill for impairment. As a result of the long-lived asset impairment tests, upfront licensing fees held and used with a carrying amount of \$1.0 million and \$0.1 million (Refer to Note 16) were fully impaired, with the resulting impairment charges included in earnings for the year ended December 31, 2013 and December 31, 2014, respectively.

TAOMEET HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

Domain Name

Company purchased a domain name from a third party in 2009 for \$141,735. The domain name is considered to have an indefinite useful life, as there is no legal or contractual limit to its terms of usage. The intangible asset is carried at cost less any accumulated impairment losses.

The Group recorded amortization of acquired intangible assets of \$204,266, \$414,510 and \$248,867 for the years ended December 31, 2012, 2013 and 2014, respectively. The amortization expenses of the above acquired intangible assets will be approximately \$246,410, \$246,410, \$246,410, \$164,697 and \$51,405 for 2015, 2016, 2017, 2018 and 2019, respectively.

(12) Film cost

Film cost include capitalized production costs, production overhead, development costs and acquired production costs for the production of animated films which have been completed or are still in production. The costs are stated at the lower of cost, less accumulated amortization, or fair value.

Film production costs are capitalized and then amortized to cost when the films are completed and on release, together with any participation and residual costs, based on the ratio of the current period's revenues to estimated remaining total revenues ("Ultimate Revenues") from all sources on an individual production basis. Ultimate Revenues for film productions include revenues that will be earned within ten years from the date of the initial theatrical release. These estimates are reviewed on a periodic basis.

Costs of film productions are subject to regular recoverability assessments which compare the estimated fair values with the unamortized costs. The amount by which the unamortized costs of film productions exceed their estimated fair values is written off.

During production, the Group records the amount paid to the third parties as its capitalized film costs up to the Group's proportionate share of the actual cumulative film production costs that have been incurred by the third parties, as the Group assumes full risk for that portion of the film asset acquired in this transaction. The Group shares the same estimates of ultimate revenue and ultimate participation costs as the other participants. When the film is released, the Group recognizes its share of the net profit due from the other participants as film revenue and amortizes the capitalized film costs as cost of film revenue on the consolidated statement of operations based on the ratio of the current period revenues to the estimated ultimate revenues and an estimated profit margin from the film. The Group records the prepayments and capitalized film costs under these arrangements in other assets on its consolidated balance sheet.

The Group recorded amortization of capitalized film costs of \$968,276, \$937,860 and \$1,255,335 for the years ended December 31, 2012, 2013 and 2014, respectively.

(13) Treasury Stock

The Group accounted for those shares repurchased but not yet cancelled as Treasury Stock at cost and presented separately in the Shareholders' Equity. When the Group cancels the treasury stock, the difference between the original issuance price and the repurchase price is charged to additional paid-in capital.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

(14) Revenue recognition

Online Business

Online virtual world revenues

The Group earns such revenue primarily through developing and operating proprietary online virtual worlds. The Group provides such services to children via an online entertainment platform pursuant to two types of revenue models: a time-based revenue model and an item-based revenue model.

For online services using the time-based model, users pay a subscription fee for calendar days of unlimited play on the online platform. The Group recognizes revenue generated from subscription fees based on the number of calendar days on which the users are provided the services.

For the item-based model, revenue is recognized over the estimated lives of the in-game virtual premium items purchased or as the virtual premium items are consumed. For the virtual premium items that are immediately consumed, revenue is recognized upon consumption. For virtual premium items with no predetermined expiration ("permanent items"), revenue is recognized ratably over the estimated average lives of the permanent items, which range from six to 18 months. The amount of the unamortized permanent items and unconsumed items are recognized as deferred revenue. The Group recognized \$16,269,659, \$22,396,393 and \$20,112,059 gross revenue from virtual premium items accounted for under the item-based model for the years ended December 31, 2012, 2013 and 2014, respectively. The Group estimates the average lives of the permanent items based on an assessment of its historical data and user behavior patterns, including the average period that users typically stay on the platform, the age group of the target users, and the number of active paying users in the virtual worlds, and the promotional events launched, with reference to industry research data. The Group assesses the estimated lives of premium items periodically. If there are indications of any significant changes to the estimated lives of these premium items, the revised estimates would be applied prospectively in the period of change. Prior to June 30, 2010, the Group did not have sufficient historical data from its virtual worlds to estimate the useful life of the permanent items, and used the industry research data and peer company information in developing the estimate of the average life of permanent items, which was determined to be one year for all its virtual worlds. Effective on July 1, 2010, the Group changed the accounting estimate of the useful life of the permanent items in Mole's World from one year to 18 months based on an analysis of the life of the virtual world and user behavior patterns using historical user data since the launch of Mole's World in September 2008, and applied such change prospectively. The effect of the change in accounting estimate on the results of operations for the year ended December 31, 2010 was immaterial. In 2011 and 2012, the Group did not make any changes to the useful life of any of its virtual worlds. In 2013, the Group assessed its historical data of user behavior as well as industry research data and noticed a shortening trend user lifespan and changed the estimated lives of premium items for newly launched online virtual worlds to half a year. The estimated lives of existing virtual worlds remained unchanged. In 2014, the Group assessed its historical data of user behavior as well as industry research data again and concluded estimated lives of existing virtual worlds remained unchanged. The Group will continue to monitor the user behavior patterns of each of its virtual worlds and will utilize such information to update the estimates of the useful lives of permanent items.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

Revenues are recorded net of sales discounts and rebates paid to distributors. The cost of providing free virtual items as a result of promotional activities was immaterial for each of the three years presented.

Users pay subscription fees and purchase virtual items using the Group's virtual currency, which can be purchased via various distribution channels, such as the prepaid cards sold by the Group, third party prepaid cards, online payment channels, and via Short Message Services ("SMS") through cellular telecom operators. Under both the time-based and the item-based revenue models, proceeds that the Group receives directly from end users for sales of online points are recorded as deferred revenues, while proceeds received from sales of online points to parties in the distribution channel and from sales of prepaid cards are initially recorded as advances from customers. As the Group does not have control over and generally does not know the ultimate selling price of the prepaid cards or online points sold by the distributors, the Group records net proceeds from the distributors as advances from customers. Upon activation of prepaid cards or purchase of online points, advances from customers are immediately transferred to deferred revenues.

Prepaid cards will expire on the expiration date printed thereon, which is generally two years after the date of card production. In November 2014, the Group changed the expiration term of newly issued prepaid cards to five years after the date of card production. Proceeds from expired prepaid cards that have not been activated are recognized as other operating income upon expiration of the cards. The Group had recognized \$1,867,626, \$1,620,842 and \$587,274 in other operating income in connection with expired prepaid cards for the years ended December 31, 2012, 2013 and 2014, respectively.

Online mobile game revenues

The Group generates such revenues primarily from licensing of its self-developed mobile games, which are played on iOS or Android based smartphones and tablets, to certain publishers including Chukong, IGG, True Digital Plus and Netmarble, etc. They publish such games to end users distribution channels, such as the iOS App Store, Google Play Store, 360 Mobile Assistant, UC Web, 91 Wireless, SnapPea, etc. Revenues generated from those games are shared between the Group and the publishers based on a predetermined percentage for each mobile game. These mobile game licensing agreements typically are two to three years.

The Group performs assessment for each mobile game licensing agreement to determine whether or not the Group acts as the principal or as an agent in the arrangement, in order to determine if relevant revenues should be reported in gross or net. The assessment and determination including but not limited to whether the Group (i) is the primary obligor in the arrangement, (ii) has latitude in establishing the selling price, (iii) has the power to change the product or perform part of the service, and (iv) has involvement in the determination of product and service specifications.

The Group concludes its responsibilities are limited to delivering mobile games to publishers for whom to operate as well as providing limited ongoing technical and customer services associate with the game contents, hence, the Group considers itself as the agent in the mobile game licensing arrangements. Accordingly, the Group records revenues generated from these licensed mobile games based on the net amount collected from those third-party publishers.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

In addition, the Group usually receives an upfront licensing fee from the publishers after the licensing agreements are signed and before the commercial launch of these mobile games. Those upfront licensing fees would be deferred and recognized as revenue until the date of the commercial launch and amortized on a straight-line basis over the licensing terms.

Offline Business

Licensing and royalty fee revenue

Revenues from the Group's offline business include licensing income and royalty fees for licensing the Group's proprietary cartoon figures to merchandisers and book publishers. Most of the revenues generated under merchandise licensing income and royalty fees are recognized at the end of each month and calculated at the contractual royalty rate times the sales of the licensed merchandise product for the month. The sales of the licensed product are derived from the monthly sales reports provided by the licensee.

In certain of the merchandise licensing arrangements, the Group receives a guaranteed base fee and additional royalty fees that are contingent on sales volume. Proceeds from minimum guaranteed royalties in excess of royalties earned are generally recognized as revenues at the end of the contract term. In a small number of its merchandise licensing arrangements, the Group receives a fixed royalty fee from the licensee over the contract period. The Group recognizes this type of royalty revenue ratably over the contract period.

Merchandise sales revenue

Revenues from selling toys, books and merchandise are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable, and collectability is reasonably assured.

Film revenue

The Group recognizes revenue from the distribution of its films when the film is exhibited in theaters, provided that no significant obligations remain, amounts can be accurately estimated, and collection is reasonably assured. Revenue from the distribution of the film on television and websites is recognized when the production is made available for exhibition and other contractual obligations or conditions are met.

Sales tax and Value-added tax

The Group is subject to sales tax at a rate of 5% for sales of prepaid Mimi cards, or value-added tax at a rate of 17% for software sales and toy sales, or value-added tax at a rate of 6% for certain other services such as advertisement, merchandise licensing and box office revenue sharing, as well as related surcharges on revenue earned from online services and offline business conducted in the PRC, respectively. The Group presents revenue net of sales taxes or value-added tax incurred.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

In July 2012, the Ministry of Finance and the State Administration of Taxation jointly issued a circular regarding the pilot collection of Value-added tax in lieu of business tax in certain areas and industries in the PRC. Such VAT pilot program is to be phased in Beijing, Jiangsu, Anhui, Fujian, Guangdong, Tianjin, Zhejiang, and Hubei between September and December 2012. Starting from August 2012, certain subsidiaries and VIEs became subject to VAT at the rates of 6% on certain service revenues which were previously subject to business tax.

(15) Advance from customers and deferred revenue

For online virtual world services, online points that have been sold but not activated yet are recognized as advance from customers. Online points that have been activated but for which online entertainment services will be rendered in the future are recognized as deferred revenue. Under the time-based model, deferred revenue is recognized as revenue based on the calendar days on which the online services are provided to the end users. Under the item-based model, deferred revenue represents the amounts of unamortized permanent items and unconsumed items. For online mobile game services, advance from customers represents the unamortized balance of upfront licensing fees paid by licensees. For offline business, advance from customers represents the unamortized balance of advance royalty fees paid by licensees.

(16) Cost of revenues

Cost of revenues consists of primarily of salaries and benefits, bandwidth costs, film production costs, amortization of upfront licensing fees, depreciation and amortization of equipment and software, inventory cost of merchandise and other direct costs.

(17) Product development costs

Product development costs consist primarily of personnel-related expenses and other overhead expenses related to the research and development activities.

The Group expenses software development costs incurred prior to reaching technological feasibility. Once a software product has reached technological feasibility, all subsequent software costs for that product are capitalized until that product is released for marketing. After a virtual world is released, the capitalized product development costs are amortized over the estimated product life. Since the inception of the Group, the amount of costs qualifying for capitalization has been immaterial and, as a result, all software development costs have been expensed as incurred.

(18) Sales and marketing expenses

Sales and marketing expenses consist primarily of advertising and promotional expenses, animation related expenses, payroll and other overhead expenses incurred by the Group's sales and marketing personnel. Advertising expenses in the amount of \$5,078,703, \$3,468,749 and \$3,983,329, for the years ended December 31, 2012, 2013 and 2014, respectively, were expensed as incurred.

(19) Government subsidies

The Group received unrestricted cash subsidies of \$3,377,496, \$3,792,495 and \$ 3,961,423 for the years ended December 31, 2012, 2013 and 2014, respectively, from local government agencies. The

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

government agencies use their discretion to determine the amount of the subsidies with reference to business tax, value-added tax and income tax paid by the Group and qualification as high technology projects as well as producing of film and TV animations. These subsidies were an incentive to the Group to establish business within a particular geographic area in China. The subsidies are unrestricted as to use and can be utilized by the Group in any manner it deems appropriate. The Group has utilized, and expects to continue to utilize, these subsidies to fund general operating expenses. The Group records unrestricted government subsidies as other operating income in the consolidated statements of operations.

(20) Share-based compensation

Share-based payment transactions with employees, such as share options and non-vested restricted shares are measured based on the grant date fair value of the equity instrument. Share-based payment transactions with nonemployees are remeasured at the end of each reporting period until a measurement date is established. The measurement date of a nonemployee award is the earlier of (1) the performance commitment date or (2) the date on which the performance is complete. The Group recognizes the compensation costs net of a forfeiture rate on a straight-line basis, over the requisite service period of the award, which is generally the vesting period of the award. The amount of compensation expenses recognized for any period is not less than the portion of the grant date fair value of the options vested during that 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 stock compensation expense to be recognized in future periods.

	Years ended December 31,		
	2012	2013	2014
Includes share-based compensation related to:			
Cost of revenues	\$ 255,315	\$ 289,921	\$ 294,132
Product development expenses	498,500	360,852	448,179
Sales and marketing expenses	68,978	31,938	16,394
General and administrative expenses	1,383,687	1,459,734	1,469,726
	<u>\$ 2,206,480</u>	<u>\$ 2,142,445</u>	<u>\$ 2,228,431</u>

(21) Operating leases

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

(22) 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

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

and liabilities and their reported amounts in the consolidated 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.

Under ASC 740 "Income Taxes", a deferred tax liability ("DTL"), except for certain exceptions which is only applicable in terms of investment in foreign subsidiaries, should be recorded for taxable temporary differences attributable to the excess of financial reporting basis over tax basis of an investment in a more than 50% interest in a domestic subsidiary, which represents the outside basis difference. However, the DTL is also not required in the situation where that such outside basis difference can be recovered tax-free and the enterprise expects that it will ultimately use that means.

The Group recognizes the impact of uncertain income tax positions at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. The Group classifies interest and/or penalties related to uncertain tax positions in income tax expense.

(23) Foreign currency translation

The functional currency and reporting currency of Taomee Holdings Limited and Taomee Hong Kong are the United States dollar ("U.S. dollar"). Monetary assets and liabilities denominated in currencies other than the U.S. dollar are translated into the U.S. dollar at the rates of exchange ruling at the balance sheet date. Transactions in currencies other than the U.S. dollar during the year are converted into U.S. dollar at the applicable rates of exchange prevailing on the first day of the month in which the transactions occurred. Transaction gains and losses are recognized in the consolidated statements of operations.

The financial records of the Group's PRC subsidiaries and VIEs are denominated in its local currency, the Renminbi ("RMB"), which is the functional currency. Assets and liabilities are translated into the U.S. dollar at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates. Revenues, expenses, gains and losses are translated into the U.S. dollar using the average rate for the period. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of accumulated other comprehensive income in the consolidated statements of changes in equity and comprehensive income (loss).

The RMB is not a freely convertible currency. The PRC State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of RMB into foreign currencies. The value of RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market. The Group's aggregate amount of cash and cash equivalents denominated in RMB amounted to RMB590,488,850 and RMB549,167,928 as of December 31, 2013 and 2014, respectively.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

(24) Concentration of credit risk

Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash and cash equivalents, due from related party and accounts receivable. All of the Group's cash and cash equivalents are held with financial institutions that the Group believes to be high credit quality. The Group conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Group establishes an allowance for doubtful accounts primarily based on the age of the receivables and factors surrounding the credit risk of specific customers.

Due to the limited availability of online payment systems in China, a substantial portion of the Group's sales are carried out via a distribution network composed of third-party distributors. In 2012, 2013 and 2014, there was no concentration of third-party distributors, and none of the distributors represented more than 10% of the total sales to third-party distributors.

(25) Fair value measurement

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 Group 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 which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The level in the hierarchy within which the fair value measurement in its entirety falls is based upon the lowest level of input that is significant to the fair value measurement as follows:

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

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 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 Group's financial instruments not reported at fair value consist of cash and cash equivalents, accounts receivable, due from related parties, accounts payable, and due to related parties. The carrying amounts of these financial instruments as of December 31, 2013 and 2014 were considered representative of their fair values due to their short-term nature.

(26) Earnings per share

Basic earnings per share is computed by dividing net income attributable to the holders of ordinary shares by the weighted average number of ordinary shares outstanding during the year. Diluted

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Continued)

earnings per share is calculated by dividing net income attributable to the holders of ordinary shares as adjusted for the effect of dilutive ordinary share equivalents, if any, by the weighted average number of ordinary shares and dilutive ordinary share equivalents outstanding during the period. Ordinary share equivalents of stock options and warrants are calculated using the treasury stock method. However, ordinary share equivalents are not included in the denominator of the diluted earnings per share calculation when inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded.

(27) Recently issued accounting pronouncements

In May 2014, the FASB and International Accounting Standards Board ("IASB") issued their converged standard on revenue recognition. The objective of the revenue standard ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries, and across capital markets. The revenue standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. For public companies, the revenue standard is effective for the first interim period within annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. The Group is in the process of evaluating the impact of the standard on its consolidated financial statements.

On August 27, 2014, the FASB issued ASU 2014-15, which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern." The ASU is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The adoption of the ASU will not have a material impact on the Group's consolidated financial statements.

In November 2014, the FASB issued a new pronouncement which provides guidance on determining whether the host contract in a hybrid financial instrument issued in the form of a share is more akin to debt or to equity. The new standard requires management to determine the nature of the host contract by considering the economic characteristics and risks of the entire hybrid financial instrument, including the embedded derivative feature that is being evaluated for separate accounting from the host contract. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. The effects of initially adopting the amendments should be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the fiscal year for which the amendments are effective. The adoption of the amendments will not have a material impact on the Group's consolidated financial statements.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

3. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consisted of the following:

	December 31,	
	2013	2014
Leasehold improvements	\$ 1,287,820	\$ 1,565,172
Computers and office equipment	4,329,524	4,474,072
Vehicle	370,346	261,317
Software	637,988	289,455
	6,625,678	6,590,016
Less: accumulated depreciation and amortization	(4,785,259)	(4,776,356)
Property and equipment, net	<u>\$ 1,840,419</u>	<u>\$ 1,813,660</u>

Depreciation and amortization expense for property and equipment was \$1,456,990, \$1,296,956 and \$990,583 for the years ended December 31, 2012, 2013 and 2014, respectively.

4. INVESTMENT IN EQUITY METHOD INVESTEEES

As of December 31, 2013 and 2014, the Group's investments in equity method investees comprised of the following:

	As of December 31,	
	2013	2014
Elyn Corporation ("Elyn")/Playgame Sdn. Bhd ("Playgame")	\$ 1,216,776	\$ 906,158
Joy Children Technology Co., Ltd. ("Joy Children")	748,883	694,502
Guangzhou Chuangyou Information Technology Co., Ltd. ("Chuangyou")	82,521	16,320
Shanghai Taoyue Information Technology Co., Ltd. ("Taoyue")	173,452	—
Jiangxi Haomi Network Technology Co., Ltd. ("Jiangxi Haomi")	2,070,874	1,581,734
Shanghai Weiju Network Technology Co., Ltd ("Shanghai Weiju")	—	505,642
Beijing Caviar Communications Co., Ltd ("Caviar Communications")	—	4,079,501
	<u>\$ 4,292,506</u>	<u>\$ 7,783,857</u>

Elyn, Joychildren and Playgame

In December 2009, the Company obtained a 40% equity interest in Elyn Corporation ("Elyn"), a newly formed entity and its wholly owned subsidiary, Taiwan Taomee Co., LTD ("Taiwan Taomee"), of which 20% equity interest was initially held through a related party, as consideration, in exchange for a three-year exclusive right to operate three virtual worlds on the Group's online entertainment platform in Taiwan and other areas in Asia. The fair value of the exclusive operating right contributed by the Company was \$1,666,680. As the Company has the ability to exercise significant influence over Elyn, the Group accounts for this investment using the equity method of accounting.

TAOMEE HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

4. INVESTMENT IN EQUITY METHOD INVESTEEES (Continued)

In February 2011, the Company entered into an agreement to sell 10.5% of its equity interest in Elyn and recognized a gain of \$3,662,098 in the consolidated statement of operations. In addition, the nominee shareholding agreement was terminated with the related party and the Company held all of its 29.5% equity in Elyn directly, and continues to account for this investment using the equity method.

On August 12, 2011, the Company's equity interest in Elyn was diluted from 29.5% to 28.8% as a result of Elyn's issuing shares to its employees.

In November 2011, Taiwan Taomee underwent reorganization and contemporaneously issued new ordinary shares to existing shareholders and certain employees. As a result of such transactions, the Company's equity interest in Taiwan Taomee was changed from 28.8% interest held through Elyn to a 27.6% effective interest which is now held through (1) 29.50% in Elyn, which held 72.09% of Taiwan Taomee, and (2) 28.77% in Joy Children, shell company with no operations, which held 21.86% of Taiwan Taomee. The decrease in the Company's equity interest in Taiwan Taomee reflected a dilution resulting from shares issued to Taiwan Taomee's employees. In addition, the Company paid cash consideration of \$668,992 for the newly issued shares of Taiwan Taomee through Joy Children, which was recorded as an increase in equity method investment.

In July 2012, the Company's aggregated equity interest through Elyn and Joy Children in Taiwan Taomee was diluted from 27.6% to 27.1% due to an issuance of new ordinary shares by Taiwan Taomee from capital surplus and appropriations of 2011 earnings to certain existing shareholders and employees.

In June 2013, as part of a restructuring of Taiwan Taomee, our equity interest in Taiwan Taomee held through Elyn was transferred to Playgame Sdn. Bhd ("Playgame"), a holding company established in Malaysia, and Elyn was liquidated. Our aggregated equity interest in Taiwan Taomee was not changed. In September 2013, Playgame transferred 3% of Taiwan Taomee's shares to Taiwan Taomee's underwriters after its initial public offering in Taiwan Emerging Stock Market. As a result, Playgame's equity interest in Taiwan Taomee was diluted from 70.88% to 67.87%, resulting in a gain from investment of approximately \$287,790 recognized within share of profit in equity method investees in the consolidated statements of operations of 2013.

The Group received cash dividends of \$6,318, \$424,483, and \$337,659 from Elyn/Playgame and \$616,802, \$156,755 and \$63,728 from Joy Children, which were recorded as return on investment in Elyn/Playgame and Joy Children in 2012, 2013 and 2014, respectively.

As of December 31, 2013 and 2014, the Group effectively held 26.2% and 26.2% in Taiwan Taomee through Playgame and Joy Children. The Group's share of profit in these equity method investments recorded in the consolidated statements of operations for 2012, 2013 and 2014 was \$506,644, \$500,388 and \$27,041 from Elyn/Playgame and \$191,381, \$96,869 and \$9,347 from Joy Children, respectively.

Ruigao

In October 2010, pursuant to an equity investment agreement entered into with Shenzhen Decent Investment Limited (Note 14) and two individuals unrelated to the Group, Shenzhen Ruigao

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

4. INVESTMENT IN EQUITY METHOD INVESTEEES (Continued)

Information Technology Co., Ltd. ("Ruigao") was formed in the PRC for the purpose of developing console games. Shanghai Taomee obtained a 17.65% equity interest in Ruigao for total cash consideration of \$986,370, which was paid in two installments, with the first payment being made in October 2010 and the remaining payment of \$502,534 being paid in the first quarter of 2011. As Shanghai Taomee has the ability to exercise significant influence over Ruigao, the Group accounts for this investment using the equity method of accounting.

In May 2012, a third party investor obtained 7.5% equity interest in Ruigao through a capital injection. As a result of this transaction, Shanghai Taomee's effective equity interest in Ruigao was diluted to 15.61%. In July 2012, Shanghai Taomee sold all its equity interest in RuiGao for \$1,041,124 and recorded a gain of \$323,982. The Group's equity in profit of Ruigao in 2012 was \$152,953.

Chuangyou

In the first quarter of 2012, Shanghai Taomee paid RMB900,000 (\$142,694) to acquire a 6% of equity interest in Guangzhou Chuangyou Information Technology Co., Ltd ("Chuangyou"), a company principally engaged in the design and development of online games in China, and a call option to further subscribe for a 13.16% newly issued equity interest in the future at RMB3,500,000 (equivalent to \$555,476) if certain operating targets are met ("Call Option"). In September 2012, Shanghai Taomee exercised the Call Option and completed the further acquisition in January 2013 with a total equity share of 19.16%. Prior to these events, Chuangyou was a related party of the Group as one of Chuangyou's investors is the Company's director and also a principal shareholder. Refer to Note 14 for detail description of related party transactions.

Shanghai Taomee has the ability to exercise significant influence over Chuangyou primarily through representation in the board of directors and accounts for the investment using the equity method of accounting. In December 2013, Chuangyou entered into an agreement to issue new shares for RMB2.5 million (approximately \$0.4 million) to a new investor and the transaction was completed in June 2014. The Group's equity interest in Chuangyou was diluted to 9.58% (the investment is still accounted for using the equity method of accounting as Shanghai Taomee has the ability to exercise significant influence) while the Group did not participate in the subscription of the new issuance of shares, and the Group recorded a gain of \$41,826 as the deemed disposal of investment.

As of December 31, 2013, the Group assessed that Chuangyou had experienced a deteriorating financial position and performance and could hardly generate any positive future cash flows. Accordingly, the Group recorded an impairment loss of \$370,407 on Chuangyou investment based on its fair value.

The Group's equity in the losses of Chuangyou in 2012, 2013 and 2014 were \$35,310, \$212,240 and \$108,027, which were recognized as share of loss in equity method investments in the consolidated statements of operations.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

4. INVESTMENT IN EQUITY METHOD INVESTEEES (Continued)

Taoyue

In March 2013, pursuant to an equity investment agreement entered into with five individuals unrelated to the Group, Shanghai Taoyue Information Technology Co., Ltd. ("Taoyue") was formed in the PRC for the purpose of developing online games. Shanghai Taomee obtained a 40% equity interest in Taoyue for a cash consideration of RMB2.0 million (equivalent to \$323,798).

As Shanghai Taomee has the ability to exercise significant influence over Taoyue, the Group accounts for this investment using the equity method of accounting. In January 2014, Shanghai Taomee sold all its equity interest in Taoyue to an existing shareholder of Taoyue for RMB2.0 million and recorded a gain of \$156,530 upon the completion of the transaction.

The Group's equity in the losses of Taoyue in 2013 and 2014 were \$150,052 and \$5,627, which were recognized as share of loss in equity method investments in the consolidated statements of operations.

Jiangxi Haomi

In September 2013, pursuant to an equity investment agreement entered into with two individuals unrelated to the Group, Jiangxi Haomi Network Technology Co., Ltd. ("Jiangxi Haomi") was formed in the PRC to develop family entertainment and education applications on mobile and multi-screen platforms in Mainland China. Shanghai Taomee obtained a 43% equity interest in Jiangxi Haomi for cash consideration of RMB12.9 million (approximately \$2.1 million).

As Shanghai Taomee has the ability to exercise significant influence over Jiangxi Haomi, the Group accounts for this investment using the equity method of accounting.

The Group's equity in the losses of Jiangxi Haomi in 2013 and 2014 were \$27,199 and \$489,140, which were recognized as share of loss in equity method investments in the consolidated statements of operations.

Shanghai Weiju

In January 2014, Shanghai Taomee entered into an agreement with Shanghai Weiju Network Technology Co., Ltd. ("Shanghai Weiju"), a Hi-tech toy design and R&D company, to acquire its 25% equity interest for a cash consideration of RMB3.0 million (approximately \$0.5 million).

As Shanghai Taomee has the ability to exercise significant influence over Shanghai Weiju, the Group accounts for this investment using the equity method of accounting.

In December 2014, Shanghai Taomee increased its equity shareholding in Shanghai Weiju from 25% to 45% for a cash consideration of RMB10.0 million (approximately \$1.6 million), of which RMB0.5 million (approximately \$0.1 million) was paid in December 2014, and the rest was paid in January 2015. The Group continues to account for this investment using the equity method of accounting as the Group has no control over Shanghai Weiju.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

4. INVESTMENT IN EQUITY METHOD INVESTEEES (Continued)

The Group's equity in the losses of Shanghai Weiju in 2014 was \$64,824 and was recognized as share of loss in equity method investments in the consolidated statements of operations.

Caviar Communications

In November 2014, Shanghai Taomee entered into an investment agreement with two unrelated parties to establish a company, Beijing Caviar Communications Co., Ltd ("Caviar Communications") to operate "the Voice Kids China" live show and other family entertainment shows focusing on kids and teenagers in China. Shanghai Taomee obtained a 20% equity interest in Caviar Communications for a cash consideration of RMB25.0 million (approximately \$4.1 million).

As Shanghai Taomee has the ability to exercise significant influence over Caviar Communications, the Group accounts for this investment using the equity method of accounting.

The Group's equity in the profit or loss of Caviar Communications in 2014 was nil as the Caviar Communications was newly formed in December and there were no operations in 2014.

5. INVESTMENT IN COST METHOD INVESTEEES

As of December 31, 2013 and 2014, the Group's investments in cost method investees comprise the following:

	As of December 31,	
	2013	2014
Gamespedia Holdings Limited. (Gamespedia)	6,205,000	6,205,000
Voozclub Co., Ltd. (Voozclub)	1,400,000	—
Company A	2,000,000	2,000,000
Company B	150,003	150,003
Total	9,755,003	8,355,003

The Company applies the cost method of accounting for investments in unconsolidated affiliates when the Company does not have the ability to exercise significant influence.

In September 2012, the Company acquired 8.02% equity interest in Gamespedia Holdings Limited ("Gamespedia") for \$6.2 million in cash. Gamespedia is a Cayman company and operates its mini game portal website through its wholly owned subsidiaries and VIEs in China. This investment is accounted for under the cost method.

In February 2013, the Company acquired a minority equity interest in Voozclub Co., Ltd. ("Voozclub"), a Korea-based character and animation studio with an established presence in global brand licensing, online games, publishing and theme parks, for a cash consideration of \$1.4 million. As of September 30, 2014, the Company assessed that Voozclub had experienced a deteriorating financial position and performance, was in doubt to generate positive future cash flows and is highly likely facing bankruptcy. Accordingly, the Company recorded an impairment loss of \$1.4 million on its entire investment in Voozclub.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

5. INVESTMENT IN COST METHOD INVESTEEES (Continued)

In September 2013, the Company acquired a minority stake of a Beijing-based pre-school education service provider ("Company A") for a cash consideration of \$2.0 million.

In December 2013, the Company acquired a minority stake of a company in United States that develops mobile applications, animation and products for pre-school children ("Company B"), for a cash consideration of \$150,003.

6. ORDINARY SHARES

On June 10, 2011, the Company completed an initial public offering of 154,254,480 ordinary shares on New York Stock Exchange and received proceeds of \$64,555,500, net of underwriting discounts and commissions of \$4,859,016. On June 8, 2011, the Company listed its ADSs on the New York Stock Exchange, or NYSE, under the ticker symbol "TAOM". As of December 31, 2013 and 2014, the Group had 16,557,901 and 6,596,410 ordinary shares respectively, including restricted shares, which were legally issued according to its share incentive plans, but were not deemed issued or outstanding from an accounting perspective.

7. TREASURY STOCK

In November 2011, the Company's Board authorized a share repurchase program to repurchase up to US\$10 million of the Company's American Depositary Shares ("ADSs") (each ADS represents twenty ordinary shares) from November 2011 to November 2012. In September 2012, the Group decided to further extend the share repurchase plan for another 12 months to November 23, 2013. In December 2013, the Group announced the further extension of the share repurchase plan from November 24, 2013 to November 23, 2014.

During the years of 2012, 2013 and 2014, the Company repurchased 461,894, 478,625 and 990,812 ADSs respectively on the open market, representing 9,237,880, 9,572,500 and 19,816,240 ordinary shares for total cash consideration of \$1,754,792, \$2,056,771 and \$5,625,935, respectively. As of December 31, 2014, the Company has repurchased a total of 2,054,989 ADSs, representing 41,099,780 ordinary shares for cash consideration of \$10,000,000.

On March 28, 2014, the Company's Board authorized a second share repurchase program to repurchase up to another \$10 million worth of the outstanding American Depositary Shares ("ADSs") (each ADS represents twenty ordinary shares of the Company) over the next 12 months. On March 21, 2015, the Group extended this share repurchase plan from March 29, 2015 to March 28, 2016.

Pursuant to the second share repurchase program, the Company repurchased 885,381 ADSs on the open market, representing 17,707,620 ordinary shares for total cash consideration of \$4,696,477 during the year ended December 31, 2014.

8. SHARE-BASED COMPENSATION

The Company measures share-based compensation cost on the grant date at the fair value of the award and recognizes this cost as an expense over the grant recipients' requisite service periods.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

8. SHARE-BASED COMPENSATION (Continued)

The following table presents the Company's share-based compensation expense by type of award:

	Years ended December 31,		
	2012	2013	2014
Share options	\$ 792,691	\$ 671,768	\$ 387,817
Non-vested restricted shares	1,413,789	1,470,677	1,840,614
Total share-based compensation	\$ 2,206,480	\$ 2,142,445	\$ 2,228,431

Prior to 2009, the Group did not grant share-based awards to employees, officers, directors or individual consultants and/or advisors who rendered services to the Group.

2009 Share Incentive Plan

On May 6, 2009, the Board of Directors of the Company approved the 2009 Share Incentive Plan, which authorized the issuance of options to purchase up to 45,000,000 ordinary shares to the Group's employees, directors, and consultants, as determined by the Board of Directors of the Company. The maximum contractual term of the awards under this plan shall be no more than ten years from the date of grant.

In June 2009 and June 2010, 10,500,000, 35,175,000 options were granted to the employees of the Group at exercise prices at \$0.04 and \$0.07, respectively, and these awards vest over a four-year period, with 25% of the options to vest on the each of the anniversary after the grant date.

As of December 31, 2014, options to purchase 6,548,240 ordinary shares were outstanding under the Company's 2009 Share Incentive Plan.

On March 18, 2014, the Company granted a total of 1,600,000 non-vested restricted shares to employees at par value, under the Company's 2009 Share Incentive Plan. These restricted shares will vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date.

As of December 31, 2014, there was \$413,636 of total unrecognized compensation expense related to non-vested restricted shares granted under 2009 share incentive plan, which is expected to be recognized over a weighted-average period of 3.2 years.

2010 Share Incentive Plan

On June 13, 2010, the Board of Directors of the Company further approved the 2010 Share Incentive Plan, which authorized the issuance of options to purchase up to 55,000,000 ordinary shares to employees, directors, and consultants of the Group, as determined by the Board of Directors of the Company. The maximum contractual term of the awards under this plan shall be no more than ten years from the date of grant.

On January 4, 2011, the Company granted options to the employees of the Group and a third party consultant to purchase 16,665,000 and 2,500,000 of ordinary shares of the Company, respectively, at an exercise price of \$0.36 per share under the Company's 2010 Share Incentive Plan. These options

TAOMEE HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

8. SHARE-BASED COMPENSATION (Continued)

vest over a four-year requisite service period, with 25% of the options to vest on each anniversary after the grant date. The 2,500,000 options were provided in exchange for consulting services which were to have been delivered over the next four years. In September 2011, the options granted to a third party consultant were forfeited as the underlying service contract was terminated.

On May 24, 2011, the Company granted options to the directors and certain employees to purchase a total of 20,175,000 ordinary shares of the Company at an exercise price of \$0.45 per share under the Company's 2010 Share Incentive Plan. These options vest over either a four or three year period, each with a graded vesting schedule, all commencing on May 24, 2011.

On November 21, 2011, the Company granted options to an employee of the Group to purchase up to 150,000 ordinary shares at an exercise price of \$0.26 per share under the Company's 2010 Share Incentive Plan. These options vest over a four-year requisite service period, with 25% of the options to vest on each anniversary after the grant date.

On July 16, 2012, the Company granted options to employees and directors of the Group to purchase up to a total of 19,840,000 ordinary shares of the Company at an exercise price of \$0.24 per share under the Company's 2010 Share Incentive Plan. These options vest over a four-year period, each with a graded vesting schedule, all commencing on July 16, 2012.

On July 20, 2012, the Company granted options to directors of the Group to purchase up to a total of 3,600,000 ordinary shares of the Company at an exercise price of \$0.20 per share under the Company's 2010 Share Incentive Plan. These options vest over a three year period, each with a graded vesting schedule, all commencing on July 20, 2012.

As of December 31, 2014, options to purchase 10,970,000 ordinary shares were outstanding under the Company's 2010 Share Incentive Plan.

On May 24, 2011 and July 16, 2012, the Company granted 4,500,000 and 400,000 non-vested restricted shares to its employees and officers for no consideration, respectively, under the Company's 2010 Share Incentive Plan. These restricted shares vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date.

On September 4, November 5, and December 11, 2013, the Company granted a total of 10,190,000, 4,800,000 and 394,560 non-vested restricted shares to employees, officers and an external consultant at par value, respectively, under the Company's 2010 Share Incentive Plan. These restricted shares vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date.

As of December 31, 2014, there was \$1,366,494 of total unrecognized compensation expense related to non-vested restricted shares granted under 2010 share incentive plan, which is expected to be recognized over a weighted-average period of 2.7 years

2012 Share Incentive Plan

On July 25, 2012, the Annual General Meeting of the Company further approved the 2012 Share Incentive Plan, which authorized the issuance of options to purchase up to 30,000,000 ordinary shares

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

8. SHARE-BASED COMPENSATION (Continued)

to employees, directors, and consultants of the Group, as determined by the Board of Directors of the Company. The maximum contractual term of the awards under this plan shall be no more than ten years from the date of grant. As of December 31, 2014, there were no options granted under the 2012 Share Incentive Plan.

On April 22, 2014, the Company granted 1,000,000 non-vested restricted shares to an officer at par value, under the Company's 2012 Share Incentive Plan. One-fourth ($\frac{1}{4}$) of the restricted shares will vest on the first anniversary of the grant date; the remaining three-fourth ($\frac{3}{4}$) of the restricted shares (rounded down to the next whole number of shares) will vest over thirty-six (36) equal installments at the ending of each calendar month over a period of thirty-six (36) consecutive months subsequent to the first anniversary of the grant date requisite service period.

On July 1, 2014, the Company granted 60,000 non-vested restricted shares to an independent director at par value, under the Company's 2012 Share Incentive Plan. These restricted shares will vest over a one-year requisite service period, with 100% to vest on the first anniversary after the grant date.

As of December 31, 2014, there was \$254,292 of total unrecognized compensation expense related to non-vested restricted shares granted under 2012 share incentive plan, which is expected to be recognized over a weighted-average period of 3.2 years

Share Options

The weighted-average grant date fair value for options granted during the years ended December 31, 2012, 2013 and 2014 was \$0.12, nil and nil per share, respectively. 9,639,780, 10,412,700 and 5,157,820 options were exercised during the years ended December 31, 2012, 2013 and 2014, respectively. Total intrinsic value of options exercised for the years ended December 31, 2012, 2013 and 2014 was \$1,251,212, \$1,569,183 and \$1,048,500, respectively.

On March 30, 2012, 14,090,000 shares granted on January 4, 2011 and 14,700,000 shares granted on May 24, 2011 have been converted to restricted shares at a ratio of 3:1. This event was accounted for as a modification of share-based award with no incremental compensation cost recognized as the fair value of the restricted shares was not more than the fair value of the options canceled on the date of exchange.

The fair value of the options was estimated using the binomial option-pricing model in 2012. The risk-free interest rate for periods within the contractual life of the option is based on the yield of Chinese International Government Bond, which is denominated in U.S. dollars. The expected life of options granted represents the period of time that the options are expected to be outstanding and is based on option terms related to vesting schedule and option expiration date. Expected volatilities are based on the volatility of comparable companies with the time period commensurate with the expected time period.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

8. SHARE-BASED COMPENSATION (Continued)

The key assumptions used in the binomial option-pricing model were as follows:

	2012
Risk-free interest rate	2.51%-3.04%
Expected term	—
Contractual term	8.78-10 years
Expected volatility rate	54.57%-57.16%
Dividend yield	0%

In determining the fair value of the Company's ordinary shares underlying the options, the Company used the closing spot price of the Company on the principal exchange or system.

A summary of the option activity for the year ended December 31, 2014 and the information regarding the options outstanding as of December 31, 2014 were as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contract terms	Aggregate intrinsic value
Options outstanding at January 1, 2014	27,999,840	\$ 0.16		
Forfeited	(5,323,780)	\$ 0.21		
Exercised	(5,157,820)	\$ 0.09		
Options outstanding at December 31, 2014	<u>17,518,240</u>	\$ 0.17	6.6 years	701,202
Options vested or expected to vest at December 31, 2014	<u>16,642,328</u>	\$ 0.11	3.1 years	666,142
Options exercisable at December 31, 2014	<u>13,275,740</u>	\$ 0.15	6.4 years	701,202

As of December 31, 2014, there was \$332,267 in total unrecognized compensation expense related to unvested options granted under the share incentive plans, which is expected to be recognized over a weighted-average period of 1.3 years.

Non-vested Restricted Shares

In June, 2012, Shanghai Taomee granted a co-founder and senior management of Guangdong Taomee a 15% equity interest in Guangdong Taomee in the form of non-vested restricted shares. These restricted shares will vest over a three-year requisite service period, with 33.3% to vest on each anniversary after the grant date. The fair value of non-vested restricted shares was determined based on estimated fair value of Guangdong Taomee on the grant date. The Company recorded \$46,072, \$80,571 and \$81,323 compensation expense related to these non-vested restricted shares in 2012, 2013 and 2014. As of December 31, 2014, there was \$40,681 unrecognized compensation expense to be recognized over the weighted-average period of 0.5 years.

In June, 2014, Shanghai Shengran granted a co-founder and senior management of Shanghai Xinsheng an 8.33% equity interest in Shanghai Xinsheng in the form of non-vested restricted shares. 5.33% of the granted restricted shares will vest upon the completion of Shanghai Xinsheng's capital

TAOMEET HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

8. SHARE-BASED COMPENSATION (Continued)

injection, and another 3% will be vested in increments of 1% on each January 1, following the first, second and third anniversaries, respectively, of the starting date of the co-founder's labor contract. The Company recorded \$216,854 compensation expense related to these non-vested restricted shares in 2014. As of December 31, 2014, there was \$68,516 unrecognized compensation expense to be recognized over the weighted-average period of 2.0 years.

In June, 2014, Shanghai Taomee granted a co-founder and senior management of Shanghai Jushou an 8.33% equity interest in Shanghai Jushou in the form of non-vested restricted shares. 5.33% of the granted restricted shares will vest upon Shanghai Jushou's establishment, and another 3% will be vested in increments of 1% on each January 1, following the first, second and third anniversaries, respectively, of the starting date of the co-founder's labor contract. The Company recorded \$108,163 compensation expense related to these non-vested restricted shares in 2014. As of December 31, 2014, there was \$34,258 unrecognized compensation expense to be recognized over the weighted-average period of 2.0 years.

The fair value of non-vested restricted shares granted to employees, officers and independent director was computed based on the fair value of the Group's ordinary shares on each respective grant date, while the fair value of non-vested restricted shares granted to an external consultant was re-measured at the end of each reporting period until the services being provided is completed.

A summary of the non-vested restricted shares activities under share incentive plan for the year ended December 31, 2014 and the information regarding the restricted shares outstanding as of December 31, 2014 were as follows:

	Number of Non-vested Restricted Shares	Weighted average grant-date fair value
Non-vested as of January 1, 2014	19,040,414	0.32
Granted	2,660,000	0.32
Forfeited	(7,553,727)	0.32
Vested	(4,803,671)	0.40
Non-vested as of December 31, 2014	<u>9,343,016</u>	<u>0.28</u>

9. TAXATION

Cayman Islands

The Company is incorporated in the Cayman Islands. Payments of dividends and capital in respect of the Company's shares will not be subject to taxation in the Cayman Islands and no withholding will be required on the payment of a dividend or capital to any holder of the Company's shares, nor will gains derived from the disposal of the Company's shares be subject to Cayman Islands income or corporation tax. The Cayman Islands currently have no income, corporation or capital gains tax and no estate duty, inheritance tax or gift tax.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

9. TAXATION (Continued)

Hong Kong

The Group's subsidiary in Hong Kong did not have assessable profits that were derived in Hong Kong during each of the three years ended December 31, 2012, 2013 and 2014. Therefore, no Hong Kong profit tax has been provided for in the years presented.

PRC

Pursuant to PRC New Corporate Income Tax Law effective January 1, 2008, the Group's VIE subsidiaries incorporated in the PRC are subject to Enterprise Income Tax ("EIT") on the taxable income as reported in their respective statutory financial statements adjusted in accordance with the EIT Law and the Income Tax Law of the People's Republic of China.

In April 2009, Shanghai Taomee obtained a Software Enterprise Certification (the "Certification"), which was effective on January 1, 2009. An enterprise having such Certification is entitled to two years' exemption and three years' 50% reduction in corporate income tax (the "tax holiday"). Shanghai Taomee was subject to an income tax rate of 0% for both 2009 and 2010, and 12.5% from 2011 to 2013. Shanghai Taomee's tax holiday period was approved by relevant tax authorities in May 2010. In 2010 Shanghai Taomee obtained "High and New Technology Enterprise" ("HNTE") qualification. Subject to certain new implementation rules for application and assessment of HNTE announced by certain government authorities in 2008, every qualified HNTE company is required to re-apply for this qualification. The HNTE qualification is valid for three years and could be renewed for another 3 year period. In 2013 Shanghai Taomee re-applied for the HNTE and received approval for the HNTE qualification. In 2014 Shanghai Taomee was approved to apply for the 15% preferential tax treatment as a HNTE from January 2014 to December 2015.

In September 2010, Shanghai Shengran also obtained a Software Enterprise Certification and was informed in April 2011 that the full EIT exemption would apply retroactively in 2009 and 2010, and 50% reduction in EIT rate will apply from 2011 to 2013. In May 2012, Shanghai Shengran further received a written approval from local tax authorities, according to which Shanghai Shengran was entitled to the full EIT exemption for 2010 and 2011, and 50% reduction in EIT rate of 12.5%, from 2012 to 2014, which resulted in an adjustment of \$2.1 million as a one-time tax benefit in 2012. In 2013, Shanghai Shengran obtained "High and New Technology Enterprise" qualification, or HNTE qualification, which is effective for a period of three years and could be renewed thereafter. Currently, Shanghai Shengran has not applied to the relevant tax authority for preferential tax treatment as a HNTE.

In November 2013, Shanghai Animation obtained an Animation Enterprise Certification, which provides an enterprise entitling to two years' exemption and three years' 50% reduction in corporate income tax (the "tax holiday"). Currently Shanghai Animation has not applied to the relevant tax authority for the two-year EIT exemption and a three-year 50% EIT rate reduction preferential tax treatment as an "animation enterprise" due to its accumulated loss position.

In October 2013, Shanghai Xinsheng also obtained a Software Enterprise Certification and in 2014 Shanghai Xinsheng has not applied to the relevant tax authority for the two-year EIT exemption and a three-year 50% EIT rate reduction preferential tax treatment as a "software enterprise" due to its accumulated loss position.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

9. TAXATION (Continued)

Shanghai Qidong, Guangdong Taomee, Shanghai Xinsheng, Shanghai Wireless, Shanghai Software, Shanghai Property Service and Shanghai Jushou were subject to an income tax rate of 25%.

Pursuant to the Notice on Several Economic Policies for Supporting the Development of Films promulgated jointly by the Ministry of Finance, the National Development and Reform Commission, the Ministry of Land and Resources, and other departments on May 31, 2014, which took effect on the same day, from January 1, 2014 to December 31, 2018, film producing companies will be exempted from paying VAT on the revenues generated from their sale of film copies (including digital copies) or the transfer of copyright, and film distribution companies will be exempted from paying VAT on revenues generated from distribution of films. Shanghai Taomee has obtained such VAT exemption for revenues generated from Mole II film and Shanghai Animation has obtained such VAT exemption for revenues generated from Seer IV film and Mole III film.

In accordance with the EIT Law, dividends, which arise from profits of foreign invested enterprises ("FIEs") earned after January 1, 2008, are subject to a 10% withholding income tax. In addition, under certain tax treaties between the PRC and Hong Kong, if the foreign investor is incorporated in Hong Kong and qualifies as a Hong Kong tax resident and beneficial owner, the applicable withholding tax rate is reduced to 5%, if the investor holds at least 25% in the FIE, or 10%, if the investor holds less than 25% in the FIE. A deferred tax liability should be recognized for the undistributed profits of PRC companies unless the Company has sufficient evidence to demonstrate that the undistributed dividends will be reinvested and the remittance of the dividends will be postponed indefinitely. As of December 31, 2014, the Group plans to indefinitely reinvest undistributed profits earned from Shanghai Shengran in its operations in the PRC. Therefore, no withholding income tax for undistributed profits of Shanghai Shengran has been provided in 2014.

Upon distribution of those earnings generated after January 1, 2008, in the form of dividends, the Group would be subject to the applicable PRC dividend withholding tax. Distributions of earnings generated before January 1, 2008 are exempt from PRC dividend withholding tax. The amounts of unrecognized deferred tax liabilities for these earnings generated after January 1, 2008 are in the range of \$3.4 million to \$6.9 million, as the withholding tax rate of the profit distribution will be 5% or 10% depending on whether the immediate offshore companies can enjoy the preferential withholding tax rate of 5%.

Under applicable accounting principles, a deferred tax liability should be recorded for taxable temporary differences attributable to the excess of financial reporting basis over tax basis 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. In 2013, deferred tax liabilities of US\$1.5 million were accrued for undistributed earnings of Shanghai Taomee and Guangdong Taomee, on the basis that distribution of the earnings, in the form of dividends or otherwise, to Shanghai Shengran would be subject to the applicable PRC tax laws and regulations, unless a tax strategy which the Group determined to avail itself of were devised to avoid such tax. Prior to 2013, these entities were in an accumulated loss position. In 2014, the Group reversed the deferred tax liabilities of US\$1.5 million after the Group completed its feasibility analysis on a method, which the Group could ultimately execute if necessary to repatriate the undistributed earnings of VIEs without significant tax costs.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

9. TAXATION (Continued)

The Group made its assessment of the level of authority for each of its uncertain tax position (including the potential application of interests and penalties) based on the technical merits, and has measured the unrecognized benefits associated with the tax positions. This assessment did not have any impact on the Group's total liabilities or equity. At December 31, 2012, 2013 and 2014, the amounts of gross unrecognized tax benefits were zero. The Group does not anticipate any significant increase to its liability for unrecognized tax benefit within the next 12 months. The Group will classify interest and penalties related to income tax matters, if any, in income tax expense.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of income taxes is due to computational errors made by the taxpayer. The statute of limitations will be extended to five years under special circumstances, which are not clearly defined, but an underpayment of income tax liability exceeding RMB100,000 is specifically listed as a special circumstance. In the case of a transfer pricing related adjustment, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. The Group's PRC subsidiaries are therefore subject to examination by the PRC tax authorities from 2010 through 2014 on non-transfer pricing matters, and from 2007 (year of incorporation) through 2014 on transfer pricing matters.

Reconciliation between the effective income tax rate and the PRC statutory income tax rate was as follows:

	Years ended December 31,		
	2012	2013	2014
PRC statutory tax rate	25.0%	25.0%	25.0%
Tax effect of other expenses that are not deductible in determining taxable profit	0.4%	2.5%	(1.1)%
Effect of different tax rate of group entity operating in other jurisdictions	7.0%	3.5%	(94.5)%
Effect of tax holidays granted to PRC subsidiaries, deferred income tax impact	(2.8)%	(8.5)%	42.5%
Effect of tax holidays granted to PRC subsidiaries, current income tax impact	(13.9)%	(13.7)%	60.5%
Effect of additional research and development of new technology, products, and processes ("R&D") deduction	(3.5)%	(1.8)%	20.9%
Effect of valuation allowance	1.4%	1.3%	(30.1)%
Withholding tax on undistributed earnings	—	21.8	120.4%
Effect of adjustment of prior year tax benefit	(26.0)%	(9.6)%	28.5%
Effective tax rate	<u>(12.4)%</u>	<u>20.5%</u>	<u>172.1%</u>

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

9. TAXATION (Continued)

The aggregate dollar effect of tax holidays on income tax expense for the period amounted to \$2,546,454, \$1,551,717 and \$1,294,093 in 2012, 2013 and 2014, respectively, representing a decrease in basic earnings per share of less than \$0.01 and a decrease in diluted earnings per share less than of \$0.01 for each of the three years in the period ended December 31, 2014.

The principal components of the Group's deferred income tax assets and liabilities as of December 31, 2013 and 2014 were as follows:

	<u>December 31,</u>	
	<u>2013</u>	<u>2014</u>
Deferred tax assets:		
Deferred revenue and advance from customers	\$ 2,738,502	\$ 3,413,330
Payroll payable and accrued expenses	639,491	890,948
Net operating losses	475,471	923,494
Advertising expenses	356,419	928,032
Other	292,192	422,975
Gross deferred tax assets:	\$ 4,502,075	\$ 6,578,779
Valuation allowances	(335,987)	(705,962)
Net deferred tax assets	<u>\$ 4,166,088</u>	<u>\$ 5,872,817</u>
Deferred tax liabilities:		
U.S. GAAP related and amortization of intangible assets	229,540	698,800
Undistributed retained earnings of VIE	1,528,594	—
Net deferred tax liabilities	<u>\$ 1,758,134</u>	<u>\$ 698,800</u>
Deferred tax assets are analyzed as:		
Current	\$ 4,166,088	\$ 5,872,817
Non-Current	—	—
	<u>\$ 4,166,088</u>	<u>\$ 5,872,817</u>
Deferred tax liabilities are analyzed as:		
Current	\$ 1,758,134	\$ 698,800
Non-Current	—	—
	<u>\$ 1,758,134</u>	<u>\$ 698,800</u>

The Group considers positive and negative evidence to determine whether some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

As of December 31, 2014, some of the Group's PRC subsidiaries and VIE subsidiaries had net operating loss carry forwards of \$3.69 million, of which \$0.01 million, \$0.01 million, \$0.78 million, \$0.26 million and \$2.63 will expire in 2015, 2016, 2017 and 2018 and 2019, respectively. The Group has

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

9. TAXATION (Continued)

provided a full valuation allowance on certain subsidiaries as it is more likely than not that the net operating losses cannot be utilized before expiry.

10. EMPLOYMENT BENEFITS AND PROFIT APPROPRIATION

The full-time employees of the Company's subsidiaries and VIE subsidiaries that are incorporated in the PRC are entitled to staff welfare benefits, including medical care, welfare subsidies, unemployment insurance and pension benefits through a PRC government-mandated multi-employer defined contribution plan. These companies are required to accrue for these benefits based on certain percentages of the employees' salaries in accordance with the relevant regulations, and to make contributions to the state-sponsored pension and medical plans out of the amounts accrued for medical and pension benefits. The total amounts charged to the consolidated statements of operations for such employee benefits amounted to \$3,130,133, \$3,721,218 and \$3,865,896 for the years ended December 31, 2012, 2013 and 2014 respectively. The PRC government is responsible for the medical benefits and ultimate pension liability to these employees.

11. RESTRICTED NET ASSETS

Pursuant to laws applicable to entities incorporated in the PRC, the subsidiaries and the VIEs of the Group in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires annual appropriation of 10% of after tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserve fund reaches 50% of their registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserve funds can only be used for specific purposes of enterprise expansion and staff bonus and welfare and are not distributable as cash dividends and amounted to \$2,318,591 as of December 31, 2014. In addition, due to restrictions on the distribution of registered capital from the Company's PRC subsidiaries, the PRC subsidiaries' registered capital of \$41,962,846 as of December 31, 2014, were considered restricted. As a result of these PRC laws and regulations, as of December 31, 2014, approximately \$44,281,437, were not available for distribution to the Company by its PRC subsidiaries in the form of dividends, loans or advances.

Relevant PRC laws and regulations restrict the WFOE and VIEs from transferring a portion of their net assets, equivalent to the balance of their statutory reserves and their share capital, to the Company in the form of loans, advances or cash dividends. The balance of restricted net assets was \$44,281,437, of which \$9,382,933 was attributed to the paid in capital and statutory reserves of the VIEs and \$34,898,504 was attributed to the paid in capital and statutory reserves of the WFOE, as of December 31 2014, respectively. The WFOE's accumulated profits may be distributed as dividends to the Company without the consent of a third party. The VIEs' revenues and accumulated profits may be transferred to WFOE 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.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

12. COMMITMENTS AND CONTINGENCIES

(a) Operating lease commitments

The Group has entered into operating lease arrangements relating to the use of certain office premises and internet data centers. Rental expenses under operating leases for 2012, 2013 and 2014 were \$2,149,379, \$2,689,618 and \$ 1,823,198, respectively.

As of December 31, 2014, total future minimum lease payments under non-cancelable operating leases agreements are as follows,

	RMB	USD
2015	5,029,039	818,355
2016	751,543	122,296
	<u>5,780,582</u>	<u>940,651</u>

(b) Contractual commitment

In December 2014, the Group entered into a land use right transfer agreement with Songjiang Planning and Land Administration Bureau of Shanghai Municipality to purchase the land use right of two parcels of land for considerations of RMB11.0 million (\$1.8 million) (the "First Parcel") and RMB10.4 million (\$1.7 million) (the "Second Parcel"), respectively. Prepayments of RMB2.2 million (\$0.4 million) and RMB2.1 million (\$0.3 million) were paid in December 2014 and the rest of considerations were paid in January 2015. Under the land use right transfer agreement in connection with the First Parcel, the Group agreed that the total aggregate of our corporate entities registered under the Shanghai Songjiang District will (i) reach annual revenues of RMB259.2 million (US\$41.8 million), (ii) the relevant annual tax expenses will be no less than RMB14.6 million (US\$2.4 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by January 26, 2020. In addition, the Group also committed to pay a project completion security deposit of RMB2.2 million (US\$0.4 million), adhering us to certain project commencement, completion and operation milestones on specific dates. Should the Group not meet these requirements and depending on the severity of breach, the Group may be subject to liabilities for breach including forfeiture of a portion or all of the Group's deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

Under the land use right transfer agreement in connection with the Second Parcel, the Group agreed that the total aggregate of its corporate entities registered under the Shanghai Songjiang District will (i) reach annual revenues of RMB244.3 million (US\$39.4 million), (ii) the relevant annual tax expenses will be no less than RMB13.8 million (US\$2.2 million) and (iii) the annual tax expenses per square meter will be no less than RMB1,200 (US\$193.4) by February 11, 2020. In addition, the Group also committed to pay a project completion security deposit of RMB2.1 million (US\$0.3 million), adhering the Group to certain project commencement, completion and operation milestones on specific dates. Should the Group not meet these requirements and depending on the severity of breach, the Group may be subject to liabilities for breach including forfeiture of a portion or all of the Group's deposit allocated separately to each of the three requirements, termination of the transfer agreement and the forfeiture of the land use right etc.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

12. COMMITMENTS AND CONTINGENCIES (Continued)

Separate from the project completion security deposits, if the Group fail to comply with the terms of the land use right transfer agreements (and depending on the severity of breach), the Group may be subject to liabilities for the breach including the forfeiture of the land use rights by the PRC government.

In December 2014, Shanghai Xinsheng was granted a two-year right from a third party to develop a web game and a mobile ARPG game based on "Fairy Tail", a famous Japanese IP derived from manga series. License fee and minimum guarantee for each game was \$0.5 million and \$0.4 million, respectively, and the total amount of license fees and minimum guarantees were \$1.8 million. The Group made payments of \$1.0 million license fees and \$0.4 million minimum guarantees in February 2015.

(c) Contingencies

The Group is subject to periodic legal or administrative proceedings in the ordinary course of our business. Currently, the Group does not have any significant pending legal or administrative proceedings to which the Group is a party and the Group believes that none of the existing proceedings will have a material effect on the Company's cash flows, operating results, or financial condition.

13. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2012, 2013 and 2014:

	For the years ended December 31,		
	2012	2013	2014
Basic earnings per share:			
Net income attributable to Taomee Holdings Limited— basic and diluted	\$ 8,861,867	\$ 5,441,260	\$ 1,006,457
Weighted average ordinary shares outstanding—basic	<u>731,303,362</u>	<u>733,333,891</u>	<u>712,973,565</u>
Basic earnings per share	<u>\$ 0.01</u>	<u>\$ 0.01</u>	<u>\$ 0.001</u>
Diluted earnings per share:			
Net income attributable to Taomee Holdings Limited— basic and diluted	\$ 8,861,867	\$ 5,441,260	\$ 1,006,457
Weighted average ordinary shares outstanding—basic	731,303,362	733,333,891	712,973,565
Stock options	22,230,137	13,198,221	6,879,075
Weighted average ordinary shares outstanding—diluted	<u>753,533,499</u>	<u>746,532,112</u>	<u>719,852,640</u>
Diluted earnings per share	<u>\$ 0.01</u>	<u>\$ 0.01</u>	<u>\$ 0.001</u>

For the years ended December 31, 2012, 2013 and 2014, the Group had securities which could potentially dilute basic earnings per share in the future, but were excluded from the computation of

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

13. EARNINGS PER SHARE (Continued)

diluted earnings per share as their effects would have been anti-dilutive. Such securities consisted of the following:

	For the years ended December 31,		
	2012	2013	2014
Options	21,425,000	12,520,000	10,970,000
Non-vested restricted shares	8,649,648	3,525,010	3,860,000
Total	30,074,648	16,045,010	14,830,000

14. RELATED PARTY TRANSACTIONS

The following parties/ entities are considered to be related parties of the Group:

<u>Related Party</u>	<u>Nature of the Relationship</u>
WANG Haibing	Co-founder and CEO
CHENG Yunpeng	Co-founder and President
WEI Zhen	Co-founder and director
ZENG Liqing	Director and a principal shareholder
WANG Bin	Principal shareholder before May 2010
Shenzhen Decent Investment Limited ("Decent Investment")	Controlled by ZENG Liqing
Shenzhen ParaEngine Corporation ("PE")	Significantly influenced by ZENG Liqing who is a director of the controlling entity
Guangzhou Chuangyou Information Technology Co., Ltd ("Chuangyou")	Equity method investee of the Group
Taiwan Taomee Co., Ltd. ("Taiwan Taomee")	Equity method investee of the Group
Beijing Enlight Pictures Co. Ltd ("Enlight Media")	Controlled by WANG Changtian who is a director
Shenzhen Taole Network Technology Co., Ltd ("Shenzhen Taole")	Significantly influenced by ZENG Liqing who is a director and principal shareholder
Qiming Funds	Principal shareholder
Shanghai Weiju Network Technology Co., Ltd ("Shanghai Weiju")	Equity method investee of the Group

TAOMEE HOLDINGS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars, except share data, unless otherwise stated)

14. RELATED PARTY TRANSACTIONS (Continued)

In June 2009 and May 2012, Shanghai Taomee entered into two agreements with PE to co-develop 3-D online virtual worlds for children. For the years ended December 31, 2012, 2013 and 2014, Shanghai Taomee has paid \$203,444, \$193,559 and \$121,230 royalties and \$200,000, nil and nil licensing fee to PE, respectively. As of December 31, 2013 and 2014, the Group had \$18,857 and \$4,700 royalty fee due to PE, respectively.

In June 2011, Shanghai Shengran entered into an agreement with Taiwan Taomee to grant a license to Taiwan Taomee for certain operating rights of an online game developed and owned by Shanghai Shengran. Shanghai Shengran also entered into an agreement with Taiwan Taomee for the license of certain offline products which are derived from the online game images. In years 2012, 2013 and 2014, Shanghai Shengran further licensed Taiwan Taomee additional two, three and one online games, respectively. In addition, Shanghai Shengran granted Taiwan Taomee an exclusive sublicense right to utilize a licensed brand to design and distribute licensed products, including mobile applications, animation, books, products in Taiwan in 2014. For the years ended December 31, 2012, 2013 and 2014, revenues generated from Taiwan Taomee were \$127,644, \$767,267 and \$442,902 for online licensing and \$175,500, \$130,808 and \$99,536 for offline licensing. As of December 31, 2013 and 2014, the Group had an amount due from Taiwan Taomee of \$72,517 and \$19,140, respectively, and amount due to Taiwan Taomee of \$347,026 and \$298,146, respectively.

In November 2011, Shanghai Taomee entered into an agreement with Shenzhen Taole for the license to Shanghai Taomee of certain operating rights of an online game. For the years ended December 31, 2012, 2013 and 2014, Shanghai Taomee has paid \$8,969, \$6,067 and \$889 royalties, respectively. As of December 31, 2013 and 2014, there were \$1,594 and nil royalty fees due to Shenzhen Taole.

In November 2011, the Company entered into a share transfer agreement with Qiming Funds at consideration of \$52,989. The Company paid this amount in February 2012. Refer to Note 4 for a detailed description of the share transfer.

In July 2012, Shanghai Taomee entered into an operating agreement with Chuangyou for the license to Shanghai Taomee of certain operating rights of an online game developed and owned by Chuangyou. For the years ended December 31, 2012, 2013 and 2014, Shanghai Taomee has paid nil, \$9,787 and \$10,329 royalties and \$150,000, \$50,000 and nil licensing fee to Chuangyou, respectively. As of December 31, 2013 and 2014, the Group had \$2,506 and \$10,651 as online royalty fee, and nil and \$14,708 as offline licensing fee due to Chuangyou, respectively.

In November 2012, Shanghai Shengran provided a RMB480,000 (equivalent to \$76,366) interest-free loan to Chuangyou. Chuangyou paid off the loan in December 2012.

In July, August and December 2013, Guangdong Taomee entered into four cooperation agreements at an aggregate consideration of RMB0.7 million (equivalent to \$0.1 million) with Shanghai Weiju, under which Guangdong Taomee outsourced to Shanghai Weiju for development of a website for a toy, a homepage and a distributor management software for Guangdong Taomee. For the years ended December 31, 2013 and 2014, Guangdong Taomee has paid nil and RMB472,000 (equivalent to

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

14. RELATED PARTY TRANSACTIONS (Continued)

\$77,137) service fees to Shanghai Weiju, respectively. As of December 31, 2014, the Group had nil and RMB188,000 (equivalent to \$30,724) as service fees due to Shanghai Weiju.

In the first quarter of 2013 and the second quarter of 2014, Shanghai Animation entered into agreements with Enlight Media to jointly invest in the production and distribution of the Group's feature film, *Seer III: Universal Force* and *Seer IV: Magic Stone Wars*. *Seer III* and *Seer IV* were released in July 2013 and 2014, respectively, in mainland China. Enlight Media was also entitled to share a certain percentage of film licensing revenues under the agreements. For the years ended December 31, 2013 and 2014, film investment from Enlight Media were RMB3.9 million (equivalent to \$639,669) and RMB4.0 million (equivalent to \$653,702) and revenues generated from Enlight Media were RMB13,299,454 (equivalent to \$2,169,865) and RMB11,746,083 (equivalent to \$1,919,608) as box office revenue sharing. As of December 31, 2013 and 2014, the Group had an amount due from Enlight Media of RMB13,299,454 (equivalent to \$2,169,865) and RMB15,746,083 (equivalent to \$2,573,310), and an amount due to Enlight Media of nil and RMB386,050 (equivalent to \$63,090), respectively.

15. SEGMENT AND GEOGRAPHIC INFORMATION

The Group's chief operating decision maker has been identified as the Chief Executive Officer, who reviews consolidated results of operations data by two segments, online business and offline business, when making decisions about allocating resources and assessing performance of the Group. In identifying its reportable segments, the Group also considers the nature of services provided by its operating segments.

The Group's chief operating decision maker evaluates segment performance based on revenues, cost of revenues and gross profit. Accordingly, all expenses that are considered corporate level activities and are not allocated to segments. Therefore, it is not feasible to show profit or loss by reportable segments. Also, the Group's chief operating decision maker does not assign assets to these segments and no asset information by segment is provided to the chief operating decision maker.

The Group has two reportable segments: online business and offline business. The online business segment is responsible for developing and operating online virtual worlds, mobile games and applications, as well as other online entertainment services.

The offline business segment is responsible for licensing the Group's proprietary cartoon figures, producing films and merchandising sales of the Group's cartoon figures.

<u>Year ended December 31, 2012</u>	<u>Online Business</u>	<u>Offline Business</u>	<u>Total</u>
Revenue	\$ 34,091,925	\$ 8,188,499	\$ 42,280,424
Less: sales tax and related taxes	1,922,430	149,760	2,072,190
Net revenue	32,169,495	8,038,739	40,208,234
Less: cost of revenues	6,949,772	3,048,618	9,998,390
Gross profit	\$ 25,219,723	\$ 4,990,121	\$ 30,209,844

TAOMEET HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

15. SEGMENT AND GEOGRAPHIC INFORMATION (Continued)

<u>Year ended December 31, 2013</u>	<u>Online Business</u>	<u>Offline Business</u>	<u>Total</u>
Revenue	\$ 37,670,793	\$ 13,117,356	\$ 50,788,149
Less: sales tax and related taxes	2,340,641	93,821	2,434,462
Net revenue	35,330,152	13,023,535	48,353,687
Less: cost of revenues	7,643,598	5,620,619	13,264,217
Gross profit	<u>\$ 27,686,554</u>	<u>\$ 7,402,916</u>	<u>\$ 35,089,470</u>

<u>Year ended December 31, 2014</u>	<u>Online Business</u>	<u>Offline Business</u>	<u>Total</u>
Revenue	\$ 35,277,786	\$ 8,976,888	\$ 44,254,674
Less: sales tax and related taxes	1,985,337	80,186	2,065,523
Net revenue	33,292,449	8,896,702	42,189,151
Less: cost of revenues	6,534,883	5,182,265	11,717,148
Gross profit	<u>\$ 26,757,566</u>	<u>\$ 3,714,437</u>	<u>\$ 30,472,003</u>

The Group generates substantially all of its revenues from customers in the PRC. Substantially all of the Group's long-lived assets are located in the PRC.

16. FAIR VALUE MEASUREMENTS

The Group did not have any assets or liabilities measured at fair value on a recurring or non-recurring basis for the years prior to 2013.

Assets measured at fair value on a recurring basis

In years 2013 and 2014, the Group's asset measured at fair value on a recurring basis subsequent to initial recognition consisted of short-term investment in a money market fund accounted for as available-for-sale security. As the return of the investment was referenced to short term interest rate and interest income accrued on a daily basis, the fair value approximates carrying amount of US\$3.0 million as of December 31, 2013 and was disposed in 2014. The short-term investment is classified as a Level 2 fair value measurement.

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

16. FAIR VALUE MEASUREMENTS (Continued)

Assets measured at fair value on a non-recurring basis

In the year ended December 31, 2013, the Group's assets measured at fair value on a non-recurring basis consisted of the following:

	Year Ended December 31, 2013	Fair Value Measurement at Reporting Date Using							
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses				
		USD	USD	USD					
Acquired intangible assets —upfront licensing fees	\$	—	\$	—	\$	—	\$	1,046,173	
Investment in equity investees —Chuangyou		82,466		—		—		82,466	370,407
Total								\$	1,416,580

In accordance with the provision of ASC 350, upfront licensing fees related to two games with a carrying amount of \$0.8 million and \$0.2 million, respectively, were fully impaired, with the resulting impairment charge of \$1,046,173 included in earnings for the year ended December 31, 2013.

In accordance with the provision of ASC 323, investment in Chuangyou was written down to its fair value of \$82,466, resulting in an impairment charge of \$370,407 recognized as impairment loss on investment in equity investees in the consolidated statements of operations for the year ended December 31, 2013. The fair value of the investment was measured based on a discounted cash flow approach. The discounted cash flow analysis requires the use of significant unobservable inputs, including projected future cash flows and a discount rate calculated based on the weighted average cost of capital of 45%. As the significant inputs are not observable or cannot be corroborated with market information, the fair value measurement is classified as Level 3. Any change in the projected future cash flow would result in a change in the fair value measurement in the same direction, while the change in discount rate would result in adverse change in the fair value measurement.

In the year ended December 31, 2014, the Group's assets measured at fair value on a non-recurring basis consisted of the following:

	Year Ended December 31, 2014	Fair Value Measurement at Reporting Date Using				Total Losses
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
		USD	USD	USD		
Acquired intangible assets —upfront licensing fees	\$ —	\$ —	\$ —	\$ —	\$ 115,753	
Investment in equity investees —Voozclub	—	—	—	—	1,400,000	
Total					\$ 1,515,753	

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

16. FAIR VALUE MEASUREMENTS (Continued)

In accordance with the provision of ASC 350, upfront licensing fees related to a game with a carrying amount of \$0.1 million was fully impaired, with the resulting impairment charge of \$115,753 included in earnings for the year ended December 31, 2014.

In accordance with the provision of ASC 325, investment in Voozclub was fully written down to its fair value of nil, resulting in an impairment charge of \$1,400,000 recognized as impairment loss on investment in equity investees in the consolidated statements of operations for the year ended December 31, 2014. The fair value of the investment was determined to be nil as Voozclub is not able to generate positive future cash flow and is highly likely facing bankruptcy considering the factors that a) Voozclub did not have sufficient cash balance for operation over the next year, and its operating cash inflow is in doubt; b) there were resignations of key management and significant lay-offs of employees in 2014; and c) Voozclub stopped any new business development activities.

17. NONCONTROLLING INTEREST

As of December 31, 2014, the Group's non-controlling interest mainly included equity interests in Guangdong Taomee, Shanghai Xinsheng and Shanghai Jushou and equity awards granted as compensation by the Group's subsidiaries. The following schedule shows the effects of changes in the ownership interest of Taomee Holdings Limited in its subsidiaries on equity attributed to Taomee Holdings Limited for the years ended December 31, 2012, 2013 and 2014.

	December 31, 2012	December 31, 2013	December 31, 2014
	USD	USD	USD
Net income attributable to Taomee Holdings Limited	\$ 8,861,867	\$ 5,441,260	\$ 1,006,457
Transfers (to) from the noncontrolling interest			
Decrease in Taomee Holdings Limited's additional paid-in capital for adjustment on noncontrolling interest due to change in ownership interest in Guangdong Taomee*	—	(77,135)	(60,051)
Increase in Taomee Holdings Limited's additional paid-in capital for adjustment on noncontrolling interest due to change in ownership interest in Shanghai Xinsheng*	—	—	13,421
Decrease in Taomee Holdings Limited's additional paid-in capital for adjustment on noncontrolling interest due to change in ownership interest in Shanghai Jushou*	—	—	(92,706)
Change from net income attributable to Taomee Holdings Limited and transfers (to) from noncontrolling interests	<u>\$ 8,861,867</u>	<u>\$ 5,364,125</u>	<u>\$ 867,121</u>

* The change in ownership interest is primarily due to the vesting of non-vested restricted shares by noncontrolling interest holders (Refer to Note 8).

TAOMEE HOLDINGS LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In US dollars, except share data, unless otherwise stated)

18. SUBSEQUENT EVENTS

On January 21, 2015, the Company granted 7,000,000 non-vested restricted shares to four officers, under the Company's 2012 Share Incentive Plan. One-fourth ($\frac{1}{4}$) of the restricted shares will vest on the first anniversary of the grant Date, the remaining three-fourth ($\frac{3}{4}$) of restricted shares (rounded down to the next whole number of shares) will vest in 12 equal installments at the ending of each calendar quarter over a period of 12 consecutive quarters subsequent to the first anniversary of the grant date. The Company will recognize approximately \$1.1 million share-based compensation over the four-year vesting period.

On January 26, 2015, the Company declared a special one-time cash dividend of US\$0.0325 per ordinary share, or US\$0.65 per American Depositary Share ("ADS", each representing 20 ordinary shares). The total amount of the special dividend of US\$24.6 million was fully paid on February 17, 2015.

In February 2015, the Group incorporated two wholly owned PRC subsidiaries, Shanghai Junran Information Technology Co., Ltd., wholly owned by Shanghai Shengran and focuses on developing of virtual worlds, and Shanghai Shengyu Network and Technology Co., Ltd. ("Shanghai Shengyu"), wholly owned by Shanghai Taomee and focuses on strategic investment.

On April 7, 2015, the Company granted 1,020,000 non-vested restricted shares to four employees, under the Company's 2012 Share Incentive Plan. These restricted shares will vest over a four-year requisite service period, with 25% to vest on each anniversary after the grant date. The Company will recognize approximately \$0.1 million share-based compensation over the four-year vesting period.

ADDITIONAL INFORMATION—FINANCIAL STATEMENT SCHEDULE I

TAOMEE HOLDINGS LIMITED

FINANCIAL INFORMATION OF PARENT COMPANY

BALANCE SHEETS

(In USD, except share and per share data, unless otherwise stated)

	As of December 31,	
	2013	2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 35,106,326	\$ 27,573,723
Short-term investment	2,992,343	—
Other current assets	772,412	122,905
Amounts due from subsidiaries	9,800,000	10,100,000
Total current assets	48,671,081	37,796,628
Investment in subsidiaries	64,434,458	69,491,249
Investments in joint venture	11,720,661	9,955,663
Total assets	124,826,200	117,243,540
Liabilities and equity		
Current liabilities:		
Accrued expenses and other current liabilities	\$ 788,831	\$ 253,108
Amounts due to subsidiaries	1,989,218	1,986,840
Total current liabilities	2,778,049	2,239,948
Long-term liabilities	278,017	152,706
Total liabilities	3,056,066	2,392,654
Equity:		
Taomee Holdings Limited shareholders' equity		
Ordinary shares (\$0.00002 par value; 875,000,000 shares authorized; 741,126,859 and 751,088,350 shares issued; 735,913,039 and 708,350,670 shares outstanding as of December 31, 2013 and 2014, respectively)	14,823	15,022
Treasury stock (at cost)	(1,198,904)	(11,521,316)
Additional paid-in capital	73,757,483	76,308,327
Accumulated other comprehensive income	4,342,755	4,188,419
Retained earnings	44,853,977	45,860,434
Taomee Holdings Limited shareholders' equity	121,770,134	114,850,886
Total liabilities and equity	\$ 124,826,200	\$ 117,243,540

FINANCIAL INFORMATION FOR PARENT COMPANY

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In USD, except share and per share data, unless otherwise stated)

	For the years ended December 31,		
	2012	2013	2014
Total revenues	—	—	—
Total cost of revenues	(255,315)	(289,921)	(294,132)
Gross profit	(255,315)	(289,921)	(294,132)
Operating expenses:			
Product development expenses	(498,500)	(360,853)	(448,179)
Sales and marketing expenses	(128,978)	(56,938)	(16,394)
General and administrative expenses	(1,674,529)	(1,691,514)	(3,052,836)
Total operating expenses	(2,302,007)	(2,109,305)	(3,517,409)
Loss from operations	(2,557,322)	(2,399,226)	(3,811,541)
Interest income	765,544	892,353	483,718
Other income (expenses), net	860,337	800,988	(398,536)
Impairment loss on investment in equity investees	—	—	(1,400,000)
Loss before income taxes	(931,441)	(705,885)	(5,126,359)
Income tax expense	—	(31,351)	(12,746)
Share of gain in subsidiary, net of taxes	9,095,284	5,581,239	6,109,173
Share of gain in joint venture, net of taxes	698,024	597,257	36,389
Net income attributable to Taomee Holdings Limited	<u>\$ 8,861,867</u>	<u>\$ 5,441,260</u>	<u>\$ 1,006,457</u>

FINANCIAL INFORMATION FOR PARENT COMPANY
STATEMENTS OF COMPREHENSIVE INCOME OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(In USD, except share and per share data, unless otherwise stated)

	For the years ended December 31,		
	2012	2013	2014
Net income attributable to Taomee Holdings Limited	\$ 8,861,867	\$ 5,441,260	\$ 1,006,457
Other comprehensive income, net of tax of nil			
Foreign currency translation adjustments	189,354	1,787,185	(154,336)
Comprehensive income attributable to Taomee Holdings Limited	<u>\$ 9,051,221</u>	<u>\$ 7,228,445</u>	<u>\$ 852,121</u>

FINANCIAL INFORMATION FOR PARENT COMPANY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

	For the years ended December 31,		
	2012	2013	2014
Operating activities:			
Net income attributable to Taomee Holdings Limited	\$ 8,861,867	\$ 5,441,260	\$ 1,006,457
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Share-based compensation	2,252,552	2,142,445	2,228,431
Share of profit in subsidiaries	(9,370,537)	(6,578,897)	(4,554,504)
Share of profit in equity investment	(698,024)	(597,257)	(36,389)
Deferred income taxes	—	31,351	12,746
Gain on disposal of short-term investment	—	—	(15,043)
Impairment on investment in equity investees	—	—	1,400,000
Changes in assets and liabilities:			
Amount due from subsidiaries	—	(9,800,000)	(300,000)
Prepayments and other current assets	(256,109)	389	649,507
Accrued expenses and other current liabilities	(513,883)	108,389	(535,723)
Amounts due to subsidiaries	1,574	345,341	(2,378)
Long-term liabilities	403,371	(125,354)	(125,311)
Net cash provided by (used in) operating activities	<u>680,811</u>	<u>(9,032,333)</u>	<u>(272,207)</u>
Investing activities:			
Cash paid to acquire equity investees	(6,205,000)	(3,550,003)	—
Purchases of short-term investment	—	(2,992,343)	—
Disposal of short-term investment	—	—	3,007,386
Net cash provided by (used in) investing activities	<u>(6,205,000)</u>	<u>(6,542,346)</u>	<u>3,007,386</u>
Financing activities:			
Issuance cost of ordinary shares	(340,713)	—	—
Proceeds from exercise of share options	275,825	1,046,021	648,663
Repurchase of ordinary shares	(1,681,520)	(2,144,386)	(10,322,412)
Net cash used in financing activities	<u>(1,746,408)</u>	<u>(1,098,365)</u>	<u>(9,673,749)</u>
Effect of exchange rate changes on cash and cash equivalents	664,840	800,988	(594,033)
Net decrease in cash and cash equivalents	<u>(6,605,757)</u>	<u>(15,872,056)</u>	<u>(7,532,603)</u>
Cash and cash equivalents, beginning of the year	57,584,139	50,978,382	35,106,326
Cash and cash equivalents, end of the year	<u>\$ 50,978,382</u>	<u>\$ 35,106,326</u>	<u>\$ 27,573,723</u>

FINANCIAL INFORMATION OF PARENT COMPANY

Note to Schedule I

1. Schedule I has been provided pursuant to the requirements of Rule 12-04(a) and 5-04(c) of Regulation S-X, which require condensed financial information as to the financial position, changes in financial position and results of operations of a parent company as of the same dates and for the same periods for which audited consolidated financial statements have been presented when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.
2. The condensed financial information of Taomee Holdings Limited has been prepared using the same accounting policies as set out in the accompanying consolidated financial statements except that the equity method has been used to account for investments in its subsidiaries.
3. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. The statements of changes in equity have been omitted from the financial information of parent company as they are the same as the Group's consolidated statements of changes in equity. The footnote disclosures contain supplemental information relating to the operations of the Company and, as such, these statements should be read in conjunction with the notes to the Consolidated Financial Statements of the Company.
4. As of December 31, 2014, there were no material contingencies, significant provisions of long-term obligations, mandatory dividend or redemption requirements of redeemable stocks or guarantees of the Company, except for those which have been separately disclosed in the Consolidated Financial Statement, if any.

* * * * *

Termination Agreement

Lessor (Party A): M&G Chenguang Holding (Group) Co., Ltd

Address: 3488 Jinqian Rd, Qingcun Town, Fengxian District, Shanghai, China

Legal representative: Chen Huxiong

Lessee (Party B): Shanghai Taomee Animation Co., Ltd

Address: Rm. 1302, F/13, Building No.2, No. 1528 Gumei Road, Xuhui District, Shanghai

Legal representative: Wang Haibing

Party A and Party B entered into a *Lease Contract* in December 2013 with regard to the real property located in Caohejing Development Zone addressed at Room 1302, F/13, Building No.2, No. 1528 Gumei Road, Xuhui District, Shanghai and the lease term will commence on January 1, 2014 and end on June 30, 2015.

Whereas, the two parties, of their own accord, agree to terminate the *Lease Contract* in advance, the following agreement is hereby entered into with regard to the termination of the Lease Contract on the basis of equality, consultation, and mutual benefits and understanding in accordance with the *Contract Law of the People's Republic of China* and other relevant laws:

1. The two parties hereto agree to terminate the above-mentioned Lease Contract on February 28, 2015 (hereinafter referred to as the "Termination Date").
 2. Party B shall demolish and remove the decoration, equipment, and facilities, etc. in the property of which it has ownership prior to the Termination Date and return the property to Party A; the ownership of the portion of the foregoing decoration, equipment, and facilities which have not been demolished after the Termination Date shall be deemed waived by Party B and such portion may be demolished and disposed of by Party A at its own discretion, however, the demolition costs arising therefrom shall be borne by Party B.
 3. Party B shall timely complete payment of related expenses and go through procedures for returning the property with property management department, and Party A shall provide assistance where necessary; Party A shall refund to Party B the security deposit of four hundred and twenty thousand nine hundred and fifty-four yuan and fourteen cents (RMB ¥420,954.14) that Party B has paid within ten (10) working days subsequent to the Termination Date and the inspection and acceptance of the property.
 4. The Agreement shall take effect as soon as the legal representatives or agents of the two parties hereto set their hands and seals hereto.
 5. Any disputes arising from the performance hereof shall be settled through friendly consultation by the two parties. Should the consultation fail, any party hereto may bring a legal action before the people's court where the real property under the Lease Agreement is located.
 6. The Agreement shall be executed in duplicate. Each party holds one copy respectively and both copies are equally authentic and valid.
-

Party A (Seal): M&G Chenguang Holding (Group) Co., Ltd

Date: January 22, 2015



Party B (Seal): Shanghai Taomee Animation Co., Ltd

Date of signature: January 22, 2015



Agreement on Termination of Contract

Party A: M&G Chenguang Holding (Group) Co., Ltd

Party B: Shanghai Shengran Information Technology Co., Ltd.

Based on the *Lease Contract* (hereinafter referred to as the “Master Contract”) made and entered into by and between Party A and Party B, the property located at 14F, Building No.2, No. 1528 Gumei Road, Caohejing Development Zone, Shanghai was leased to Party B as business offices, and the specific building area is 1,798.38m². The two parties hereto agreed that the lease term shall commence on July 1, 2012 and end on June 30, 2015 and the rents shall accrue as of July 1, 2012. Whereas, Party B wishes to terminate the Master Contract, and Shanghai Xinsheng Information Technology Co., Ltd. and Shanghai Taomee Animation Co., Ltd., related companies of Party B, will lease the property under the Master Contract, Party A and Party B will officially terminate the Master Contract on and after February 28, 2015 after a preliminary discussion, and specify related content in the Master Contract for the two parties to implement accordingly.

1. Party B promises that it will pay off relevant expenses on its own and go through property delivery procedures with property management department;
2. Party A promises that it will, after receiving the receipt for the security deposit (¥689,229.14 yuan) from Party B and concluding a *Lease Contract* with Shanghai Xinsheng Information Technology Co., Ltd. and Shanghai Taomee Animation Co., Ltd, issue a receipt for security deposit to the foregoing companies based on the content of the newly executed contract.
3. The execution of this Agreement and the termination of the Master Contract will in no case affect the performance of obligations of any party hereto to keep confidential the trade secrets of the other party.

The Agreement shall take effect as soon as the two parties set their hands and seals hereto. The Master Contract mentioned herein will officially terminate as soon as Party A and Party B settle all outstanding rents.

The Agreement shall be executed in duplicate. Each party holds one copy respectively and both copies are equally authentic and valid.



Party A:

(Seal)

M&G Chengguang Holding (Group) Co., Ltd

Legal (authorized) representative:

Date of signature: January 22, 2015



Party B:

(Seal)

Shanghai Shengran Information Technology Co., Ltd.

Legal (authorized) representative:

Date of signature: January 22, 2015

Housing Lease Contract

This Housing Lease Contract (hereinafter referred to as this "Contract") is made by and between the following two parties in Shanghai, P.R. China (hereinafter "China")

Lessor (Party A): M&G Chenguang Holding (Group) Co., Ltd.

Address: 3488 Jinqian Road, Qingcun Town, Fengxian District, Shanghai

Legal representative: Chen Huxiong

Postal code: 201406

Tel.: 021-57474488

Fax:

Business license no.: 310226000797609

Lessee (Party B): Shanghai Xinsheng Information Technology Co., Ltd.

Address: Suite1301, 13/F, Building A2, No.1528 Gumei Road, Xuhui District, Shanghai

Legal representative: Wang Haibing

Postal code:

Tel.: 021-61280056

Fax:

Business license no.:310104000530522

In accordance with the provisions of the *Contract Law of the People's Republic of China*, *Regulations of Shanghai Municipality on the Lease of Houses* and other applicable laws and regulations, Party A and Party B hereby enter into this Contract with respect to Party B leasing from Party A the house that is leasable by Party A according to law (the "Premises"), on the basis of equality, voluntariness, fairness and good faith and by reaching consensus through consultation.

1. Legal Statutes of both Parties and Relevant Documents

1.1 Party A is lawfully incorporated with the approval of the Chinese Government and undertakes to legally own the complete ownership and right of use of the Premises involved in this Contract.

1.2 Party B leases the Premises from Party A as the place of business of Shanghai Xinsheng Information Technology Co., Ltd.

2. Confirmation and Warranties of both Parties

2.1 In addition to those already specified herein, both parties shall each confirm and ensure the following:

(1) Each party has the legal qualification, capacity for civil rights and capacity for civil conduct to enter into and perform this Contract, is fully aware of their respective rights, obligations and duties and is willing to act in strict accordance with provisions hereof. If either party breaches this Contract, the other party shall have the right to make claims according to this Contract.

(2) Each party has gone through the internal approval procedures necessary to enter into this Contract.

(3) There is no contract with any third party nor any other matter that might prevent the execution and performance of this Contract.

2.2 Party A warrants that at the execution of this Contract, it has lawfully acquired the valid ownership certificate of the Premises described in Article 3.1 hereof, with the number indicated below:

Shanghai Real Estate Ownership Certificate for the land where the Premises are located: Hu Fang Di Xu Zi (2012) No. 000313;

3. Details about the Premises

3.1 The Premises to be let to Party B by Party A is situated at Suite 1401, 14/F, Building 2, No.1528 Gumei Road, Shanghai (hereinafter the “Premises”).

The Premises is of an office building type, with a construction area of 1204.915 square meters.

3.2 Delivery standards are set forth in Annex I.

3.3 Shanghai Real Estate Ownership Certificate is given in Annex II.

4. Use of the Premises

4.1 Party B undertakes to Party A that, it leases the Premises to engage in lawful economic activities, within the scope specified in its business license and shall comply with the regulations of the State and Shanghai Municipality on use of houses and fire safety as well as the regulations of Caohejing High-Tech Park on industrial development, environmental protection and property management.

4.2 Party B warrants that, during the lease term, it will not alter the purposes agreed in the preceding paragraph without the written consent of Party A and before being subject to the examination and approval of competent department.

5. Delivery Date and Lease Term

5.1 Both parties agree that the lease term of the Premises commences from March 1, 2015 (lease commencement date) and ends on June 30, 2015, and the rent commencement date is March 1, 2015.

5.2 Upon expiry of the lease term, Party A has the right to repossess the Premises, while Party B shall return the same as scheduled. In case Party B needs to continue to lease the Premises, it shall file a written application for renewal to Party A three months in advance of the expiry of the lease term, while Party A will reply to Party B indicating whether it agrees to such renewal within one month from the date when Party B's written application is received. Where Party A agrees to renewal by Party B, both parties shall sign a new lease contract. Both parties have the right to adjust certain clauses including rent clause of the renewed contract according to the current market. If both parties fail to agree upon the rent clause and enter into the renewed contract within one month prior to the expiry of the lease term, then Party A has the right to terminate this Contract upon expiry of the lease term and take back the Premises.

6. Rent, Method and Term of Payment

6.1 Both parties agree that, the unit rent per square meter of construction area of the Premises per day is RMB Four Point Two Zero (RMB4.20), and total amount is RMB Six Hundred and Seventeen Thousand Three Hundred and Ninety Eight Point Forty Five (RMB617,398.45);

6.2 The rent of the Premises shall be paid before use. The rent shall be paid to Party A in two installments, of which RMB One Hundred and Fifty Six Thousand Eight Hundred and Seventy Nine Point Ninety Three (RMB 156,879.93) shall be paid to Party A prior to March 1 of the current year, and RMB Four Hundred and Sixty Thousand Five Hundred and Eighteen Point Fifty Two (RMB 460,518.52) shall be paid to Party A prior to April 1. Where the final payment date of each installment coincides with a Saturday, Sunday or a public holiday, then the final payment date shall be postponed to the first working day subsequent to the holiday. In case Party B defaults on payment, it must pay an overdue fine equivalent to 0.05% of the due and unpaid rent for each delayed day.

7. Lease Deposit and Other Expenses

7.1 Both parties agree that, within three days as from the date of signing hereof, Party B shall pay Party A lease deposit, which is equivalent to three-month rent, that is, RMB Four Hundred and Sixty One Thousand Seven Hundred and Eighty Three Point Sixty Seven (RMB 461,783.67). Upon collection of lease deposit, Party A shall issue a receipt to Party B.

During the lease term, Party B may not set off the lease deposit against the rent of the Premises. When this Contract is terminated upon expiry of the lease term, within 10 working days after Party B pays off relevant expenses and goes through the return and handover procedures of the Premises with the Premises management department, the lease deposit paid by Party B will be refunded by Party A interest-free; in case Party B fails to pay off relevant expenses and causes any economic loss to Party A due to any cause attributable to Party B, Party A has the right to deduct relevant amount from the deposit and return the remaining portion to Party B interest-free. Where the lease deposit is insufficient for deduction, Party B shall otherwise pay the insufficient portion.

7.2 During the lease term, all water, electricity, communications, equipment and other expenses incurred in connection with the use of the Premises shall be borne by Party B.

7.3 Party B shall be solely responsible for applying to and handling electricity and communications usage and other relevant procedures at competent departments, and the relevant expenses incurred by the required application, connection and installation shall be for Party B's account.

7.4 Prior to the delivery of the Premises, Party B shall sign a property management contract with the property management company of the residential district where the Premises is located and pay the Premises management fee according to relevant regulations. The current standard property management fee for the Premises is RMB Nineteen Point Six Eight (RMB 19.68) per square meter (construction area) per month.

8. Use Requirements and Maintenance Responsibilities for the Premises

8.1 During the lease term, if Party B finds any natural damage in the Premises and its ancillary facilities, Party B shall promptly notify the property management company entrusted by Party A and request the company to make repairs. When the Premises and its ancillary facilities are repaired, Party B shall render active assistance and cooperation. The consequences arising from the failure to make timely repairs due to Party B's action or omission shall be solely borne by Party B.

8.2 During the lease term, Party B shall reasonably use and cherish the Premises and its ancillary facilities. Where Party B causes artificial damage or failure to the Premises, and/or fails to adopt proper fire control measures in accordance with applicable national/local laws and regulations, Party B shall be responsible for timely repairs/renovation and bear the expenses incurred thereby.

8.3 During the lease term, Party A ensures that the Premises and its ancillary facilities are in normal usable and safe conditions. Party A may perform inspections and maintenance to the Premises, while Party B shall cooperate at the time of such inspections and maintenance. Party A shall try its best to minimize the impact on Party B's use of the Premises.

8.4 If Party B needs to perform decoration or add ancillary facilities and equipment other than the existing decoration and facilities in the Premises, Party B shall obtain the prior written consent of Party A and handle relevant procedures with the property management company. where such decoration or addition is subject to the examination and approval of competent departments, Party B shall also report to competent departments for approval and is then permitted to carry out such decoration or addition.

8.5 When this Contract is cancelled or terminated, if there are structures added or improved by Party B subject to the written consent of Party A, Party B shall be responsible for restoring the Premises to its original state, except any reasonable wear and tear. Until the Premises is inspected and accepted by Party A, Party B may not handle check-out procedures.

9. Return of the Premises

9.1 Unless Party A agrees to renewal by Party B and both parties sign a lease renewal contract, Party B shall return the Premises upon expiry of the lease term of this Contract or termination of this Contract for any reason. Where Party B delays returning the Premises without the consent of Party A, Party B shall pay Party A the use fees payable during the occupation of the Premises equivalent to two times of the daily rent for each delayed day. Party B agrees that, if it delays in restoring the Premises to its original state and returning the same for 15 days, Party A shall have the right to enter the Premises at its option, meanwhile, Party B shall be deemed to waive the ownership and right of use in the decoration, facilities, equipment in the Premises and other articles that have not been dismantled or removed from the Premises, including equipment and articles deemed the Premises of Party B (regardless of whether they belong to Party B or any third party), and Party A has the right to dispose of them at its own discretion. In case the legitimate interests of any third party are involved, Party B shall be liable for compensating such third party. The expenses incurred by Party A for restoring the Premises to its original state on behalf of Party B shall be borne by the latter. The Premises shall be deemed to have been repossessed upon Party A's entry into it.

9.2 When returned by Party B, the Premises shall be in the conditions after normal use. At the time of return, the Premises shall be inspected and accepted by Party A, and both parties shall settle expenses payable by them respectively.

10. Subletting and Transfer

10.1 Unless Party A has permitted Party B to sublet the Premises in supplemental clauses of this Contract or other documents, Party B may not sublet the Premises to others in whole or in part within the lease term.

10.2 During the lease term, if Party A needs to sell the Premises, it shall notify Party B in advance. Party B shall have the preemptive right under the same conditions.

11. Conditions for Termination

11.1 Both parties agree that, within the lease term, should any of the following circumstances occur, this Contract shall be terminated and neither party will assume any liability towards the other party:

- (1) The right to use the land occupied by the Premises is withdrawn in advance;
 - (2) The Premises are lawfully expropriated for public interests;
-

(3) The Premises are lawfully listed in the licensing scope of house demolition due to the needs of urban construction;

(4) The Premises are damaged or destructed or recognized as a dangerous building.

11.2 Both parties agree that, should either party commit any of the following breaches, the other party may notify in writing that this Contract be cancelled. The breaching party shall pay the other party a penalty equivalent to 2 months rent then in effect; where losses are caused to other party and the penalty is insufficient to cover the losses, the breaching party shall make up the difference between the losses incurred and the penalty:

(1) Party A fails to hand over the Premises in a timely manner and still fails to do so within ten days upon receipt of a written reminder from Party B;

(2) The Premises, when handed over by Party A, does not comply with the covenants contained herein, rendering Party B unable to fulfill the purposes for which the Premises is leased;

(3) Party B alters the leasing purposes as agreed herein, without the prior written consent of Party A;

(4) The Premises are damaged for any reason attributable to Party B;

(5) Party B sublets the Premises, transfers the right to lease the Premises or exchanges the Premises for any other property leased by others;

(6) Party B defaults on payment of rent for over one month;

(7) Party B uses the Premises for any illegal activity;

(8) Party B occupies public areas or fire passages without authorization, or fails to comply with applicable laws and regulations on environmental protection and fire safety, and still fails to make rectification within 5 working days upon receipt of a written notice from Party A.

12. Defaulting Liability

12.1 During the lease term, if Party A fails to timely perform its repair and maintenance duties as agreed herein, thus causing damage to the Premises and property or personal damage to Party B, Party A shall compensate Party B for its direct losses.

12.2 In case Party B renovates the Premises or adds ancillary facilities without the written consent of Party A or beyond the scope and requirements of Party A's written consent, or occupies/uses public areas or fire passages without authorization, Party A shall have the right to require Party B to restore the Premises to its original state and compensate for the losses arising therefrom. Where Party B fails to restore the Premises to its original state during said period, Party B may rescind this Contract by written notice to Party B, and Party B shall pay Party A three-month rent at that time as the liquidated damages.

12.3 During the lease term, under conditions other than those agreed herein, if Party A cancels this Contract and repossesses the Premises in advance, Party A shall pay Party B a penalty equivalent to 0.5 times of the rent for the lead days (no more than three months rent). If the penalty is insufficient to cover the direct losses suffered by Party B, Party A shall also be liable for compensating for the difference.

12.4 During the lease term, under conditions other than those agreed herein, if Party B surrenders the lease without authorization, Party B shall pay Party A a penalty equivalent to 0.5 times of the rent for the lead days (but no more than three months rent). If the penalty is insufficient to cover the losses sustained by Party A, Party B shall also be liable for compensating for the difference. Party A may withhold the penalty from the lease deposit, and if the lease deposit is insufficient for such withholding, the deficient portion shall be paid by Party B separately.

13. Disclaimer

13.1 Where Party B sustains loss or damage due to any natural disaster, theft, robbery, other criminal events or events of force majeure, etc. occurring in the Premises;

13.2 Where disaster occurs, thereby frustrating use of the Premises, or any facility fails or does not function properly, or air conditioning, heating, water, electricity, gas and other supplies interrupts due to the reasons attributable to Party A;

13.3 Where water, power, gas supply or other public facilities interrupt due to routine maintenance or repair;

13.4 Where Party A alters or transforms the building or any portion thereof, thereby resulting in that the Premises or public areas cannot be used or the level of service provided by Party A declines.

Where this Contract cannot be performed due to the reasons under the above Paragraph 13.4, the parties are entitled to select to continue to perform or rescind this Contract, and in case of rescission of this Contract, Party B shall settle the rent and management fee by the number of days for actual use, and shall also deal with the deposits in accordance with this Contract.

14. Miscellaneous

14.1 During the lease term, in addition to the right of Party B to use the Premises, Party B shall also have the access to the corridor, staircases, elevators and hallway and the right to use public restrooms and firefighting equipment. Party B may not arbitrarily store flammable, explosive or toxic articles, nor arbitrarily discharge exhaust gas, waste water, and waste residue, nor arbitrarily occupy public areas, fire passages and non-leased areas. During the lease term, Party B shall be responsible for managing the Premises that belongs to it and take out insurance for such property if it is required to purchase insurance from an insurance company.

14.2 In case Party B relates to flammable, explosive articles, noise as well as exhaust gas, waste water, waste residue and other dangerous goods and pollution sources, Party B must report to competent departments of Caohejing High-Tech Park and Shanghai Municipality for examination and approval, and use the Premises after relevant safety standards and discharge standards are met. In case of any secondary decoration, Party B may not commence construction until it obtains the approval of competent governmental departments in charge of fire control.

14.3 In the event that either party hereto is prevented from performing any clause hereof due to war (whether declared or not), earthquake, typhoon, flood, fire and other acts of god, the prevented party shall immediately inform the other party in writing and furnish the other party with details on Force Majeure, as well as the reasons for failure of performance or delayed performance and written materials like valid documentary evidence within fifteen days thereafter.

Both parties may consult each other to decide whether to cancel this Contract, or waive the performance of this Contract partially, or delay the performance of this Contract.

14.4 The formation, validity, interpretation, performance of, and resolution of disputes in connection with, this Contract shall be governed by Chinese laws and regulations as well as local regulations and rules of Shanghai Municipality.

14.5 All disputes arising from the performance of or in connection with this Contract shall be settled by both parties through friendly consultation, failing which, either party may bring an action before the people's court of the place where the real estate is located, and the final judgment of the court shall be binding upon both parties.

14.6 In case of any matter not mentioned herein, both parties may enter into a separate written agreement to be made a part hereof after reaching consensus through consultation, and such agreement shall have the same force as this Contract.

This Contract may be modified by both parties through consultation. Any modification to this Contract may not come into force unless made in writing and signed by legal representatives of both parties or their respective authorized agents. Before the modified contract goes into force, both parties shall still perform the clauses of this Contract.

14.7 At the execution of this Contract, both parties have complete capacity for civil conduct, are fully aware of their respective rights, obligations and duties, and are willing to act in strict accordance with the provisions of this Contract. If either party violates this Contract, the other party shall have the right to make claims as specified herein.

14.8 Both parties confirm their mailing addresses and telephone numbers as follows:

Party A's address:
No.3488 Jinqian Road, Qingcun Town, Fengxian District, Shanghai

Party B's address:
Suite1301, 13/F, Building A2, No.1528 Gumei Road, Xuhui District, Shanghai

All notices, documents and materials sent or provided to each other due to the performance of this Contract shall be delivered according to the abovementioned addresses and fax numbers. Should either party change its correspondence address or telephone number, it shall notify the other party in writing.

In case of hand delivery, such notices, documents and materials shall be deemed delivered at the time of receipt acknowledgement; if sent by fax, they shall be deemed delivered when the fax is sent out; if sent by mail, they shall be deemed delivered on the day when a registered mail is sent or posted.

14.9 This Contract comes into force upon stamping by the parties.

14.10 This Contract is written in five (5) originals, with Party A and Party B holding one (1) copy respectively, and the remaining three (3) copies to be used for government filing.

Party A: M&G Chenguang Holding (Group) Co., Ltd. (seal)

Legal representative (or authorized agent)
Chen Huxiong



Signature:

Date: 2015-1-29

Bank of deposit: Agricultural Bank of China
Shanghai Fengxian Guangming Sub-branch

Bank account no.: 03803920040030177

Party B: Shanghai Xinsheng Information Technology Co., Ltd. (seal)

Legal representative (or authorized agent)
Wang Haibing



Signature:

Date:

Bank of deposit: China Construction Bank
Shanghai Caohejing Sub-branch

Bank account no: 31001613402050017386

Annex I Delivery Standards for the Premises

The delivery standards applicable to the Premises are as follows:

1. Reinforced concrete structure, with a uniform live load of 350kg/square meter, and a building storey height of 5 m.
 2. Design power supply capacity is 120KW/floor, with one-line power supply. If the required capacity of Party B exceeds 120KW/floor, Party B shall solely apply to the power supply company for high-voltage power, install relevant transformation equipment and bear relevant expenses arising therefrom.
 3. Telephone and distribution cables are connected into the weak current room on each floor, and the telephone capacity is 100 pairs/floor.
 4. With fire control spraying system equipped with smoke detectors.
 5. The floor is cement plaster floor.
 6. Walls are whitened with latex paint.
 7. There is no suspended ceiling, and the ceiling is whitened with latex paint.
 8. Central air-conditioning units and main riser pipes are installed in place.
 9. There are no specially designed office partitions/compartments in the Premises.
 10. Restrooms: decorated with suspended ceilings, sanitary fittings are installed in place, with ceramic tile/latex paint whitened walls and floor tile/stone floor.
 11. Elevator halls: decorated with suspended ceilings, ceramic tile/latex paint whitened walls, and floor tile/stone floor.
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Housing Lease Contract

This Housing Lease Contract (hereinafter referred to as this "Contract") is made by and between the following two parties in Shanghai, P.R. China (hereinafter "China") on Jan 23th in 2015:

Lessor (Party A): M&G Chenguang Holding (Group) Co., Ltd.

Address: 3488 Jinqian Road, Qingcun Town, Fengxian District, Shanghai
Legal representative: Chen Huxiong
Postal code: 201406
Tel.: 021-57474488
Fax:
Business license no.: 310226000797609

Lessee (Party B): Shanghai Taomee Animation Co., Ltd.

Address: Suite1302, 13/F, Building A2, No.1528 Gumei Road, Xuhui District, Shanghai
Legal representative:
Postal code:
Tel.:
Fax:
Business license no.:

In accordance with the provisions of the *Contract Law of the People's Republic of China*, *Regulations of Shanghai Municipality on the Lease of Houses* and other applicable laws and regulations, Party A and Party B hereby enter into this Contract with respect to Party B leasing from Party A the house that is leasable by Party A according to law (the "Premises"), on the basis of equality, voluntariness, fairness and good faith and by reaching consensus through consultation.

1. Legal Statutes of both Parties and Relevant Documents

1.1 Party A is lawfully incorporated with the approval of the Chinese Government and undertakes to legally own the complete ownership and right of use of the Premises involved in this Contract.

1.2 Party B leases the Premises from Party A as the place of business of Shanghai Taomee Animation Co., Ltd.

2. Confirmation and Warranties of both Parties

2.1 In addition to those already specified herein, both parties shall each confirm and ensure the following:

(1) Each party has the legal qualification, capacity for civil rights and capacity for civil conduct to enter into and perform this Contract, is fully aware of their respective rights, obligations and duties and is willing to act in strict accordance with provisions hereof. If either party breaches this Contract, the other party shall have the right to make claims according to this Contract.

(2) Each party has gone through the internal approval procedures necessary to enter into this Contract.

(3) There is no contract with any third party nor any other matter that might prevent the execution and performance of this Contract.

2.2 Party A warrants that at the execution of this Contract, it has lawfully acquired the valid ownership certificate of the Premises described in Article 3.1 hereof, with the number indicated below:

Shanghai Real Estate Ownership Certificate for the land where the Premises are located: Hu Fang Di Xu Zi (2012) No. 000313;

3. Details about the Premises

3.1 The Premises to be let to Party B by Party A is situated at Suite 1402, 14/F, Building 2, No.1528 Gumei Road, Shanghai (hereinafter the "Premises").

The Premises is of an office building type, with a construction area of 593.465 square meters.

3.2 Delivery standards are set forth in Annex I.

3.3 Shanghai Real Estate Ownership Certificate is given in Annex II.

4. Use of the Premises

4.1 Party B undertakes to Party A that, it leases the Premises to engage in lawful economic activities, within the scope specified in its business license and shall comply with the regulations of the State and Shanghai Municipality on use of houses and fire safety as well as the regulations of Caohejing High-Tech Park on industrial development, environmental protection and property management.

4.2 Party B warrants that, during the lease term, it will not alter the purposes agreed in the preceding paragraph without the written consent of Party A and before being subject to the examination and approval of competent department.

5. Delivery Date and Lease Term

5.1 Both parties agree that the lease term of the Premises commences from March 1, 2015 (lease commencement date) and ends on June 30, 2015, and the rent commencement date is March 1, 2015.

5.2 Upon expiry of the lease term, Party A has the right to repossess the Premises, while Party B shall return the same as scheduled. In case Party B needs to continue to lease the Premises, it shall file a written application for renewal to Party A three months in advance of the expiry of the lease term, while Party A will reply to Party B indicating whether it agrees to such renewal within one month from the date when Party B's written application is received. Where Party A agrees to renewal by Party B, both parties shall sign a new lease contract. Both parties have the right to adjust certain clauses including rent clause of the renewed contract according to the current market. If both parties fail to agree upon the rent clause and enter into the renewed contract within one month prior to the expiry of the lease term, then Party A has the right to terminate this Contract upon expiry of the lease term and take back the Premises.

6. Rent, Method and Term of Payment

6.1 Both parties agree that, the unit rent per square meter of construction area of the Premises per day is RMB Four Point Two Zero (RMB4.20), and total amount is RMB Three Hundred and Four Thousand Ninety One Point Forty Seven (RMB304,091.47);

6.2 The rent of the Premises shall be paid before use. The rent shall be paid to Party A in two installments, of which RMB Seventy Seven Thousand Two Hundred and Sixty Nine Point Fourteen (RMB 77,269.14) shall be paid to Party A prior to March 1 of the current year, and RMB Two Hundred and Twenty Six Thousand Eight Hundred and Twenty Two Point Thirty Three (RMB 226,822.33) shall be paid to Party A prior to April 1. Where the final payment date of each installment coincides with a Saturday, Sunday or a public holiday, then the final payment date shall be postponed to the first working day subsequent to the holiday. In case Party B defaults on payment, it must pay an overdue fine equivalent to 0.05% of the due and unpaid rent for each delayed day.

7. Lease Deposit and Other Expenses

7.1 Both parties agree that, within three days as from the date of signing hereof, Party B shall pay Party A lease deposit, which is equivalent to three-month rent, that is, RMB Two Hundred and Twenty Seven Thousand Four Hundred and Forty Five Point Forty Six (RMB 227,445.56). Upon collection of lease deposit, Party A shall issue a receipt to Party B.

During the lease term, Party B may not set off the lease deposit against the rent of the Premises. When this Contract is terminated upon expiry of the lease term, within 10 working days after Party B pays off relevant expenses and goes through the return and handover procedures of the Premises with the Premises management department, the lease deposit paid by Party B will be refunded by Party A interest-free; in case Party B fails to pay off relevant expenses and causes any economic loss to Party A due to any cause attributable to Party B, Party A has the right to deduct relevant amount from the deposit and return the remaining portion to Party B interest-free. Where the lease deposit is insufficient for deduction, Party B shall otherwise pay the insufficient portion.

7.2 During the lease term, all water, electricity, communications, equipment and other expenses incurred in connection with the use of the Premises shall be borne by Party B.

7.3 Party B shall be solely responsible for applying to and handling electricity and communications usage and other relevant procedures at competent departments, and the relevant expenses incurred by the required application, connection and installation shall be for Party B's account.

7.4 Prior to the delivery of the Premises, Party B shall sign a property management contract with the property management company of the residential district where the Premises is located and pay the Premises management fee according to relevant regulations. The current standard property management fee for the Premises is RMB Nineteen Point Six Eight (RMB 19.68) per square meter (construction area) per month.

8. Use Requirements and Maintenance Responsibilities for the Premises

8.1 During the lease term, if Party B finds any natural damage in the Premises and its ancillary facilities, Party B shall promptly notify the property management company entrusted by Party A and request the company to make repairs. When the Premises and its ancillary facilities are repaired, Party B shall render active assistance and cooperation. The consequences arising from the failure to make timely repairs due to Party B's action or omission shall be solely borne by Party B.

8.2 During the lease term, Party B shall reasonably use and cherish the Premises and its ancillary facilities. Where Party B causes artificial damage or failure to the Premises, and/or fails to adopt proper fire control measures in accordance with applicable national/local laws and regulations, Party B shall be responsible for timely repairs/renovation and bear the expenses incurred thereby.

8.3 During the lease term, Party A ensures that the Premises and its ancillary facilities are in normal usable and safe conditions. Party A may perform inspections and maintenance to the Premises, while Party B shall cooperate at the time of such inspections and maintenance. Party A shall try its best to minimize the impact on Party B's use of the Premises.

8.4 If Party B needs to perform decoration or add ancillary facilities and equipment other than the existing decoration and facilities in the Premises, Party B shall obtain the prior written consent of Party A and handle relevant procedures with the property management company. where such decoration or addition is subject to the examination and approval of competent departments, Party B shall also report to competent departments for approval and is then permitted to carry out such decoration or addition.

8.5 When this Contract is cancelled or terminated, if there are structures added or improved by Party B subject to the written consent of Party A, Party B shall be responsible for restoring the Premises to its original state, except any reasonable wear and tear. Until the Premises is inspected and accepted by Party A, Party B may not handle check-out procedures.

9. Return of the Premises

9.1 Unless Party A agrees to renewal by Party B and both parties sign a lease renewal contract, Party B shall return the Premises upon expiry of the lease term of this Contract or termination of this Contract for any reason. Where Party B delays returning the Premises without the consent of Party A, Party B shall pay Party A the use fees payable during the occupation of the Premises equivalent to two times of the daily rent for each delayed day. Party B agrees that, if it delays in restoring the Premises to its original state and returning the same for 15 days, Party A shall have the right to enter the Premises at its option, meanwhile, Party B shall be deemed to waive the ownership and right of use in the decoration, facilities, equipment in the Premises and other articles that have not been dismantled or removed from the Premises, including equipment and articles deemed the Premises of Party B (regardless of whether they belong to Party B or any third party), and Party A has the right to dispose of them at its own discretion. In case the legitimate interests of any third party are involved, Party B shall be liable for compensating such third party. The expenses incurred by Party A for restoring the Premises to its original state on behalf of Party B shall be borne by the latter. The Premises shall be deemed to have been repossessed upon Party A's entry into it.

9.2 When returned by Party B, the Premises shall be in the conditions after normal use. At the time of return, the Premises shall be inspected and accepted by Party A, and both parties shall settle expenses payable by them respectively.

10. Subletting and Transfer

10.1 Unless Party A has permitted Party B to sublet the Premises in supplemental clauses of this Contract or other documents, Party B may not sublet the Premises to others in whole or in part within the lease term.

10.2 During the lease term, if Party A needs to sell the Premises, it shall notify Party B in advance. Party B shall have the preemptive right under the same conditions.

11. Conditions for Termination

11.1 Both parties agree that, within the lease term, should any of the following circumstances occur, this Contract shall be terminated and neither party will assume any liability towards the other party:

- (1) The right to use the land occupied by the Premises is withdrawn in advance;
 - (2) The Premises are lawfully expropriated for public interests;
-

(3) The Premises are lawfully listed in the licensing scope of house demolition due to the needs of urban construction;

(4) The Premises are damaged or destructed or recognized as a dangerous building.

11.2 Both parties agree that, should either party commit any of the following breaches, the other party may notify in writing that this Contract be cancelled. The breaching party shall pay the other party a penalty equivalent to 2 months rent then in effect; where losses are caused to other party and the penalty is insufficient to cover the losses, the breaching party shall make up the difference between the losses incurred and the penalty:

(1) Party A fails to hand over the Premises in a timely manner and still fails to do so within ten days upon receipt of a written reminder from Party B;

(2) The Premises, when handed over by Party A, does not comply with the covenants contained herein, rendering Party B unable to fulfill the purposes for which the Premises is leased;

(3) Party B alters the leasing purposes as agreed herein, without the prior written consent of Party A;

(4) The Premises are damaged for any reason attributable to Party B;

(5) Party B sublets the Premises, transfers the right to lease the Premises or exchanges the Premises for any other property leased by others;

(6) Party B defaults on payment of rent for over one month;

(7) Party B uses the Premises for any illegal activity;

(8) Party B occupies public areas or fire passages without authorization, or fails to comply with applicable laws and regulations on environmental protection and fire safety, and still fails to make rectification within 5 working days upon receipt of a written notice from Party A.

12. Defaulting Liability

12.1 During the lease term, if Party A fails to timely perform its repair and maintenance duties as agreed herein, thus causing damage to the Premises and property or personal damage to Party B, Party A shall compensate Party B for its direct losses.

12.2 In case Party B renovates the Premises or adds ancillary facilities without the written consent of Party A or beyond the scope and requirements of Party A's written consent, or occupies/uses public areas or fire passages without authorization, Party A shall have the right to require Party B to restore the Premises to its original state and compensate for the losses arising therefrom. Where Party B fails to restore the Premises to its original state during said period, Party B may rescind this Contract by written notice to Party B, and Party B shall pay Party A three-month rent at that time as the liquidated damages.

12.3 During the lease term, under conditions other than those agreed herein, if Party A cancels this Contract and repossesses the Premises in advance, Party A shall pay Party B a penalty equivalent to 0.5 times of the rent for the lead days (no more than three months rent). If the penalty is insufficient to cover the direct losses suffered by Party B, Party A shall also be liable for compensating for the difference.

12.4 During the lease term, under conditions other than those agreed herein, if Party B surrenders the lease without authorization, Party B shall pay Party A a penalty equivalent to 0.5 times of the rent for the lead days (but no more than three months rent). If the penalty is insufficient to cover the losses sustained by Party A, Party B shall also be liable for compensating for the difference. Party A may withhold the penalty from the lease deposit, and if the lease deposit is insufficient for such withholding, the deficient portion shall be paid by Party B separately.

13. Disclaimer

13.1 Where Party B sustains loss or damage due to any natural disaster, theft, robbery, other criminal events or events of force majeure, etc. occurring in the Premises;

13.2 Where disaster occurs, thereby frustrating use of the Premises, or any facility fails or does not function properly, or air conditioning, heating, water, electricity, gas and other supplies interrupts due to the reasons attributable to Party A;

13.3 Where water, power, gas supply or other public facilities interrupt due to routine maintenance or repair;

13.4 Where Party A alters or transforms the building or any portion thereof, thereby resulting in that the Premises or public areas cannot be used or the level of service provided by Party A declines.

Where this Contract cannot be performed due to the reasons under the above Paragraph 13.4, the parties are entitled to select to continue to perform or rescind this Contract, and in case of rescission of this Contract, Party B shall settle the rent and management fee by the number of days for actual use, and shall also deal with the deposits in accordance with this Contract.

14. Miscellaneous

14.1 During the lease term, in addition to the right of Party B to use the Premises, Party B shall also have the access to the corridor, staircases, elevators and hallway and the right to use public restrooms and firefighting equipment. Party B may not arbitrarily store flammable, explosive or toxic articles, nor arbitrarily discharge exhaust gas, waste water, and waste residue, nor arbitrarily occupy public areas, fire passages and non-leased areas. During the lease term, Party B shall be responsible for managing the Premises that belongs to it and take out insurance for such property if it is required to purchase insurance from an insurance company.

14.2 In case Party B relates to flammable, explosive articles, noise as well as exhaust gas, waste water, waste residue and other dangerous goods and pollution sources, Party B must report to competent departments of Caohejing High-Tech Park and Shanghai Municipality for examination and approval, and use the Premises after relevant safety standards and discharge standards are met. In case of any secondary decoration, Party B may not commence construction until it obtains the approval of competent governmental departments in charge of fire control.

14.3 In the event that either party hereto is prevented from performing any clause hereof due to war (whether declared or not), earthquake, typhoon, flood, fire and other acts of god, the prevented party shall immediately inform the other party in writing and furnish the other party with details on Force Majeure, as well as the reasons for failure of performance or delayed performance and written materials like valid documentary evidence within fifteen days thereafter.

Both parties may consult each other to decide whether to cancel this Contract, or waive the performance of this Contract partially, or delay the performance of this Contract.

14.4 The formation, validity, interpretation, performance of, and resolution of disputes in connection with, this Contract shall be governed by Chinese laws and regulations as well as local regulations and rules of Shanghai Municipality.

14.5 All disputes arising from the performance of or in connection with this Contract shall be settled by both parties through friendly consultation, failing which, either party may bring an action before the people's court of the place where the real estate is located, and the final judgment of the court shall be binding upon both parties.

14.6 In case of any matter not mentioned herein, both parties may enter into a separate written agreement to be made a part hereof after reaching consensus through consultation, and such agreement shall have the same force as this Contract.

This Contract may be modified by both parties through consultation. Any modification to this Contract may not come into force unless made in writing and signed by legal representatives of both parties or their respective authorized agents. Before the modified contract goes into force, both parties shall still perform the clauses of this Contract.

14.7 At the execution of this Contract, both parties have complete capacity for civil conduct, are fully aware of their respective rights, obligations and duties, and are willing to act in strict accordance with the provisions of this Contract. If either party violates this Contract, the other party shall have the right to make claims as specified herein.

14.8 Both parties confirm their mailing addresses and telephone numbers as follows:

Party A's address:
No.3488 Jinqian Road, Qingcun Town, Fengxian District, Shanghai

Party B's address:
Suite1302, 13/F, Building A2, No.1528 Gumei Road, Xuhui District, Shanghai

All notices, documents and materials sent or provided to each other due to the performance of this Contract shall be delivered according to the abovementioned addresses and fax numbers. Should either party change its correspondence address or telephone number, it shall notify the other party in writing.

In case of hand delivery, such notices, documents and materials shall be deemed delivered at the time of receipt acknowledgement; if sent by fax, they shall be deemed delivered when the fax is sent out; if sent by mail, they shall be deemed delivered on the day when a registered mail is sent or posted.

14.9 This Contract comes into force upon stamping by the parties.

14.10 This Contract is written in five (5) originals, with Party A and Party B holding one (1) copy respectively, and the remaining three (3) copies to be used for government filing.

Party A: M&G Chenguang Holding (Group) Co., Ltd. (seal)

Party B: Shanghai Taomee Animation Co., Ltd. (seal)

Legal representative (or authorized agent)
Chen Huxiong

Legal representative (or authorized agent)



Signature:

Signature:

Date: 2015-1-22

Date: 2015-1-22

Bank of deposit: Agricultural Bank of China
Shanghai Fengxian Guangming Sub-branch

Bank of deposit: []

Bank account no.: 03803920040030177

Bank account no.: []

Annex I Delivery Standards for the Premises

The delivery standards applicable to the Premises are as follows:

1. Reinforced concrete structure, with a uniform live load of 350kg/square meter, and a building storey height of 5 m.
 2. Design power supply capacity is 120KW/floor, with one-line power supply. If the required capacity of Party B exceeds 120KW/floor, Party B shall solely apply to the power supply company for high-voltage power, install relevant transformation equipment and bear relevant expenses arising therefrom.
 3. Telephone and distribution cables are connected into the weak current room on each floor, and the telephone capacity is 100 pairs/floor.
 4. With fire control spraying system equipped with smoke detectors.
 5. The floor is cement plaster floor.
 6. Walls are whitened with latex paint.
 7. There is no suspended ceiling, and the ceiling is whitened with latex paint.
 8. Central air-conditioning units and main riser pipes are installed in place.
 9. There are no specially designed office partitions/compartments in the Premises.
 10. Restrooms: decorated with suspended ceilings, sanitary fittings are installed in place, with ceramic tile/latex paint whitened walls and floor tile/stone floor.
 11. Elevator halls: decorated with suspended ceilings, ceramic tile/latex paint whitened walls, and floor tile/stone floor.
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Contract No.:

JOINT INVESTMENT CONTRACT FOR ANIMATED FILM**“SEER IV: Magic Stone Wars”**

THIS JOINT INVESTMENT CONTRACT (this “Contract”) is made as of , 2014 in Shanghai, the People’s Republic of China (“PRC”) by and between:

(1) Party A: Shanghai Taomee Animation Co., Ltd.
 Address: 14F, A2, No.1528 Gumei Road, Xuhui District, Shanghai
 Tel.: 021-61280056
 Fax: 021-33674012
 Postal code: 200233

(2) Party B: Beijing Enlight Pictures Co., Ltd.
 Address: 3F, No.3 Nanmen Hangxing Science Park, No.11 Hepingli East Street, Dongcheng District, Beijing
 Tel.: 010-64516384
 Fax: 010-64516025
 Postal code: 100013

In order to jointly invest to produce and operate the animated film “SEER IV: Magic Stone Wars” (temporary name, hereafter referred to as this “Film”), Party A and Party B, on the basis of equality and free will, adhering to the principle of mutual benefit and after friendly negotiations, hereby agree below to define their respective rights and obligations:

ARTICLE 1 PRINCIPLES OF COOPERATION

1. All the terms of this Contract are in compliance with *the Contract Law of the People’s Republic of China, the Copyright Law of the People’s Republic of China, the Regulations for the Implementation of the Copyright Law of the People’s Republic of China, the Regulations on the Administration of Films* as well as the relevant regulations of the Film Bureau under the State Administration of Radio, Film and Television (SARFT) concerning administration of films.

2. Each party warrants that it is a company duly organized and validly existing under the laws of its jurisdiction and has the full legal right, capacity and authority to execute this Contract and exercise and perform its rights and obligations hereunder.

3. Party A has the right to adapt the animated film “SEER IV: Magic Stone Wars”. Party A shall provide relevant certificate of ownership. Now, Party A and Party B jointly adapt the original work of SEER (i.e. SEER online game) to produce the animated feature film of “SEER IV: Magic Stone Wars”. Party A and Party B will jointly invest and permanently share the distribution earnings according to the provisions of this Contract. The copyright of the animated film “SEER IV: Magic Stone Wars” shall belong to Party A. The intellectual property rights of the separately usable works like cartoon characters, music, screenplay and so on in the animated film “SEER IV: Magic Stone Wars” shall be exclusively owned by Party A or a third party designated by Party A.

4. Party A shall be responsible for the initiation of this Film, approval and review of screenplay, film production, film examination and review, film publicity and other matters in connection with this Film and Party B shall be responsible for the theatrical projection and distribution (execution of relevant contracts to obtain earnings, including sub-licensing) as well as related commercial operations of “SEER IV: Magic Stone Wars” in mainland China. Party B is obliged to assist Party A in obtaining the Permit for Public Projection of Films and participate in the film publicity. The screenplay of this Film must be subject to the joint examination and confirmation by the Parties. The screenplay of this Film submitted to the Film Bureau for approval is the chief source of shooting. The shooting is subject to approval comments.

5. Upon execution of this Contract, Party B shall not use the major elements in animated film “SEER IV: Magic Stone Wars” (including, but not limited to, major themes, cartoon characters, story plots or any contents producing any effect similar to a film) for any other known or unknown works or any purpose other than as specified herein.

6. If the box office revenues of this Film reaches RMB 100 million, under the equal conditions, Party B shall have right of first refusal to the investment and distribution of the subsequent “SEER” films.

ARTICLE 2 BASIC TERMS

1. Name of animated film: “SEER IV: Magic Stone Wars” (temporary name)

2. Screenwriter: Wang Zhangjun

3. Chief director: Wang Zhangjun

4. Executive director: Li Zhi, Yin Yuqi

5. Chief producer: Ye Xiajun

6. Chief supervisor: Wang Yu

7. Film length: ~85 minutes

8. Audio system: SRD

9. Estimated date of shooting start: before December 2013 (temporary)

10. Estimated date of submission for review: late June 2014 (temporary)

11. Estimated date of delivery: early July 2014 (temporary)

The release date of this Film in mainland China (excluding Hong Kong SAR, Macao SAR and Taiwan) is temporarily determined to be July 1, 2014 to August 31, 2014, and Party B may decide the most favorable release date as appropriate but it shall notify Party A in advance and obtain the written permission of Party A. In no case may the release date of this Film in any region other than mainland China be earlier than the release date in mainland China, but it can be simultaneous with the latter.

12. The production cost of the film SEER IV: Magic Stone Wars may not exceed a maximum of RMB ten million (in figures: RMB 10,000,000), including but not limited to screenplay, story boards, interim production, post-production, dubbing, star dubbing, music, audio mixing, HDCAM finished film, DCP master, D5 digital tape, DVD submitted for review and so on. As the executor of the production of this Film, Party A must carry out production and shooting according to the dates specified herein, while Party B shall render necessary assistance in a timely manner.

13. All the production, lease, labor and other contracts related to the shooting and production of this Film shall be signed with Party A. Any dispute arising as a result thereof shall be resolved by Party A. Party B shall timely provide necessary assistance.

14. Party A shall supervise the film crew to purchase insurances for all the working personnel and ensure that all the risks are insured. The insurance period shall not be less than the shooting period of this Film so as to ensure that this Film is completed smoothly and as scheduled. Party A shall be solely responsible for the safety problems on personnel, equipment and the like or any dispute with any other third parties (including, but not limited to, contract dispute, infringement dispute, etc.) during the production process.

15. Party A shall submit to Party B the settlement statement of film production (Annex I) and settlement statement of publicity and distribution costs (Annex II). If the budgets of production, publicity and distribution costs are not used up, Party A will refund the remaining portion based on Party B's investment proportion. Party A and Party B shall be responsible for using the funds in full conformity with the plan within the total amount of investment. The portion of publicity and distribution costs (excluding advanced publicity and distribution costs as specified in Paragraph 2.2.3 of Article 6 hereof) exceeding RMB 10 million shall be borne by Party A, and the portion of advanced publicity and distribution costs as specified in Paragraph 2.2.3 of Article 6 hereof exceeding RMB 5 million shall be borne by Party A and Party B respectively under their respective scope of implementation for overrun portion. Party B shall have the right to, at any time, supervise the use of funds and inspect the relevant financial materials and Party A shall cooperate in this regard. Party A shall guarantee the truthfulness of the budgets and settlement statements provided by it, otherwise Party A shall compensate the losses incurred by Party B as a result thereof.

ARTICLE 3 INVESTMENT

1. Party A and Party B acknowledge that the total investment of this Film (i.e. production, publicity and distribution costs) is RMB twenty million (in figures: RMB 20,000,000), in which RMB ten million (in figures: RMB 10,000,000) is used for production and RMB ten million (in figures: RMB 10,000,000) is used for publicity and distribution.

2. Party A and Party B will jointly invest in this Film. Party A's investment is RMB sixteen million (in figures: RMB 16,000,000), accounting for 80% of the total amount of investment and Party B's investment is RMB four million (in figures: RMB 4,000,000), accounting for 20% of the total amount of investment.

3. Party B shall, in accordance with its proportion of investment, pay its investment payable to Party A's account in two installments. The specific times and amounts are as follows:

First installment: within fifteen (15) working days following the execution of this Contract and after Party B examines and confirms the letters of authorization about distribution issued by publishers, detailed budget of production costs and detailed budget of publicity and distribution (refer to Annex 1) from Party A, Party B shall pay [50]% of the investment payable, i.e. RMB [two million] in figures: RMB [2,000,000];

Second installment: after Party A provides all the materials and the settlement statement of production costs in the List of Delivered Materials and Timetable (Annex III) and all of them are examined and confirmed by Party B, Party B shall pay [50]% of the investment payable, i.e. RMB [two million] in figures: RMB [2,000,000].

4. Except as otherwise agreed herein, neither party may assign its rights and obligations hereunder to any third party (except Party A's affiliate), except with the written consent of the other party.

5. During the cooperation of this Film, if any new investor intends to participate, Party A shall be responsible for approaching and determining such new investor. The investment return of such new investor will be allocated from Party A's investment proportion. The ROI and all the rights herein of Party B shall remain unchanged.

6. Party B agrees to pay the investment payable to Party A's account below:

Account holder: Shanghai Taomee Animation Co., Ltd.

Deposit bank: Shanghai Caohejing Sub-branch, China Construction Bank

Account number: 31001613402050012420

7. If this Film does not obtain *the Permit for Public Project of Films* within [12] months following the effectiveness of this Contract, Party B may demand Party A to refund all the sums already paid by Party B within 15 days and Party A shall pay to Party B the interest on the said sums for the period of occupation at the loan rate published by the People's Bank of China for the same period.

ARTICLE 4 SUBMISSION FOR REVIEW

1. Party A shall be specifically responsible for relevant matters related to the submission of the screenplay of this Film for review and the relevant procedures and matters following the final approval, and the relevant expenses arising therefrom will be included into the production cost of this Film, subject to the authorization of the Parties and the entry into detailed accounts. The ultimate editing right of this Film shall remain with the Parties, and any difference in opinions shall be resolved by the Parties according to the needs of release and review opinions of Film Bureau, SARFT.
2. Subject to the examination and approval of the Parties, Party A shall submit mixed copies to the Film Bureau for final examination, while it shall be Party B's liability to assist Party A in obtaining the final approval of the Film Bureau for this Film and the release permit, and the finished film shall be the copy finally approved by the Film Bureau.
3. In case this Film needs to be revised prior to the release as required by relevant departments under SARFT, Party A must implement such revision in order to ensure that this Film can pass the final examination successfully.

ARTICLE 5 AUTHORSHIP

1. Subject to the approval of Film Bureau, SARFT, the Parties will be jointly listed as the "co-presenters" and "co-producers" of the animated film. The order of authorship in the release, sales and co-presenting of this Film is: Shanghai Taomee Animation Co., Ltd. and Beijing Enlight Pictures Co., Ltd., and the order of authorship in the co-production is: Shanghai Taomee Animation Co., Ltd. and Beijing Enlight Pictures Co., Ltd. The order of presenters is: Wang Haibing, Cheng Yunpeng, Li Xiaoping; producers: Cheng Yunpeng, Chen Hongli
2. Other authorship-related matters shall comply with applicable regulations, and Party A shall produce authorship clips according to relevant regulations of the Film Bureau and ensure that all captions of the Film comply with provisions of laws and regulations and normative documents. In case Party B has to assume liabilities or suffers any losses because the captions fail to meet such provisions, Party A shall fully compensate Party B for the losses it suffers.

ARTICLE 6 DISTRIBUTION INTERESTS AND ALLOCATION OF INCOME

1. Distribution interest.

1.1 The Parties unanimously agree after consultation that Party B will be exclusively and permanently responsible for the release and distribution of this Film in the Mainland of the People's Republic of China (including but not limited to the distribution and release in theater chains, digital release, digital release in rural areas, release in the military system as well as the release in hotels, means of transport and outdoors) and commercial operations: including but not limited to the preparation of distribution plan and budget, negotiation, implementation, statistics and settlement, etc., provided that Party B shall provide Party A with appropriate copy of contract for the record. Party A shall be exclusively and permanently responsible for and decides on at its own discretion distribution other than distribution and release in theater chains and the sales of copyrights of this Film on Mainland of the People's Republic of China (including but not limited to sales of copyright on TV, new media and audio and video), enter into mutual agreements with buyers and be responsible for collection, provided that Party A shall provide all copies of contract to Party B for the record.

1.2 Overseas distribution: Party A and Party B unanimously agree after consultation that: Party A shall be exclusively and permanently responsible for and decides on distributions of this Film other than those on Mainland of the People's Republic of China, including sales of distribution copyright other than distribution and release in overseas theater and theater broadcasting right, and Party B shall provide necessary support.

1.3 Party A shall be exclusively and permanently responsible for book publishing and distribution concerning this film, and shall be exclusively entitled to income on copyright.

2. Allocation of Income

2.1 The Parties agree that Party B or the distributor designated by Party B will be responsible for the collection of the income from the distribution in the Mainland of the People's Republic of China, but must provide the details and statements of the distributor to Party A for the record.

2.2 The Parties agree to carry out distribution and settlement of the distributable profits resulting from distribution of this Film in theater chains on Mainland of the People's Republic of China, and the parties shall respectively bear the taxes and fees arising during performance of this Agreement.

2.2.1 Distributable profits from distribution in theater chains on Mainland China = net box office-profit shares of theaters — distribution agency fee by Mainland theaters— distribution costs advanced by Party A (only referring to the copying cost, site distribution cost, activity cost and other costs not exceeding RMB 5 million advanced by Party A as specified in Paragraph 2.2.3 of this Article)

Net box office*=gross box office – national fund for films – VAT and surcharges

National fund for films = gross box office X5%

VAT and surcharges shall be calculated by the State's existing tax payment requirements

*Net box office is based on the amount confirmed in the final settlement letter of China Film

Profit shares of theaters = (gross box office – national fund for films – VAT and surcharges) x proportion of profit shares of theaters

2.2.2 Agency fee for distribution in theater chains on Mainland China= net box office x agency fee proportion

Agency fee proportion shall be calculated by excess progressive system in the following table:

Gross box office (RMB/Yuan)	Agency fee proportion
Portion not exceeding RMB 80 million	4%
Portion of more than RMB 80 million and less than RMB 100 million	7%
Portion exceeding RMB 100 million	10%

For example, where the gross box office is RMB 100 million, agency fee for distribution in theater chains=[RMB 80 million –(RMB 80 million*5%)-VAT and surcharge]*4%+[RMB 20 million –(RMB 20 million*5%)-VAT and surcharge]*7%

2.2.3 Party A and Party B agree that copy cost, site distribution cost, activity cost and other costs shall be advanced by Party A first, and the total of the aforesaid costs shall not exceed RMB Five Million (In numbers: RMB 5,000,000). The parties shall jointly prepare the budget for distribution costs through consultation, and remit the costs required by Party B's distribution as confirmed to Party B's account within 3 working days after the budget be confirmed by both parties. At the time of settlement for this Film, the parties shall submit the settlement statement of costs required by distribution, and in case the distribution costs are not used up, the remaining portion shall be returned to Party A, and Party B shall issue a valid invoice of equivalent amount in accordance with the actually expended costs. In case of overrun of the aforesaid costs, the parties shall bear the overrun portion respectively in their respective scope of implementation. Either party shall ensure authenticity of settlement statements provided by it, or it shall make compensation to the other party for losses.

2.3 Allocation of other gross income on distribution on Mainland China (excluding books): other income on sale of copyright and distribution of this Film on Mainland China (excluding books) other than gross income from distribution in theater chains (hereinafter referred to as "Other Gross Income on Distribution", subject to the payment actually received by Party A), including, but not limited to, income on distribution and sale of television, new media, audio and video copyright, shall be collected and settled by Party A, and after deducting 15% agency fee (as an exclusive distributor, Party A may collect 15% of other gross income on distribution as agency fee), said gross income shall be allocated in accordance with their respective investment proportions.

2.4 Gross income on overseas distribution (excluding books): income on distribution in the regions other than Mainland of the People's Republic of China, including: income from release and distribution in overseas theater chains and sale of distribution copyright other than right to release the Film in theater chains (subject to payment actually received by Party A), shall be collected and settled by Party A, and after deducting 15% agency fee (as an exclusive distributor, Party A may collect 15% of other gross income on distribution as agency fee), the gross income shall be allocated in accordance with their respective investment proportions.

2.5 Party A shall fully responsible for operating the books relating to this Film and interests thereon, and shall be solely entitled to relevant benefits.

2.6 Settlement cycle: The parties shall make settlement and payment once every six months within 2 years after this Film is released, and either party shall provide the other party with the statement of the income on the current distribution prior to settlement, and make the appropriate payments to the payee within 7 working days after the parties confirm amount of settlement and the payor receives the payment to be settled from a third party. Party A provide Party B with special valid VAT invoice of the amount equivalent to all investments by Party B prior to first settlement; meanwhile, at the time of settlement, the payee shall issue to the other party the special VAT invoice of the amount equivalent to amount to be collected prior to collection.

3. This Film can be distributed domestically only after it is granted the pass and Film Release Permit by SARFT.

4. Publicity

The Parties shall, according to the publicity plan confirmed by them, apply their respective resources and do their best to carry out the publicity and sales in a satisfactory manner, and the relevant production personnel of this Film must jointly participate in the publicity campaign. Party A shall specify in the contract signed with the production personnel that, the director and producer of this Film have the obligation to provide free services to the publicity and distribution of this Film in at least five domestic cities and shall have the same external publicity catchword. During the process of external publicity, either party must simultaneously indicate that both Party A and Party B are joint investors in the shooting of this Film.

5. Party A undertakes to deliver to Party B the materials necessary for the distribution of this Film according to the contents and deadlines specified in List and Schedule of Materials to Be Delivered (for details, see Annex III). Party A shall provide a copy of Film Release Permit of this Film (affixed with the official seal of Party A) within 5 working days upon receipt of the same.

When signing the Contract, Party A shall provide 4 originals of each of the power of attorney and certificate of rights issued by all copyright holders of this Film (including but not limited to presenter, co-presenters, producer and co-producers subscribing Film Release Permit and this Film) and form a complete authorization chain that complies with requirements of applicable laws and regulations and juridical practice.

ARTICLE 7 PARTICIPATION IN CONTESTS AND EXHIBITIONS

1. The Parties agree that, Party A shall be responsible for applying for various film & TV awards including the Best Works Award granted by the Propaganda Department of CPC Central Committee, Huabiao Award, Golden Rooster Award, and Baihua Award, and if this Film wins a single reward, the trophy and prize money shall be owned by the winner; and if this Film wins an award, the honor shall be shared by the Parties and the trophy and certificate will be jointly owned by the Parties upon reproduction, and the prize money minus participation expense will be shared by the Parties according to their respective investment proportions.

2. In case either party recommends this Film to participate in exhibition, competition and other activities in an international film festival, Party A shall report to competent department of Chinese Government for filing purposes, subject to the consultation of the Parties. The list of the delegation members shall be negotiated by the Parties, and the expenses incurred for participating in competition and exhibition shall be borne by them respectively. If this Film wins an award, the honor shall be shared by the Parties, the trophy and certificate shall be kept by each party after duplication, the prize money of individual award shall go to the individual concerned, and other prize money shall be allocated based on their respective investment proportions.

3. The subsidies involving domestic film shot in high-tech format (including 3d and giant-screen film) in government subsidies shall be shared by the parties based on their respective investment proportions, and the subsidies involving rewarding the project establishment company for such project shall be enjoyed by Party A; other government subsidies and rewards shall be distributed by the parties through separate consultation, and if consultation efforts fail, the parties shall distribute such government subsidies and rewards according to their respective investment proportions.

ARTICLE 8 DEFAULTING LIABILITY

1. Except as otherwise provided herein, if, due to any breach by either party of this Contract, the other party suffers from loss and the performance of this Contract is prevented, the breaching party shall pay 20% of the total investment hereunder as liquidated damages to the non-breaching party and make a public apology to the non-breaching party. If the liquidated damages cannot cover the loss suffered by the non-breaching party, the breaching party shall make up the deficit.

2. Party A shall ensure that the production and publicity of this Film and the contents thereof comply with the stipulations of the laws and regulations of the People's Republic of China. If Party B suffers from losses as a result of any violation of laws and regulations by this Film, Party A shall be liable for all such losses thus incurred by Party B. Likewise, if Party A suffers from losses as a result of any violation of laws and regulations by Party B's distribution of this Film, Party B shall be liable for all such losses thus incurred by Party A.

3. Upon execution of this Contract, Party B shall timely perform its investment obligation. If Party B fails to pay the investment within the term as prescribed herein, it shall pay the liquidated damages of 0.01% of the outstanding sum per delayed day.

ARTICLED 9 CONFIDENTIALITY AND RETURN OF MATERIALS

1. Each party undertakes to keep confidential the information on this Film and the business secrets of the other party known by it in connection with the performance of this Contract and without the written consent of the other party, not to disclose the same to any third party or use the same for any purpose other than as specified herein.

2. Upon completion of the cooperation hereunder, each party shall return to the other party the materials obtained from the other party in connection with the performance of this Contract and shall not retain any copy thereof without the consent of the other party.

ARTICLE 10 FORCE MAJEURE

If this Film cannot be completed or distributed for any cause of force majeure like natural disaster and war, each party shall be exempt from the defaulting liability arising as a result thereof and the Parties shall jointly bear this risk in proportion to their respective investments.

ARTICLE 11 MISCELLANEOUS

1. Each party shall comply with the related tax laws of its jurisdiction and itself declare and pay the taxes. If any legal dispute arises for any reason or any violation of tax law, each party agrees to bear its entire liability without incurring any liability to the other party.

2. This Contract and its annexes attached hereto shall have a legal effect. Upon execution, this Contract shall not be modified by either party without the permission of the other party. This Contract constitutes the entire agreement between the Parties with respect to the cooperation concerning the animated film "SEER IV: Magic Stone Wars" and supersedes all other prior documents between the Parties.

3. Any matter not mentioned herein is to be resolved by the Parties through negotiations and the Parties may enter into a supplemental agreement, which shall have the same legal effect as this Contract. The execution, validity, interpretation and performance of, resolution of disputes in connection with, this Contract, shall be governed by the PRC laws. The annexes hereto constitute part of this Contract and are equally authentic as this Contract.

4. This Contract is executed in two originals, one for each party hereto, and enters into force upon signing and stamping by the representatives of the Parties.

5. Any dispute arising from this Contract shall be resolved by the Parties through negotiations. If efforts to negotiate have failed, either party may file a lawsuit before the people's court in the place where the defendant is located.

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Party A: (seal) Shanghai Taomee Animation Co., Ltd.

Representative: (signature)



Party B: (seal) Beijing Enlight Pictures Co., Ltd.

Representative: (signature)



Annex IV

Letter of Consent

To: Shanghai Taomee Animation Co., Ltd.

In accordance with JOINT INVESTMENT CONTRACT FOR ANIMATED FILM “SEER IV: Magic Stone Wars” signed by this Company with You, this Company agrees:

1) intellectual property rights on SEER IV: Magic Stone Wars shall enjoyed by You alone.

2) You shall be solely responsible for negotiating with and introducing new investors (“New Investors”) to participate in a joint investment in the film version, and this Company agrees that new investors serve as the producer of animated film “SEER IV: Magic Stone Wars” and shares income from such film under the agreement between You and new investors. Your introduction of new investors and signing of corresponding investment agreements do not need to obtain prior consent from this Company, provided that your introduction of new investors shall not affect this Company’s ROI (Return on Investment) in the animated film “SEER IV: Magic Stone Wars”.

3) You shall be solely responsible for and independently operating all matters on sale of copyright and distribution of SEER IV: Magic Stone Wars on Mainland China other than the right to release this film in theater chains, and your signing of relevant distribution, authorization or sales contract does not require prior consent of this Company, provided that You shall submit relevant contracts and agreements signed to this Company for the record for future settlement purposes.

This Letter of Consent takes effect upon issuance and remains effective.

Beijing Enlight Pictures Co., Ltd.

Seal of Beijing Enlight Pictures Co., Ltd.

, 2014



Special Notice

- I. This Contract is formulated in accordance with such laws and regulations as the *Real Rights Law of the People's Republic of China*, the *Contract Law of the People's Republic of China*, the *Land Administration Law of the People's Republic of China*, the *Urban Real Estate Administration Law of the People's Republic of China*, the *Rules on the Implementation of the Land Administration Law of the People's Republic of China*, and the *Measures of the Shanghai Municipality on the Implementation of the Land Administration Law of the People's Republic of China*.
- II. The ownership of the land to be transferred belongs to the People's Republic of China. PRC and its government have the jurisdiction and administrative management rights vested by law over the land and other rights to be exercised by the State as provided by law and the interests required for the purpose of social public benefits in the land.
- III. The parties to this Contract shall formulate this Contract based on the principle of openness, equity, fairness and integrity.
- IV. This Contract shall take effect upon execution and the two parties must strictly perform the agreement made in this Contract. Without the consent of the two parties and the approval document from competent department, no change or amendment shall be made to this Contract.

Bar Code



Contract on Transfer of Rights to Use State-owned Construction Land in Shanghai Municipality

Hu Song GuiTu (2014) Chu Rang He Tong No. 56 (1.0 version)

Songjiang Planning and Land Administration Bureau of Shanghai Municipality

December 19, 2014



172014005611

Contract on Transfer of the Right to Use State-owned Construction Land

Parties to this Contract:

Transferor: Songjiang Planning and Land Administration Bureau of Shanghai Municipality

Contact Address: Bldg. 2, Rong Le Road East, Songjiang District

Zip Code: 201613

Telephone: 57740811

Fax: 57740785

Transferee: Shanghai Taomee Software Development Co., Ltd;

Contact person: Chen Xi

Ratio of contribution: 100%

Contact address: F15, Bldg. A2, No. 1528, Gumei Road, Xuhui District

Zip code: 200233

Telephone: 18621935812

Fax: 33674312

Bank of deposit: Shanghai Bank Wanyuan Road Branch

Account Number: 03002409298

Chapter 1 General Provisions

Article 1 This Contract is formulated by the two parties in accordance with the *Real Rights Law of the People's Republic of China*, the *Contract Law of the People's Republic of China*, the *Land Administration Law of the People's Republic of China*, the *Urban Real Estate Administration Law of the People's Republic of China*, and other related administrative laws and regulations and policies in respect of land supply and based on the principle of equality, free will, compensation and good faith.

Article 2 The ownership of the land to be transferred belongs to the PRC. The transferor shall transfer the right to use state-owned construction land based on the authorization granted by law. And underground resources and buried objects are not included in the scope of transferring the right to use State-owned construction land.

Article 3 Transferee has the right to possess, use, profit from and dispose of the State-owned construction land it acquires according to law during the term of the transfer, and has the right to erect constructions, buildings and ancillary facilities on the land.

Chapter 2 Delivery of transferred land and payment of transfer price

Article 4 The number of the parcel under this Contract is 201317287266436317 and the area of the parcel is fourteen thousand one hundred and sixty five point six square meters (in figures: 14,165.60m²). Among which, the area of the parcel to be transferred is eleven thousand five hundred and eight point three square meters (11,508.30m²).

The parcel to be transferred under this Contract locates at Jiuting Town, Songjiang District (JT-13-001-2).

The boundaries of the land transferred hereunder are: eastward to the river; westward to Gaoke No.2 Road; southward to planned road; northward to the river, as shown in Annex 1.

The vertical boundary of the parcel to be transferred under this Contract has an upper limit of \ meters and a lower limit of \ meters, and the elevation difference is \ meters. For the vertical boundary of the parcel to be transferred, see Appendix 2.

The spatial scope of the parcel to be transferred is the enclosed space with the foregoing boundary sites as vertical plane and the horizontal plane at the upper limit or lower limit level.

Article 5 The parcel to be transferred under this Contract shall be used as industrial land.

Article 6 Transferor agrees to deliver the parcel to be transferred to Transferee prior to February 11, 2015, and Transferor agrees that at the time of delivering the parcel, the parcel shall be a cleared land.

Article 7 The term for the transfer of the right to use State-owned construction land under this Contract shall be 50 years for industrial land, commencing on the date of delivery of land set forth in Article 6 of this Contract; if the State-owned construction land is originally allotted and leased, and will be transferred after going related transfer formalities retrospectively, the term of transfer shall commence on the date of the execution of this Contract.

Article 8 The price for transferring the right to use State-owned construction land of the parcel under this Contract shall be ten million four hundred thousand yuan only (in figures: 10,400,000.00 yuan) and nine hundred and three point seven yuan (in figures: 903.70 yuan).

Article 9 The earnest money for the parcel under this Contract shall be RMB two million and eighty thousand yuan (2,080,000.00 yuan), which may be used to offset the price for transfer of the right to use land. Within five working days of the execution of this Contract, i.e., prior to December 26, 2014, Transferee shall pay to local State Treasury the earnest money for the performance of this Contract.

Article 10 Transferee agrees to pay to Transferor the price for the transfer of the right to use State-owned construction land in accordance with the requirements of Section (1) of this Article:

- (1) Within 30 working days of the execution of this Contract, Transferee shall pay the price for transferring the right to use State-owned construction land in a lump sum;
- (2) Transferee shall pay the price for transferring the right to use State-owned construction land in \ installments based on the following time and amount.

First installment, \ % of the land transfer price, i.e. RMB \ yuan; paid within \ working days of execution of this Contract, i.e., within MMDD, YY.

Second installment, \ % of the land transfer price, i.e. RMB \ yuan; paid within \ working days of execution of this Contract, i.e., within MMDD, YY.

The time limit for paying the price for transferring the right to use State-owned construction land shall not exceed 90 working days. Among which the first installment shall be paid within 10 working days of the execution of this Contract, with a ratio of no less than 50% of the total land transfer price (including earnest money). Transferee shall pay interest to Transferor based on the interest rates issued by the People's Bank of China on the date of payment of first installment of land transfer price together with the land transfer price for the second installment or any installment thereafter.

Article 11 Transferee shall apply for the registration of the rights to use State-owned construction land upon the presentation of this Contract, payment receipt of land transfer price and related certificates after paying all the transfer price of the parcel of land under this Contract.

Chapter 3 Land development, construction and utilization

Article 12 Transferee agrees that the investment intensity for the parcel under this Contract shall be subject to the requirements made in Section (1) in this Article:

- (1) The parcel under this Contract shall be used for industrial construction. Transferee agrees that the fixed assets investment for the parcel under this Contract shall be no less than the approved or registered amount, i.e., RMB one hundred and eleven million three hundred and forty thousand yuan (in figures: 111,340,000.00 yuan). The investment intensity shall be no less than nine thousand six hundred and seventy yuan (in figures: 9,670.00 yuan) per square meters. The total fixed assets investment for the construction project on the parcel under this Contract shall include investment in constructions, buildings and ancillary facilities, equipment, transfer price, etc.
- (2) The parcel under this Contract shall be used for non-industrial project construction. The Transferee warrants that the total development and investment for the parcel under this Contract shall be no less than RMB \ yuan (in figures: \ yuan).

Article 13 Where Transferee erects new constructions, buildings and their ancillary facilities within the scope of the parcel under this Contract, the planning requirements for the parcel to be transferred determined by the planning and management department at municipal (county) level shall be satisfied (see appendix 3). Among which:

The construction plot ratio: industrial land: 2.0; above-ground building area 23,016.00 square meters;

Underground building area 0.00 square meters. Among which, the building area for operating purpose is 0.00 square meters; if this Contract has not specified but it is required to carry out underground development for operational purpose at the construction phase, Transferee shall sign a supplementary agreement with Transferor and pay land transfer price retrospectively prior to applying for a construction project planning license.

Upper limit of the constructions: 50 meters

Building intensity: subject to approved planning program;

Ratio of green space: subject to approved planning program;

Other land utilization requirements: \ \ .

Article 14 Transferee agrees that the supporting facilities for the construction on the parcel under this Contract shall be implemented based on Section (1) of this Article;

- (1) The parcel under this Contract shall be used for industrial project construction. According to the planning and design conditions determined by planning department, the area used for enterprise administration and office purpose and life services within the scope of the parcel acquired under this Contract shall not exceed 7.00% of the area of the parcel, i.e., under 805.58 square meters, and the building area shall not exceed 1,611.00 square meters. Transferee agrees not to erect any non-production facilities such as residential houses, expert apartment, hotel, guesthouse and training center. It is prohibited to erect any villa or similar building with three (in case of double house) or four detached external walls or any single building with an area of 150 to 500 square meters within the industrial land.
- (2) Where the parcel under this Contract is used for the construction of residential project, the requirements in respect of energy and land conservation shall be satisfied. The area of fully decorated residential houses shall account for more than \ \ %, and the energy conservation of the buildings shall satisfy the requirements of the laws, regulations and specifications issued by the State or Shanghai Municipality.

Article 15 The area of affordable housing constructed within the scope of the parcel of this Contract shall account for \ \ % of the total planned residential building of the parcel, i.e., more than \ \ square meters. Transferee agrees to transfer the supporting affordable housing to competent department in charge of the management of affordable housing.

Article 16 Transferee shall carry out the development and construction of the parcel based on the related requirements in respect of planning and land administration.

- (1) The ratio between the verified building area for commercial and office purpose on the parcel and that of residential areas shall be \ \ ; and the verified building area for commercial and office purpose shall be no less than \ \ ;
- (2) If the parcel under this Contract will be used for office purpose, the building area of apartment offices shall be \ \ square meters. If this Contract has not specified the building area of apartment offices, apartment offices shall not be constructed for office purpose;
- (3) The building area of small and medium sized residential houses built on the parcel (under 90 square meters) shall account for \ \ % of the total building area of the parcel, i.e., \ \ square meters.

Article 17 Transferee agrees that the construction project regarding the parcel under this Contract shall commence its construction prior to August 11, 2015 and shall be completed before February 11, 2017.

If Transferee is unable to commence construction on that date, it shall apply to Transferor thirty days in advance for postponement. If the Transferor agrees to the postponement, the date of completion shall be extended correspondingly; provided that the extension shall be no more than one year.

Article 18 Where Transferee carry out construction within the scope of the parcel under this Contract, the interface between the water, gas, sewage and other equipment and main lines outside the parcel and the interconnection project for substation shall be constructed in accordance with related requirements.

Transferee agrees that various pipelines and conduits laid by the government for public utilities may enter, exit, pass or traverse the parcel; provided that the government or the entity constructing and operating such public utilities shall provide reasonable compensations if the functions of such parcel is affected.

Article 19 Transferee shall utilize the land based on the purpose of the land and plot ratio agreed under this Contract. It shall not change the same without authorization. During the term of transfer, if the purpose of the land shall be changed, the two parties agree that the requirements made in Section (1) of this Article shall govern:

- (1) Transferor may withdraw the right to use the construction land with compensation;
- (2) The formalities in respect of changing the purpose of the land shall be gone through according to law, an agreement on amending the contract on transfer of the right to use the State-owned construction land shall be signed or a new contract on transfer of the right to use the State-owned construction land shall be executed. In the case, Transferee shall retrospectively pay the balance between the assessed price of the right to use the construction land with a new purpose on market and that of the price of the right to use the construction land for original purpose and go through land change registration.

Article 20 During the term of the parcel under this Contract, the government reserves the right to adjust the planning of the parcel under this Contract. In case of any change to the original planning, the existing buildings on the parcel shall not be affected; provided that the reconstruction, renovation, restructuring of the constructions, buildings and their ancillary facilities on the parcel within the term for use or the application for renewal after expiry of the term for use shall be made in accordance with the planning for the time being in force.

Article 21 Transferor shall not withdraw the right to use the State-owned land if Transferee exercises such rights according to law before the expiry of the term for use agreed in this Contract. Under special circumstances, if such rights shall be withdrawn in advance for the purpose of social public interests, Transferor shall apply for approval according to statutory procedures and compensate the land user in the amount based on the value of the above-ground constructions, buildings and their ancillary facilities and the value of the right to use the State-owned construction land within the residual term assessed on market and the assessed and determined direct loss thereof.

Article 22 After completion of the construction project on the parcel under this Contract, Transferee shall apply to the land administration department executed related contract for checking and inspecting the use of the land for construction project under this Contract and the performance of the contents of this Contract. If the inspection turns out to be qualified, the land administration department shall issue a completion work acceptance certificate. Among which:

If the actually-measured capacity building area exceeds the total agreed in this Contract but it is still within the tolerable error of planning, land transfer price for the exceeding portion of the area shall be paid retrospectively and such area shall be inspected for acceptance thereafter.

If the actually-measured total building area exceeds the tolerable error of the planning, the exceeding portion may be inspected for acceptance only to the extent that it has been handled according to law based on the procedures for dealing with illegal construction. If it is decided that land transfer price shall be paid retrospectively for illegal area, such price shall be paid after collective decision-making, based on the price of all the exceeding area (including the area within the tolerable error of the planning) assessed at the time of the retrospective payment on market and the land price agreed in this Contract, whichever is higher.

Article 23 Transferee shall submit a geotechnical engineering investigation report, perform geological disaster prevention obligations, and maintain the ground subsidence monitoring and prevention facilities and shallow geothermal energy monitoring facilities distributed within the scope of the land.

Chapter 4 Assign, lease or mortgage of the right to use State-owned construction land

Article 24 After Transferee pays the price for transfer of the right to use State-owned construction land pursuant to this Contract and collects the certificate for the use of State-owned construction land, it has the right to assign, lease, or mortgage the rights to use State-owned construction land under this Contract in whole or in part. For the first assignment, the requirements made in Section (1) of this Article shall be satisfied:

- (1) Carrying out investment and development pursuant to this Contract, and completing 25% or more of the total development investment;
- (2) Carrying out investment and development pursuant to this Contract, and establishing the conditions for industrial land other construction land.

Any industrial land transferred under this Contract shall be used by Transferee pursuant to this Contract, and shall not be divided for transfer or lease. Projects in the nature of standard industrial plants may be transferred or leased based on related requirements.

Article 25 The contract on the assignment, lease and mortgage of the right to use State-owned construction land shall not violate the laws and regulations of the State and the agreement made in this Contract.

Article 26 After assignment of the right to use State-owned construction land in whole or in part, the rights and obligations set forth in this Contract and land registration documents will be assigned accordingly. The term for use of the rights to use State-owned construction land shall be the term for use agreed under this Contract net the term for use elapsed.

After lease of the rights to use State-owned construction land under this Contract in whole or in part, Transferee shall have the rights and fulfill the obligations set forth in this Contract and land registration documents.

Article 27 In case of assignment or mortgage of the rights to use State-owned construction land, the parties in respect of the assignment or mortgage shall take this Contract and corresponding assignment or mortgage contract and the certificate for the use of State-owned land to land and resources management department for applying for land change registration.

Chapter 5 Expiry of term

Article 28 Where term agreed under this Contract expires and land user needs to continue to use the parcel under this Contract, it shall apply to Transferor for renewal of term at least one year prior to the expiry. In the case Transferor shall approve the approval unless the parcel under this Contract shall be withdrawn for social and public interests.

Where the term for the rights to use residential construction land expires, a renewal will be automatically effected.

If Transferor agrees to the renewal, land user shall go through such formalities in respect of transfer and lease according to law and execute a new transfer and lease contract for use of land with compensation, and pay the land transfer price, rent and other compensations for the use of the land.

Article 29 Where land user applies for renewal after expiry of the term of land transfer and such application is not approved due to social and public interests, land user shall return the certificate for the use of State-owned land and deregister the right to use State-owned construction land in accordance with related requirements, and Transferor may reclaim the rights to use State-owned construction land without compensation. Transferor and land user agree that the constructions, buildings and their ancillary facilities erected on the parcel under this Contract shall be dealt with pursuant to Section (1) of this Article:

- (1) Transferor will own the above-ground constructions, buildings and their facilities, and pay land user corresponding compensations based on the residual value of such constructions, buildings and their facilities;

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- (2) Transferor will own the above-ground constructions, buildings and their facilities without paying any compensations.

Article 30 If land user does not apply for renewal upon expiry of term of land transfer, the land user shall return the certificate on the rights to use State-owned land and deregister the rights to use State-owned construction land. And the rights to use State-owned construction land will be withdrawn by Transferor without any compensation. The constructions, buildings and their ancillary facilities will be owned by Transferor without compensation, and land user shall maintain the normal function of constructions, buildings and their ancillary facilities, without any damage due to human factors. If the above-ground constructions, buildings and their ancillary facilities lose normal functions, Transferor may require the land user to remove or demolish the above-ground constructions, buildings and their ancillary facilities, to reinstate the land to cleared land.

Chapter 6 Force majeure

Article 31 Where this Contract cannot be performed in whole or in part due to force majeure on the part of any parties hereto, such party may be exempted from liabilities; provided that such party shall use its best efforts to take necessary remedial measures to mitigate the loss due to such force majeure. If the party concerned suffers force majeure during delayed performance, such party shall not be exempted from liabilities.

Article 32 Any party affected by force majeure shall notify the other party of the same in such written forms as letter, telegraph and fax within seven days of the occurrence of the force majeure and provide the other party with a report and certificate proving the inability to perform this Contract in whole or in part or the requirements for delayed performance within fifteen days of the occurrence of the force majeure.

Chapter 7 Liabilities for breach of contract

Article 33 Transferee shall pay the price for the use of State-owned construction land as agreed under this Contract. If Transferee fails to do so, it shall pay to Transferor the liquidated damages in the amount of 1.00% of the delayed payment on a daily basis as of the date of delayed payment. If the payment of the price for the use of State-owned construction land is delayed for more than sixty days and is still not made after Transferor demands payment, Transferor has the right to terminate this Contract. In the case, Transferee does not have the right to require refund, and Transferor may require Transferee to make

compensations.

Article 34 If Transferee terminates the construction of the investment project due to any reason on its own part and applies to Transferor for termination of the performance of this Contract and redelivery of land, and if the people's government to which Transferor applied for approval of the original land transfer plan grants an approval, except for the earnest money agreed under this Contract, all or a portion of the transfer price for the right to use State-owned construction land (interest free) shall be refunded based on the following agreement to reclaim the rights to use State-owned construction land, without making compensations for any erected constructions, buildings and their ancillary facilities within the scope of the parcel. Transferor may also require Transferee to remove any erected constructions, buildings and their ancillary facilities within the scope of the parcel and restore the land to cleared status; provided that if Transferor wishes to continue to use erected constructions, buildings and their ancillary facilities within the scope of the parcel, it shall pay Transferee corresponding compensations.

- (1) If Transferee applies to Transferor at least sixty days prior to a year before the expiry of the date agreed under this Construction for the commencement of construction, Transferor shall refund the price for the rights to use State-owned construction land paid by Transferee after deducting earnest money;
 - (2) If Transferee applies to Transferor at least sixty days prior to more than a year but less than two years after the date of commencement of construction agreed in this Contract, Transferor shall refund Transferee the price for the rights to use State-owned construction land paid by Transferee after deducting earnest money and the fees for laying land idle.
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Article 35 Where Transferee lays the land idle for more than a year but less than two years, Transferee shall pay the fees for laying land idle. If the construction of the land has not commenced after the land has been laid idle for more than two years Transferor has the right to reclaim the rights to use State-owned construction land without any compensation.

Article 36 If Transferee fails to commence construction at the date agreed under this Contract or agrees to do so at any date otherwise agreed, for each day so delayed, Transferee shall pay to Transferor 1.00‰ of the total price for the rights to use State-owned construction land as liquidated damages, and Transferor has the right to require Transferee to continue the performance of this Contract.

If Transferee fails to complete construction on the date agreed under this Contract or any delayed date otherwise agreed by the two parties, it shall pay to Transferor the liquidated damages in the amount of 1.00‰ of the total price of the rights to use State-owned construction land.

Article 37 If the total investment of fixed assets, investment intensity and total development investment for the project herein fail to meet the standards agreed under this Contract, Transferor may require Transferee to pay certain ratio of the price for the rights to use State-owned construction land as liquidated damages. Such ratio is the percentage the actual investment shortfall accounts for in total investment and investment intensity agreed under this Contract. Furthermore, Transferor has the right to require Transferee to continue the performance of this Contract.

Article 38 Where the building plot ratio or building intensity for the parcel under this Contract is under the minimum standards agreed in this Contract, Transferor has the right to require Transferee to pay certain ratio of the price for the rights to use State-owned construction land as liquidated damages. Such ratio is that the actual different accounts for in the minimum standards. In addition, Transferor has the right to require Transferee to continue to perform this Contract. Where the building plot ratio or building intensity for the parcel under this Contract is above the minimum standards agreed in this Contract, Transferor has the right to possess the portion of area exceeding the maximum standards and has the right to require Transferee to pay certain ratio of the price for the rights to use State-owned construction land as liquidated damages. Such ratio is that the actual balance accounts for in the agreed standards.

Article 39 If the ratio of green space for industrial construction project, that of internal office and life service facilities for enterprise or the building area of internal office and life service facilities for enterprise exceeds the standards agreed in this Contract, Transferee shall pay to Transferor the liquidated damages in the amount of 1.00‰ of the transfer price of the parcel and be solely responsible for removing corresponding greening and construction facilities.

Article 40 Where Transferee pays the price for the rights to use State-owned construction land as agreed under this Contract, Transferor must deliver land as agree hereunder. If the possession of the parcel under this Contract by Transferee is delayed as a result of Transferor's failure to deliver the transferred land in time, for each day so delayed, Transferor shall pay to Transferee the liquidated damages in the amount of 1.00‰ of price for the rights to use State-owned construction land paid by Transferee, and the term for use of land shall commence on the date the land is actually delivered. If Transferor delays the delivery of land for more than sixty days and still fails to do so after Transferee demands delivery, Transferee has the right to terminate this Contract and Transferor shall pay double amount of the earnest money and refund the other portion of the price paid for the rights to use State-owned construction land. Furthermore, Transferee may require Transferor to indemnify related loss.

Article 41 If Transferor fails to deliver land in time or the land it delivered fails to satisfy the land requirements made in this Contract or it changes the conditions for use of the land at its sole discretion, Transferee has the right to require Transferor to perform its duties based on specified conditions and indemnify Transferee against any direct losses due to delayed performance. The term for land use shall commence on the date the land conditions have been met.

Chapter 8 Applicable law and dispute resolution

Article 42 The formation, effectiveness, construction, performance and dispute resolution of this Contract shall be governed by the laws of the People's Republic of China.

Article 43 Special provisions:

- (1) In accordance with the requirements of *Several Provisions on the Administration of Transfer of Industrial Land within Shanghai Municipality* (For Trial Implementation), the parcel under this Contract shall be managed based on full life circle, subject to the agreement made in Appendix 4 to this Contract. Appendix 4 to this Contract has the same legal force as the main body of this Contract. If there is any conflict between Article 13, 17, 18, 19, 20, 21, 24, 25, 26, 27, 28, 29, 34, 35, 36, 37, 39 and 42 of this Contract and Appendix 4 to this Contract, the provisions of Appendix 4 to this Contract shall prevail.
- (2) In case of any discrepancy between the Basic Information Sheet of Projects and this Contract with regard to the time of commencement of construction, the provisions of Appendix 4 to this Contract shall prevail.
- (3) In case of any discrepancy between the Basic Information Sheet of Projects and this Contract with regard to total fixed assets, the provisions of this Contract shall prevail.

Chapter 9 Supplementary provisions

Article 44 The transfer plan for the parcel under this Contract has been approved by the People's Government of Songjiang District, and this Contract shall take effect on the date the two parties set their hands hereto.



Article 45 The two parties hereto warrant that the name, contract address, telephone, fax, bank of deposit, agent and other contents they filled out herein are true and effective. In case of any change to such information, the party concerned shall notify the other party in writing within 15 days of the change; otherwise such party shall take any responsibilities caused due to such change.

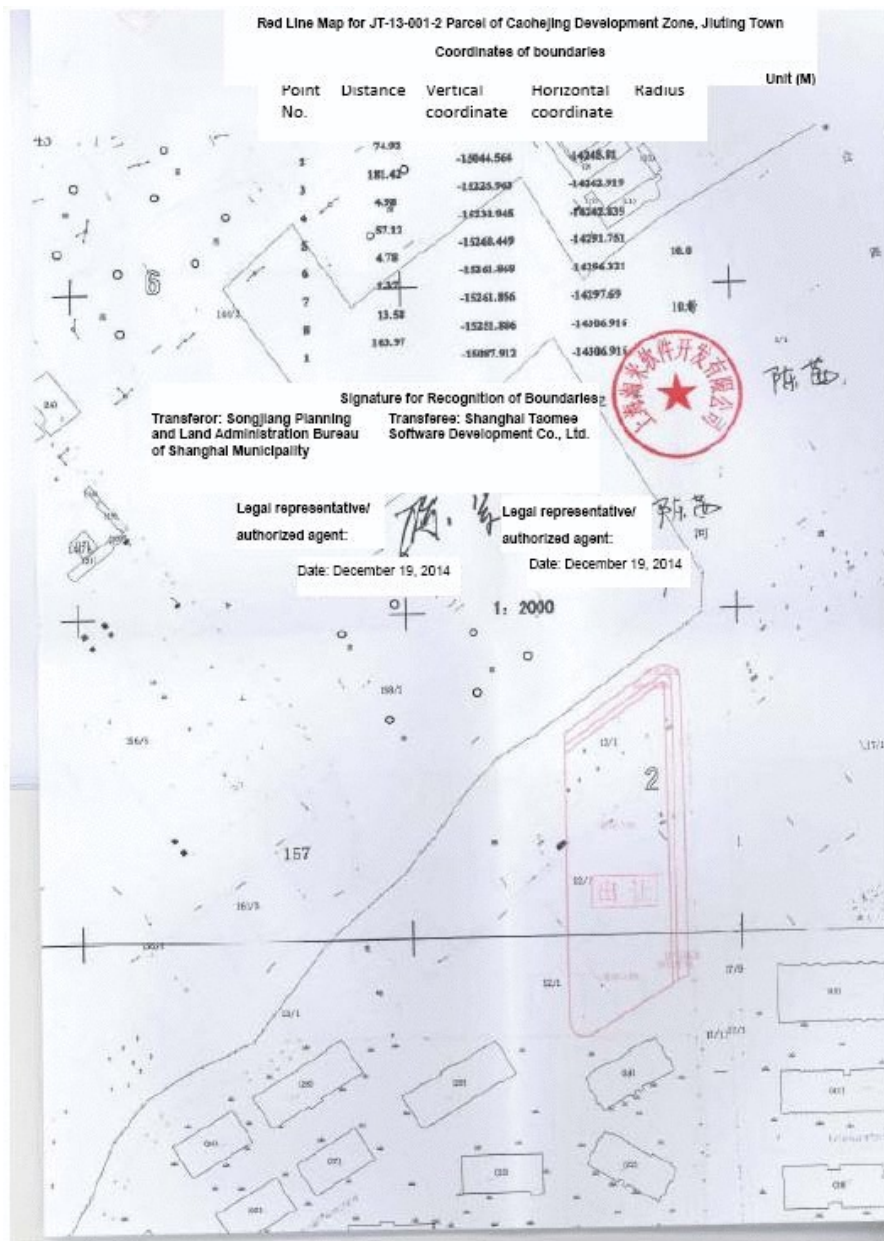
Article 46 This Contract and its appendixes have thirteen pages in total and are made in Chinese.

Article 47 The price, amount and area mentioned in this Contract shall be expressed both in words and figures. The words and figures shall conform to each other. In case of any discrepancy, the expression in words shall prevail.

Article 48 Any matters not specified herein shall be agreed by the two parties in Appendixes, which shall have the same legal force as this Contract.

Article 49 This Contract shall be made in quadruplicate, and both Transferee and Transferor shall respectively hold two copies, each of the copies has the same legal force.

Transferor (seal)	Special seal for Contracts of Songjiang Planning and Land Administration Bureau of Shanghai Municipality	Transferee (seal)	Shanghai Taomee Software Development Co., Ltd.
			
Legal representative (authorized agent)		Legal representative (authorized agent)	
(Signature)	Chen Jun	(Signature)	Chen Xi
		December 19, 2014	



Appendix 3

Planning conditions determined by Planning and Administration department for transfer of the parcel

Project No.: 

Songjiang Planning and Land Administration Bureau of Shanghai Municipality (Letter)

Hu Song Chu (2014) CB31011720144114

Letter on Verification and Issue the Planning and Design Requirements of the Parcel JT-13-001-2 of Caohejing Development Zone of Jiuting Town Songjiang District

To: Office of Shanghai Songjiang for Bid Invitation, Auction Or Listing For Sale of Land Use Right

We hereby acknowledge the receipt of the documents, drawings and data (No.2014052248127) you submitted in respect of the parcel numbered JT-13-001-2 of Caohejing Development Zone in Jiuting Town Songjiang District. We are requested to provide the design requirements for the parcel numbered JT-13-001-2 of Caohejing Development Zone in Jiuting Town Songjiang District. Based on our study and related requirements regarding planning management of the Shanghai Municipality, we hereby issue the planning and design requirements (Hu Song Chu [2014]CB31011720144114), to verify the planning and design requirements as follows:

- I. Name of constructing unit: Office of Shanghai Songjiang for Bid Invitation, Auction Or Listing For Sale of Land Use Right
 - II. Name of construction project: Parcel JT-13-001-2 of Caohejing Development Zone in Jiuting Town Songjiang District
 - III. Location of construction project: JiutingTown, Songjiang District. East: riverway; south: planned road; west: Gaoke 2nd Road; north: riverway.
 - IV. Nature of the construction project: industrial plant
 - V. Nature of the planned use of the land: Grade 1 industrial land
 - VI. Building area of construction; 11508.3 square meters (subject to actual measurement);
 - VII. Capacity building area: 23016.60 square meters.
 - VIII. Plot ratio: no more than 2 but no less than 1.2.
 - IX. Height limit: no more than 50 meters.
 - X. Planning and management requirements:
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1. Outdoor ground elevation of the construction site: 0.3 meters or more higher than the elevation of central line of Gaoke 2nd Road;
2. Concession road restriction line control: the fences shall make a concession of three meters to Gaoke 1st road and Gaoke 2nd road. The concessions made by buildings to Gaoke 1st road and Gaoke 2nd road red line shall satisfy the requirements made in Articles 34 and 37 of technical specifications;
3. Requirements on concession of green line: buildings shall make a concession to Changlujing and the estuary of Miaojing River with a distance of more than 10 meters;
4. Requirements on control of building width: the requirements of Article 50 of planning technical specifications shall be satisfied;
5. Storey height control requirements: it shall satisfy the requirements of control and calculation of storey height of industrial building regarding planning;
6. Building concession control: it is required to satisfy the requirements of planning technical specifications and fire control requirements;
7. Building space and sunshine control: it is required to satisfy the requirements of planning technical specifications and fire control requirements;
8. Setup of main exits at sites: setting up along Gaoxin 2nd Road and parking lots shall be arranged based on related requirements;
9. Other design requirements:
 - (1) The nature of the land is for industrial use and the land will be built into industrial plant. Without adjustment based on statutory procedures, the nature of building shall not be altered;
 - (2) The area for administration and office and life services within the land area shall not exceed 7% of the total land area. It is prohibited to build complete set of residential houses, expert apartments, hotel, guesthouse, training center and other non-production supporting facilities in the land area. It is also prohibited to build any single building with an area of 150 to 500 square meters or similar villas with three detached walls (in case of double houses) or four walls;

These planning and design requirements shall have term of validity of six months. If the Contract on Transfer of State-Owned Land is not signed within the term and an application for extending such term is not submitted, these planning and design requirements shall be invalid. If it is required to renew these planning and design requirements, an application shall be submitted to our bureau 30 days prior to the expiry of the term of validity.

The foregoing requirements shall be written in related land transfer contracts, and the Transferee of the rights to use land shall be notified to apply to our bureau for a *Construction Land Planning Permit* based on the requirements of the *Regulations on Urban Planning for Shanghai Municipality*.

Appendix: Topographic map of approved planning scope



May 27, 2014

Special Seal for Planning Management of the Planning and Land Administration Bureau of Songjiang District of Shanghai

Appendix 4

Registered address of Transferee:

1. In order to ensure that Transferee may commence and complete construction and put the project into operation in time, Transferee agrees to pay the project time performance security deposit (or submitted in the form of letter of guarantee) in the amount of 20% of land transfer price to Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, within five working days of the execution of this Contract.

The project time performance security deposit consists of three parts. Among which, construction commencement time performance security deposit accounts for 20% of the project time performance security deposit, completion time performance security deposit accounts for 30% of the project time performance security, and operation time performance security deposit accounts for 50% of the project time performance security.

If it is determined that Transferee commences construction in time, Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, shall, within five working days of the determination, i.e., prior to August 18, 2015, refund the commencement time performance security deposit in full amount and the interests thereof.

If it is determined that Transferee completes construction in time, Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, shall, within five working days of the completion, i.e., prior to February 17, 2017, refund the completion time performance security deposit in full amount and the interests thereof.

If it is determined that Transferee put the construction into operation in time, Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, shall, within five working days of the determination, i.e., prior to February 16, 2018, refund the operation time performance security deposit in full amount and the interests thereof.

2. If Transferee builds any new constructions, buildings and their ancillary facilities within the scope of the parcel under this Contract, the planning requirements made by the planning and administration department at municipal (county) level shall be satisfied (see Appendix 3). Among which:

With regard to the above-ground space, the main building above-ground is in the nature of industrial building and above-ground ancillary building is in the nature of supporting facilities in relation to industrial production; above-ground building plot ratio is 2.0 and above-ground building area is 23,016 square meters; the above-ground height limit is 50 meters; the above-ground building intensity shall be subject to the approved design plan; the ratio of green space shall also be subject to the approved design plan.

As to underground space, the planned nature of underground construction land shall be : \ ; the maximum horizontal projection of underground constructions (buildings): \ ; the minimum and maximum depth: \ square meters; total area of the use of underground land: \ square meters; total underground building area: \ square meters; among which, building area for commercial purpose: \ square meters; building area for industrial purpose: \ square meters; building area for warehousing \ square meters. If it is not specified in this Contract but it is required to develop underground space for operating purpose, Transferee shall sign a supplementary transfer contract with Transferor and pay land transfer price prior to applying for a project planning permit.

Other land utilization requirements \ .

3. Transferee shall use land based on the purpose and plot ratio agreed under this Contract, without any change. Without authorization, no change shall be made to the industry type of the industrial projects under this Contract.
4. Transferee agrees that the construction project on the parcel under this Contract shall commence within six months after delivery of land (i.e., prior to August 11, 2015) and completes within twenty four months after delivery of land (i.e., prior to February 11, 2017), and shall be put into operation within thirty six months after delivery of land (i.e., prior to February 11, 2018).

If Transferee cannot commence construction in time, it shall apply to Transferor thirty days in advance for postponement. If Transferor agrees to the postponement of construction, the postponement shall not exceed three months, and the time of completion of the construction shall be extended correspondingly.

If transferee cannot complete the construction in time, it shall apply to Transferor thirty days in advance for postponement. If Transferor agrees to the postponement of completion, the postponement shall not exceed three months.

5. Transferee agrees that within five years of delivery of the land for the construction project on the parcel under this Contract (i.e., prior to February 11, 2020), the sales revenue after achieving designed capacity shall be no less than two hundred and forty-four million two hundred and sixty thousand yuan (244,260,000.00 yuan), the annual total tax revenue after achieving designed capacity shall be no less than thirteen million seven hundred and sixty thousand yuan (13,760,000.00 yuan), and the annual tax production intensity for each square meters after achieving designed capacity shall be no less than RMB twelve thousand (1,200.00) yuan.
6. With regard to the right to use the land exercised by Transferee in accordance with law and the agreement of this Contract, Transferor shall not withdraw such rights before the expiry of the term for use agreed under this Contract, unless otherwise agreed in this Contract. If the rights to use land shall be withdrawn in advance for the purpose of social and public interests under special circumstances, Transferor shall apply for approval based on statutory procedures and compensate Transferee based on the residual value of constructions, buildings and their ancillary equipment on the parcel under this Contract and the land transfer price for the rest term of the rights to use the land.
7. Where Transferee carries out construction within the parcel under this Contract, the connection of water, gas, sewage and other facilities to main pipelines outside the parcel and interface and introduction of substation shall be dealt with based on related requirements.

Transferee agrees that the subway, tunnel, comprehensive pipe trench, underground road, civil air defense works, underground pipes and pipelines constructed by the government for the purpose of public utilities may enter, exit, pass, and traverse the transferred land. If the functions for the use of the land are so affected, the government of the entities in charge of the operation and construction of the public utilities shall make reasonable compensation.

8. Transferee shall properly collect and arrange the data and archives in respect of the completion of the construction project on the parcel under this Contract and submit the same to the urban construction archives management department based on related requirements.
9. The rights to use land under this Contract shall not be transferred in whole or in part. The houses within the scope of industrial land parcel under this Contract shall not be transferred by building storey or house. In case of any change to the contribution ratio of the person having the rights to use the land and equity structure of related project company, Transferor's consent shall be obtained in advance.

In case of transfer of land and houses under this Contract in whole, an application shall be made to Transferor and the Transferor's consent shall be obtained in advance before implementation according to related laws and regulations.

If the land and the houses erected there shall be transferred together, the transfer shall be implemented on the uniform land transaction market of the Shanghai Municipality.

10. If the rights to use land under this Contract are mortgaged, such rights shall be mortgaged in whole. The principal creditor's right mortgaged by shall only be limited to the loan for the development and construction of the parcel transferred under this Contract and shall not exceed the total amount of land transfer price agreed under this Contract.

In case of pledging houses under construction or newly constructed house together with land, related requirements of the *Measures of the Shanghai Municipality on the Mortgage of Real Estates* shall be implemented.

11. In case of realization of the mortgage in respect of the parcel under this Contract, the qualifications of bidders of the mortgage must be verified by planning and land resources administration department, industry management department and development zone management agency in a comprehensive way to ensure that they shall satisfy the requirements in respect of industry guidance and the planning of the development zone.
12. Except that the parcel under this Contract shall be withdrawn for social and public interests, Transferee needs to continue to use the parcel under this Contract where the term for use agreed under this Contract expires, it shall submit a renewal application to Transferor at least one year prior to expiry of such term if Transferee needs to continue to use the parcel under this Contract.

Where the Transferee makes a renewal application, it shall apply to Shanghai Songjiang Economic Committee for a comprehensive rating. If it is rated to satisfy related requirements by Shanghai Songjiang Economic Committee, Transferee shall grant an approval.

If Transferor agrees to the renewal, Transferee shall go through transfer and lease formalities by paying corresponding compensation. Transferee agrees that the constructions, buildings and their ancillary facilities within the scope of the parcel under this Contract may be taken by Transferor, provided that the Transferor shall pay corresponding compensations to Transferee based on the residual value of the constructions, buildings and their ancillary facilities.

Procedures, re-sign the contract for use of land with compensation such as transfer, lease, etc, and pay land transferring fee, rent and other costs on use of land with compensation.

13. Where, upon expiration of land transferring period, the transferee applies for extension thereof, which is not approved for comprehensive evaluation fails to meet relevant standards or due to needs of public interest, this Contract terminates, the Transferor recovers the land without compensation, and the Transferee shall go through relevant procedures for de-registration of land use right as required and return the certificate on use of land.

For buildings, structures and affiliated facilities thereof completed to the extent of this parcel of land, the Transferor shall recover buildings, structures and affiliated facilities thereof on the land, and indemnify the Transferee according based on the residual value of buildings, structures and affiliated facilities thereof completed to the extent of this parcel of land at the time of recovery.

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14. The Transferee shall pay the performance bond on the time of project (or submit a letter of guarantee) on schedule in accordance with this Contract. Where the Transferee is unable to pay the performance bond for time of project in full on schedule, and delays in making payment for more than 60 days, and remains unable to pay the performance bond for time of project in full upon demand by the Transferor, the Transferor is entitled to rescind this Contract, the Transferee is not entitled to claim return of deposit, and the Transferor may claim damages against the Transferee.
15. Where the Transferee terminates investment in construction of the project on this parcel of land hereunder, and proposes for termination of performance of this Contract and claims return of land application against the Transferor within not less than 30 days prior to expiration of agreed date of commencement of land construction, such circumstance shall be handled as follows upon consent by the parties: the Transferor shall return all the land-transferring fee other than the agreed deposit and recover the land use right; the Transferor shall refund the performance bond on time of project in full and interest on bank savings
16. The Transferee agrees that management of time of commencement of the project on construction of this parcel of land hereunder shall be implemented as follows: where the Transferee fails to commence construction on the agreed date or the date otherwise agreed on extended construction, it shall pay 50% of the performance bond on all the time of commencing construction as the liquidated damages; where the extension is beyond six months, the Transferee shall pay 100% of the performance bond on all the time of commencing construction as the liquidated damages. Where the Transferee delays in commencing construction for more than a year, the Transferor is entitled to rescind this Contract, recover the land use right, and upon deduction of the agreed deposit, return the land transfer price for the remaining years, return performance bond on time of completion in full and interest on bank savings, and return the performance bond on time of putting this project into operation in full and interest on bank savings.
17. The Transferee agrees that management of time of completion of the project on construction of this parcel of land hereunder shall be implemented as follows: where the Transferee fails to complete construction on the agreed date or the date otherwise agreed on extended construction, it shall pay 50% of the performance bond on the time of completion as the liquidated damages; where the extension is beyond six months, the Transferee shall pay 100% of the performance bond on all the time of completion as the liquidated damages. Where the Transferee delays in completing construction for more than a year, the Transferor is entitled to rescind this Contract, recover the land use right, and upon deduction of the agreed deposit, return the land transfer price for the remaining years, and return the performance bond on time of putting this project into operation in full and interest on bank savings.
- Where the project is not completed within more than a year, the Transferor is entitled to rescind this Contract, recover the land use right, and upon deduction of the agreed deposit, return the land transfer price for the remaining years. Where the project on construction of this parcel of land hereunder is not completed within more than a year, and the Transferor rescinds this Contract, the Transferor and
18. If Transferee fails to put the project under this Contract into operation, all the operation time performance security deposit shall be paid as liquidated damages. In the case, Shanghai Songjiang Economic Committee and Transferee will reappoint a date for putting the project into operation. The date shall be within twelve months, i.e., prior to February 11, 2019. If it is determined by Shanghai Songjiang Economic Committee that the date of operation of Transferee exceeds the reappointed date of operation, Transferee has the right to terminate this Contract and take back the right to use land, and refund the land transfer price of the residual term after deducting the earnest money agreed under this Contract.

If the project on the industrial parcel under this Contract is not put into operation after the reappointed date and Transferor decides to rescind this

Contract, Transferor and Transferee agrees that Transferor shall take back above ground constructions, buildings and their ancillary facilities and pay Transferee corresponding compensations based on the residual value of the constructions, buildings and their ancillary facilities.

19. After the project on the industrial parcel under this Contract is put into operation, if it is determined by Shanghai Songjiang Economic Committee that the total investment of the fixed assets of the project and investment intensity fail to satisfy the standards agreed under this Contract, Transferee shall, based on the ratio of the inadequate portion in the total investment and investment intensity, pay the liquidated damages in the amount of the same ratio of land transfer price and continue to perform this Contract.
20. Within one month after reaching the designed capacity as agreed under this Contract, the project on the industrial parcel under this Contract shall be subject to the determination of Shanghai Songjiang Economic Committee whether the project has achieved the design capacity. Where the total tax of the project fails to meet the standards agreed under this Contract but it is no less than 60% of the standards agreed under this Contract, Transferee shall pay the liquidated damages in the amount of 50% of the actual inadequate portion of the tax. Once Transferee pays the liquidated damages, it will be deemed that this provision has been fulfilled.
21. If Transferee proposes to surrender the rights to use land after achieving designed capacity due to any reason on its own part, it shall be dealt with based on the following agreement: the transferor will rescind this Contract, take back the right to use land, and refund the land transfer price for the residual term for use. Transferor and Transferee agree that Transferor may take back the above-ground constructions, buildings and their ancillary facilities; provided that Transferor shall pay to Transferee corresponding compensations based on the residual value of the constructions, buildings and their ancillary facilities.
22. If the ratio of internal administration and office for enterprises and life service facilities of the industrial construction project or the area of internal administration and office for enterprises and life service facilities exceeds the standards agreed under this Contract, Transferee shall pay to Transferor the liquidated damages in the amount of 1.00% of the land transfer price and solely be responsible for taking corresponding building facilities apart.
23. If Transferee is under any of the following circumstances as a result of its use of the parcel under this Contract, transferor has the right to rescind this Contract, take back the right to use land, and refund the land transfer price for the residual term for use:
- Transferee violates the requirements in Article 20 of Appendix 4 to this Contract and the total tax revenue fail to reach 60% of the standards agreed under this Contract, as determined by Shanghai Songjiang Economic Committee within one month of the date of achieving the designed capacity set forth herein.
- Shanghai Songjiang Economic Committee will comprehensively assess the industrial project on the industrial parcel under this Contract once three years after the third year of the achievement of designed capacity, and the assessment results turn out to be substandard;
- Transferee contravenes the requirements of the requirements of the laws and regulations of the PRC and this Contract to transfer or mortgage the land or change the contribution ratio structure of the person having the right to use the land and equity structure of related project company.
- Transferee contravenes the requirements of this Article and terminates this Contract, and both Transferor and Transferee agree that Transferor may possess the constructions, buildings and their facilities within the scope of the parcel under this Contract without any compensation.
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24. If Transferee of the parcel under this Contract breaches this Contract by changing the purpose of the land without authorization, the case is serious and Transferee fails to make rectification within specified term, Transferor has the right to rescind this Contract and withdraw the right to use land without compensation. Both Transferor and Transferee agree that Transferor may possess the constructions, buildings and their facilities within the scope of the parcel under this Contract without any compensation.
25. Where the use of the parcel under this Contract cause serious environment pollution as determined by competent environment protection department, Transferor has the right to rescind this Contract, withdraw the right to use land without compensation, and require Transferee to undertake all the costs for restoring land and underground water and geological environment. Both Transferor and Transferee agree that Transferor may possess the constructions, buildings and their facilities within the scope of the parcel under this Contract without any compensation.
26. The formation, effectiveness, interpretation, performance and dispute resolution of this Contract shall be governed by the laws of the People's Republic of China the local rules and regulations of the Shanghai Municipality. In case of any dispute arising from the performance of this Contract, Party A and Party B shall settle such dispute based on consultations. Should such consultation fail, any of the parties may file an action before the people's court.
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Housing Lease Contract

This Housing Lease Contract (hereinafter referred to as this "Contract") is made by and between the following two parties in Shanghai, P.R. China (hereinafter "China") on Jan 23th in 2015:

Lessor (Party A): M&G Chenguang Holding (Group) Co., Ltd.

Address: 3488 Jinqian Road, Qingcun Town, Fengxian District, Shanghai

Legal representative: Chen Huxiong

Postal code: 201406

Tel.: 021-57474488

Fax:

Business license no.: 310226000797609

Lessee (Party B): Shanghai Taomee Animation Co., Ltd.

Address: Suite1302, 13/F, Building A2, No.1528 Gumei Road, Xuhui District, Shanghai

Legal representative:

Postal code:

Tel.:

Fax:

Business license no.:

In accordance with the provisions of the *Contract Law of the People's Republic of China*, *Regulations of Shanghai Municipality on the Lease of Houses* and other applicable laws and regulations, Party A and Party B hereby enter into this Contract with respect to Party B leasing from Party A the house that is leasable by Party A according to law (the "Premises"), on the basis of equality, voluntariness, fairness and good faith and by reaching consensus through consultation.

1. Legal Statutes of both Parties and Relevant Documents

1.1 Party A is lawfully incorporated with the approval of the Chinese Government and undertakes to legally own the complete ownership and right of use of the Premises involved in this Contract.

1.2 Party B leases the Premises from Party A as the place of business of Shanghai Taomee Animation Co., Ltd.

2. Confirmation and Warranties of both Parties

2.1 In addition to those already specified herein, both parties shall each confirm and ensure the following:

(1) Each party has the legal qualification, capacity for civil rights and capacity for civil conduct to enter into and perform this Contract, is fully aware of their respective rights, obligations and duties and is willing to act in strict accordance with provisions hereof. If either party breaches this Contract, the other party shall have the right to make claims according to this Contract.

(2) Each party has gone through the internal approval procedures necessary to enter into this Contract.

(3) There is no contract with any third party nor any other matter that might prevent the execution and performance of this Contract.

2.2 Party A warrants that at the execution of this Contract, it has lawfully acquired the valid ownership certificate of the Premises described in Article 3.1 hereof, with the number indicated below:

Shanghai Real Estate Ownership Certificate for the land where the Premises are located: Hu Fang Di Xu Zi (2012) No. 000313;

3. Details about the Premises

3.1 The Premises to be let to Party B by Party A is situated at Suite 1402, 14/F, Building 2, No.1528 Gumei Road, Shanghai (hereinafter the "Premises").

The Premises is of an office building type, with a construction area of 593.465 square meters.

3.2 Delivery standards are set forth in Annex I.

3.3 Shanghai Real Estate Ownership Certificate is given in Annex II.

4. Use of the Premises

4.1 Party B undertakes to Party A that, it leases the Premises to engage in lawful economic activities, within the scope specified in its business license and shall comply with the regulations of the State and Shanghai Municipality on use of houses and fire safety as well as the regulations of Caohejing High-Tech Park on industrial development, environmental protection and property management.

4.2 Party B warrants that, during the lease term, it will not alter the purposes agreed in the preceding paragraph without the written consent of Party A and before being subject to the examination and approval of competent department.

5. Delivery Date and Lease Term

5.1 Both parties agree that the lease term of the Premises commences from March 1, 2015 (lease commencement date) and ends on June 30, 2015, and the rent commencement date is March 1, 2015.

5.2 Upon expiry of the lease term, Party A has the right to repossess the Premises, while Party B shall return the same as scheduled. In case Party B needs to continue to lease the Premises, it shall file a written application for renewal to Party A three months in advance of the expiry of the lease term, while Party A will reply to Party B indicating whether it agrees to such renewal within one month from the date when Party B's written application is received. Where Party A agrees to renewal by Party B, both parties shall sign a new lease contract. Both parties have the right to adjust certain clauses including rent clause of the renewed contract according to the current market. If both parties fail to agree upon the rent clause and enter into the renewed contract within one month prior to the expiry of the lease term, then Party A has the right to terminate this Contract upon expiry of the lease term and take back the Premises.

6. Rent, Method and Term of Payment

6.1 Both parties agree that, the unit rent per square meter of construction area of the Premises per day is RMB Four Point Two Zero (RMB4.20), and total amount is RMB Three Hundred and Four Thousand Ninety One Point Forty Seven (RMB304,091.47);

6.2 The rent of the Premises shall be paid before use. The rent shall be paid to Party A in two installments, of which RMB Seventy Seven Thousand Two Hundred and Sixty Nine Point Fourteen (RMB 77,269.14) shall be paid to Party A prior to March 1 of the current year, and RMB Two Hundred and Twenty Six Thousand Eight Hundred and Twenty Two Point Thirty Three (RMB 226,822.33) shall be paid to Party A prior to April 1. Where the final payment date of each installment coincides with a Saturday, Sunday or a public holiday, then the final payment date shall be postponed to the first working day subsequent to the holiday. In case Party B defaults on payment, it must pay an overdue fine equivalent to 0.05% of the due and unpaid rent for each delayed day.

7. Lease Deposit and Other Expenses

7.1 Both parties agree that, within three days as from the date of signing hereof, Party B shall pay Party A lease deposit, which is equivalent to three-month rent, that is, RMB Two Hundred and Twenty Seven Thousand Four Hundred and Forty Five Point Forty Six (RMB 227,445.56). Upon collection of lease deposit, Party A shall issue a receipt to Party B.

During the lease term, Party B may not set off the lease deposit against the rent of the Premises. When this Contract is terminated upon expiry of the lease term, within 10 working days after Party B pays off relevant expenses and goes through the return and handover procedures of the Premises with the Premises management department, the lease deposit paid by Party B will be refunded by Party A interest-free; in case Party B fails to pay off relevant expenses and causes any economic loss to Party A due to any cause attributable to Party B, Party A has the right to deduct relevant amount from the deposit and return the remaining portion to Party B interest-free. Where the lease deposit is insufficient for deduction, Party B shall otherwise pay the insufficient portion.

7.2 During the lease term, all water, electricity, communications, equipment and other expenses incurred in connection with the use of the Premises shall be borne by Party B.

7.3 Party B shall be solely responsible for applying to and handling electricity and communications usage and other relevant procedures at competent departments, and the relevant expenses incurred by the required application, connection and installation shall be for Party B's account.

7.4 Prior to the delivery of the Premises, Party B shall sign a property management contract with the property management company of the residential district where the Premises is located and pay the Premises management fee according to relevant regulations. The current standard property management fee for the Premises is RMB Nineteen Point Six Eight (RMB 19.68) per square meter (construction area) per month.

8. Use Requirements and Maintenance Responsibilities for the Premises

8.1 During the lease term, if Party B finds any natural damage in the Premises and its ancillary facilities, Party B shall promptly notify the property management company entrusted by Party A and request the company to make repairs. When the Premises and its ancillary facilities are repaired, Party B shall render active assistance and cooperation. The consequences arising from the failure to make timely repairs due to Party B's action or omission shall be solely borne by Party B.

8.2 During the lease term, Party B shall reasonably use and cherish the Premises and its ancillary facilities. Where Party B causes artificial damage or failure to the Premises, and/or fails to adopt proper fire control measures in accordance with applicable national/local laws and regulations, Party B shall be responsible for timely repairs/renovation and bear the expenses incurred thereby.

8.3 During the lease term, Party A ensures that the Premises and its ancillary facilities are in normal usable and safe conditions. Party A may perform inspections and maintenance to the Premises, while Party B shall cooperate at the time of such inspections and maintenance. Party A shall try its best to minimize the impact on Party B's use of the Premises.

8.4 If Party B needs to perform decoration or add ancillary facilities and equipment other than the existing decoration and facilities in the Premises, Party B shall obtain the prior written consent of Party A and handle relevant procedures with the property management company. where such decoration or addition is subject to the examination and approval of competent departments, Party B shall also report to competent departments for approval and is then permitted to carry out such decoration or addition.

8.5 When this Contract is cancelled or terminated, if there are structures added or improved by Party B subject to the written consent of Party A, Party B shall be responsible for restoring the Premises to its original state, except any reasonable wear and tear. Until the Premises is inspected and accepted by Party A, Party B may not handle check-out procedures.

9. Return of the Premises

9.1 Unless Party A agrees to renewal by Party B and both parties sign a lease renewal contract, Party B shall return the Premises upon expiry of the lease term of this Contract or termination of this Contract for any reason. Where Party B delays returning the Premises without the consent of Party A, Party B shall pay Party A the use fees payable during the occupation of the Premises equivalent to two times of the daily rent for each delayed day. Party B agrees that, if it delays in restoring the Premises to its original state and returning the same for 15 days, Party A shall have the right to enter the Premises at its option, meanwhile, Party B shall be deemed to waive the ownership and right of use in the decoration, facilities, equipment in the Premises and other articles that have not been dismantled or removed from the Premises, including equipment and articles deemed the Premises of Party B (regardless of whether they belong to Party B or any third party), and Party A has the right to dispose of them at its own discretion. In case the legitimate interests of any third party are involved, Party B shall be liable for compensating such third party. The expenses incurred by Party A for restoring the Premises to its original state on behalf of Party B shall be borne by the latter. The Premises shall be deemed to have been repossessed upon Party A's entry into it.

9.2 When returned by Party B, the Premises shall be in the conditions after normal use. At the time of return, the Premises shall be inspected and accepted by Party A, and both parties shall settle expenses payable by them respectively.

10. Subletting and Transfer

10.1 Unless Party A has permitted Party B to sublet the Premises in supplemental clauses of this Contract or other documents, Party B may not sublet the Premises to others in whole or in part within the lease term.

10.2 During the lease term, if Party A needs to sell the Premises, it shall notify Party B in advance. Party B shall have the preemptive right under the same conditions.

11. Conditions for Termination

11.1 Both parties agree that, within the lease term, should any of the following circumstances occur, this Contract shall be terminated and neither party will assume any liability towards the other party:

- (1) The right to use the land occupied by the Premises is withdrawn in advance;
 - (2) The Premises are lawfully expropriated for public interests;
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(3) The Premises are lawfully listed in the licensing scope of house demolition due to the needs of urban construction;

(4) The Premises are damaged or destructed or recognized as a dangerous building.

11.2 Both parties agree that, should either party commit any of the following breaches, the other party may notify in writing that this Contract be cancelled. The breaching party shall pay the other party a penalty equivalent to 2 months rent then in effect; where losses are caused to other party and the penalty is insufficient to cover the losses, the breaching party shall make up the difference between the losses incurred and the penalty:

(1) Party A fails to hand over the Premises in a timely manner and still fails to do so within ten days upon receipt of a written reminder from Party B;

(2) The Premises, when handed over by Party A, does not comply with the covenants contained herein, rendering Party B unable to fulfill the purposes for which the Premises is leased;

(3) Party B alters the leasing purposes as agreed herein, without the prior written consent of Party A;

(4) The Premises are damaged for any reason attributable to Party B;

(5) Party B sublets the Premises, transfers the right to lease the Premises or exchanges the Premises for any other property leased by others;

(6) Party B defaults on payment of rent for over one month;

(7) Party B uses the Premises for any illegal activity;

(8) Party B occupies public areas or fire passages without authorization, or fails to comply with applicable laws and regulations on environmental protection and fire safety, and still fails to make rectification within 5 working days upon receipt of a written notice from Party A.

12. Defaulting Liability

12.1 During the lease term, if Party A fails to timely perform its repair and maintenance duties as agreed herein, thus causing damage to the Premises and property or personal damage to Party B, Party A shall compensate Party B for its direct losses.

12.2 In case Party B renovates the Premises or adds ancillary facilities without the written consent of Party A or beyond the scope and requirements of Party A's written consent, or occupies/uses public areas or fire passages without authorization, Party A shall have the right to require Party B to restore the Premises to its original state and compensate for the losses arising therefrom. Where Party B fails to restore the Premises to its original state during said period, Party B may rescind this Contract by written notice to Party B, and Party B shall pay Party A three-month rent at that time as the liquidated damages.

12.3 During the lease term, under conditions other than those agreed herein, if Party A cancels this Contract and repossesses the Premises in advance, Party A shall pay Party B a penalty equivalent to 0.5 times of the rent for the lead days (no more than three months rent). If the penalty is insufficient to cover the direct losses suffered by Party B, Party A shall also be liable for compensating for the difference.

12.4 During the lease term, under conditions other than those agreed herein, if Party B surrenders the lease without authorization, Party B shall pay Party A a penalty equivalent to 0.5 times of the rent for the lead days (but no more than three months rent). If the penalty is insufficient to cover the losses sustained by Party A, Party B shall also be liable for compensating for the difference. Party A may withhold the penalty from the lease deposit, and if the lease deposit is insufficient for such withholding, the deficient portion shall be paid by Party B separately.

13. Disclaimer

13.1 Where Party B sustains loss or damage due to any natural disaster, theft, robbery, other criminal events or events of force majeure, etc. occurring in the Premises;

13.2 Where disaster occurs, thereby frustrating use of the Premises, or any facility fails or does not function properly, or air conditioning, heating, water, electricity, gas and other supplies interrupts due to the reasons attributable to Party A;

13.3 Where water, power, gas supply or other public facilities interrupt due to routine maintenance or repair;

13.4 Where Party A alters or transforms the building or any portion thereof, thereby resulting in that the Premises or public areas cannot be used or the level of service provided by Party A declines.

Where this Contract cannot be performed due to the reasons under the above Paragraph 13.4, the parties are entitled to select to continue to perform or rescind this Contract, and in case of rescission of this Contract, Party B shall settle the rent and management fee by the number of days for actual use, and shall also deal with the deposits in accordance with this Contract.

14. Miscellaneous

14.1 During the lease term, in addition to the right of Party B to use the Premises, Party B shall also have the access to the corridor, staircases, elevators and hallway and the right to use public restrooms and firefighting equipment. Party B may not arbitrarily store flammable, explosive or toxic articles, nor arbitrarily discharge exhaust gas, waste water, and waste residue, nor arbitrarily occupy public areas, fire passages and non-leased areas. During the lease term, Party B shall be responsible for managing the Premises that belongs to it and take out insurance for such property if it is required to purchase insurance from an insurance company.

14.2 In case Party B relates to flammable, explosive articles, noise as well as exhaust gas, waste water, waste residue and other dangerous goods and pollution sources, Party B must report to competent departments of Caohejing High-Tech Park and Shanghai Municipality for examination and approval, and use the Premises after relevant safety standards and discharge standards are met. In case of any secondary decoration, Party B may not commence construction until it obtains the approval of competent governmental departments in charge of fire control.

14.3 In the event that either party hereto is prevented from performing any clause hereof due to war (whether declared or not), earthquake, typhoon, flood, fire and other acts of god, the prevented party shall immediately inform the other party in writing and furnish the other party with details on Force Majeure, as well as the reasons for failure of performance or delayed performance and written materials like valid documentary evidence within fifteen days thereafter.

Both parties may consult each other to decide whether to cancel this Contract, or waive the performance of this Contract partially, or delay the performance of this Contract.

14.4 The formation, validity, interpretation, performance of, and resolution of disputes in connection with, this Contract shall be governed by Chinese laws and regulations as well as local regulations and rules of Shanghai Municipality.

14.5 All disputes arising from the performance of or in connection with this Contract shall be settled by both parties through friendly consultation, failing which, either party may bring an action before the people's court of the place where the real estate is located, and the final judgment of the court shall be binding upon both parties.

14.6 In case of any matter not mentioned herein, both parties may enter into a separate written agreement to be made a part hereof after reaching consensus through consultation, and such agreement shall have the same force as this Contract.

This Contract may be modified by both parties through consultation. Any modification to this Contract may not come into force unless made in writing and signed by legal representatives of both parties or their respective authorized agents. Before the modified contract goes into force, both parties shall still perform the clauses of this Contract.

14.7 At the execution of this Contract, both parties have complete capacity for civil conduct, are fully aware of their respective rights, obligations and duties, and are willing to act in strict accordance with the provisions of this Contract. If either party violates this Contract, the other party shall have the right to make claims as specified herein.

14.8 Both parties confirm their mailing addresses and telephone numbers as follows:

Party A's address:
No.3488 Jinqian Road, Qingcun Town, Fengxian District, Shanghai

Party B's address:
Suite1302, 13/F, Building A2, No.1528 Gumei Road, Xuhui District, Shanghai

All notices, documents and materials sent or provided to each other due to the performance of this Contract shall be delivered according to the abovementioned addresses and fax numbers. Should either party change its correspondence address or telephone number, it shall notify the other party in writing.

In case of hand delivery, such notices, documents and materials shall be deemed delivered at the time of receipt acknowledgement; if sent by fax, they shall be deemed delivered when the fax is sent out; if sent by mail, they shall be deemed delivered on the day when a registered mail is sent or posted.

14.9 This Contract comes into force upon stamping by the parties.

14.10 This Contract is written in five (5) originals, with Party A and Party B holding one (1) copy respectively, and the remaining three (3) copies to be used for government filing.

Party A: M&G Chenguang Holding (Group) Co., Ltd. (seal)

Legal representative (or authorized agent)
Chen Huxiong



Signature:

Date: 2015-1-22

Bank of deposit: Agricultural Bank of China
Shanghai Fengxian Guangming Sub-branch

Bank account no.: 03803920040030177

Party B: Shanghai Taomee Animation Co., Ltd. (seal)

Legal representative (or authorized agent)



Signature:

Date: 2015-1-22

Bank of deposit: []

Bank account no.: []

Annex I Delivery Standards for the Premises

The delivery standards applicable to the Premises are as follows:

1. Reinforced concrete structure, with a uniform live load of 350kg/square meter, and a building storey height of 5 m.
 2. Design power supply capacity is 120KW/floor, with one-line power supply. If the required capacity of Party B exceeds 120KW/floor, Party B shall solely apply to the power supply company for high-voltage power, install relevant transformation equipment and bear relevant expenses arising therefrom.
 3. Telephone and distribution cables are connected into the weak current room on each floor, and the telephone capacity is 100 pairs/floor.
 4. With fire control spraying system equipped with smoke detectors.
 5. The floor is cement plaster floor.
 6. Walls are whitened with latex paint.
 7. There is no suspended ceiling, and the ceiling is whitened with latex paint.
 8. Central air-conditioning units and main riser pipes are installed in place.
 9. There are no specially designed office partitions/compartments in the Premises.
 10. Restrooms: decorated with suspended ceilings, sanitary fittings are installed in place, with ceramic tile/latex paint whitened walls and floor tile/stone floor.
 11. Elevator halls: decorated with suspended ceilings, ceramic tile/latex paint whitened walls, and floor tile/stone floor.
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Contract on Transfer of Rights to Use State-owned Construction Land

Planning and Land Resources
Administration Bureau of Shanghai Municipality

Contract on Transfer of Rights to Use State-owned Construction Land in Shanghai Municipality

Hu Song GuiTu (2014) Chu Rang He Tong No. 37 (1.0 version)

Songjiang Planning and Land Administration Bureau of Shanghai Municipality

December 3, 2014



172014003711

Contract on Transfer of the Right to Use State-owned Construction Land

Parties to this Contract:

Transferor: Songjiang Planning and Land Administration Bureau of Shanghai Municipality

Contact Address: Bldg. 2, Rong Le Road East, Songjiang District

Zip Code: 201613

Telephone: 57740811

Fax: 57740785

Transferee; Shanghai Taomee Wireless Technology Co., Ltd;

Contact person: Chen Xi

Ratio of contribution: 100%

Contact address: F15, Bldg. A2, No. 1528, Gumei Road, Xuhui District

Zip code: 200233

Telephone: 18621935812

Fax: 33674312

Bank of deposit: China Construction Bank Shanghai Caohejing Sub-branch

Account Number: 31001613402050018804

Chapter 1 General Provisions

Article 1 This Contract is formulated by the two parties in accordance with the *Real Rights Law of the People's Republic of China*, the *Contract Law of the People's Republic of China*, the *Land Administration Law of the People's Republic of China*, the *Urban Real Estate Administration Law of the People's Republic of China*, and other related administrative laws and regulations and policies in respect of land supply and based on the principle of equality, free will, compensation and good faith.

Article 2 The ownership of the land to be transferred belongs to the PRC. The transferor shall transfer the right to use state-owned construction land based on the authorization granted by law. And underground resources and buried objects are not included in the scope of transferring the right to use State-owned construction land.

Article 3 Transferee has the right to possess, use, profit from and dispose of the State-owned construction land it acquires according to law during the term of the transfer, and has the right to erect constructions, buildings and ancillary facilities on the land.

Chapter 2 Delivery of transferred land and payment of transfer price

Article 4 The number of the parcel under this Contract is 201317287263436335 and the area of the parcel is fourteen thousand five hundred and ten point two square meters (in figures: 14,510.20m²). Among which, the area of the parcel to be transferred is twelve thousand two hundred and twelve point seven square meters (12,212.70m²).

The parcel to be transferred under this Contract locates at Jiuting Town, Songjiang District

The boundaries of the land transferred hereunder are: eastward to Gaoke No.2 Road; westward to the river; southward to Land 05-09; northward to the river, as shown in Annex 1.

The vertical boundary of the parcel to be transferred under this Contract has an upper limit of \ meters and a lower limit of \ meters, and the elevation difference is \ meters. For the vertical boundary of the parcel to be transferred, see Appendix 2.

The spatial scope of the parcel to be transferred is the enclosed space with the foregoing boundary sites as vertical plane and the horizontal plane at the upper limit or lower limit level.

Article 5 The parcel to be transferred under this Contract shall be used as industrial land.

Article 6 Transferor agrees to deliver the parcel to be transferred to Transferee prior to January 26, 2015, and Transferor agrees that at the time of delivering the parcel, the parcel shall be a cleared land.

Article 7 The term for the transfer of the right to use State-owned construction land under this Contract shall be 50 years for industrial land, commencing on the date of delivery of land set forth in Article 6 of this Contract; if the State-owned construction land is originally allotted and leased, and will be transferred after going related transfer formalities retrospectively, the term of transfer shall commence on the date of the execution of this Contract.

Article 8 The price for transferring the right to use State-owned construction land of the parcel under this Contract shall be eleven million ten thousand yuan only (in figures: 11,010,000.00 yuan) and nine hundred and one point fifty two yuan (in figures: 901.52 yuan).

Article 9 The earnest money for the parcel under this Contract shall be RMB two million two hundred and two thousand yuan (2,202,000.00 yuan), which may be used to offset the price for transfer of the right to use land. Within five working days of the execution of this Contract, i.e., prior to December 10, 2014, Transferee shall pay to local State Treasury the earnest money for the performance of this Contract.

Article 10 Transferee agrees to pay to Transferor the price for the transfer of the right to use State-owned construction land in accordance with the requirements of Section (1) of this Article:

- (1) Within 30 working days of the execution of this Contract, Transferee shall pay the price for transferring the right to use State-owned construction land in a lump sum;
- (2) Transferee shall pay the price for transferring the right to use State-owned construction land in \ installments based on the following time and amount.

First installment, \ % of the land transfer price, i.e. RMB \ yuan; paid within \ working days of execution of this Contract, i.e., within MMDD, YY.

Second installment, \ % of the land transfer price, i.e. RMB \ yuan; paid within \ working days of execution of this Contract, i.e., within MMDD, YY.

The time limit for paying the price for transferring the right to use State-owned construction land shall not exceed 90 working days. Among which the first installment shall be paid within 10 working days of the execution of this Contract, with a ratio of no less than 50% of the total land transfer price (including earnest money). Transferee shall pay interest to Transferor based on the interest rates issued by the People's Bank of China on the date of payment of first installment of land transfer price together with the land transfer price for the second installment or any installment thereafter.

Article 11 Transferee shall apply for the registration of the rights to use State-owned construction land upon the presentation of this Contract, payment receipt of land transfer price and related certificates after paying all the transfer price of the parcel of land under this Contract.

Chapter 3 Land development, construction and utilization

Article 12 Transferee agrees that the investment intensity for the parcel under this Contract shall be subject to the requirements made in Section (1) in this Article:

- (1) The parcel under this Contract shall be used for industrial construction. Transferee agrees that the fixed assets investment for the parcel under this Contract shall be no less than the approved or registered amount, i.e., RMB one hundred and eighteen million one hundred and fifty thousand yuan (in figures: 118,150,000.00 yuan). The investment intensity shall be no less than nine thousand six hundred and seventy yuan (in figures: 9,670.00 yuan) per square meters. The total fixed assets investment for the construction project on the parcel under this Contract shall include investment in constructions, buildings and ancillary facilities, equipment, transfer price, etc.
- (2) The parcel under this Contract shall be used for non-industrial project construction. The Transferee warrants that the total development and investment for the parcel under this Contract shall be no less than RMB \ yuan (in figures: \ yuan).

Article 13 Where Transferee erects new constructions, buildings and their ancillary facilities within the scope of the parcel under this Contract, the planning requirements for the parcel to be transferred determined by the planning and management department at municipal (county) level shall be satisfied (see appendix 3). Among which:

The construction plot ratio: industrial land: 2.0; above-ground building area 24,426.00 square meters;

Underground building area 0.00 square meters. Among which, the building area for operating purpose is 0.00 square meters; if this Contract has not specified but it is required to carry out underground development for operational purpose at the construction phase, Transferee shall sign a supplementary agreement with Transferor and pay land transfer price retrospectively prior to applying for a construction project planning license.

Upper limit of the constructions: 50 meters

Building intensity: subject to approved planning program;

Ratio of green space: subject to approved planning program;

Other land utilization requirements: \ \ .

Article 14 Transferee agrees that the supporting facilities for the construction on the parcel under this Contract shall be implemented based on Section (1) of this Article;

- (1) The parcel under this Contract shall be used for industrial project construction. According to the planning and design conditions determined by planning department, the area used for enterprise administration and office purpose and life services within the scope of the parcel acquired under this Contract shall not exceed 7.00% of the area of the parcel, i.e., under 854.89 square meters, and the building area shall not exceed 1,709.00 square meters. Transferee agrees not to erect any non-production facilities such as residential houses, expert apartment, hotel, guesthouse and training center. It is prohibited to erect any villa or similar building with three (in case of double house) or four detached external walls or any single building with an area of 150 to 500 square meters within the industrial land.
- (2) Where the parcel under this Contract is used for the construction of residential project, the requirements in respect of energy and land conservation shall be satisfied. The area of fully decorated residential houses shall account for more than \ \ %, and the energy conservation of the buildings shall satisfy the requirements of the laws, regulations and specifications issued by the State or Shanghai Municipality.

Article 15 The area of affordable housing constructed within the scope of the parcel of this Contract shall account for \ \ % of the total planned residential building of the parcel, i.e., more than \ \ square meters. Transferee agrees to transfer the supporting affordable housing to competent department in charge of the management of affordable housing.

Article 16 Transferee shall carry out the development and construction of the parcel based on the related requirements in respect of planning and land administration.

- (1) The ratio between the verified building area for commercial and office purpose on the parcel and that of residential areas shall be \ \ ; and the verified building area for commercial and office purpose shall be no less than \ \ ;
- (2) If the parcel under this Contract will be used for office purpose, the building area of apartment offices shall be \ \ square meters. If this Contract has not specified the building area of apartment offices, apartment offices shall not be constructed for office purpose;
- (3) The building area of small and medium sized residential houses built on the parcel (under 90 square meters) shall account for \ \ % of the total building area of the parcel, i.e., \ \ square meters.

Article 17 Transferee agrees that the construction project regarding the parcel under this Contract shall commence its construction prior to August 31, 2015 and shall be completed before August 31, 2017.

If Transferee is unable to commence construction on that date, it shall apply to Transferor thirty days in advance for postponement. If the Transferor agrees to the postponement, the date of completion shall be extended correspondingly; provided that the extension shall be no more than one year.

Article 18 Where Transferee carry out construction within the scope of the parcel under this Contract, the interface between the water, gas, sewage and other equipment and main lines outside the parcel and the interconnection project for substation shall be constructed in accordance with related requirements.

Transferee agrees that various pipelines and conduits laid by the government for public utilities may enter, exit, pass or traverse the parcel; provided that the government or the entity constructing and operating such public utilities shall provide reasonable compensations if the functions of such parcel is affected.

Article 19 Transferee shall utilize the land based on the purpose of the land and plot ratio agreed under this Contract. It shall not change the same without authorization. During the term of transfer, if the purpose of the land shall be changed, the two parties agree that the requirements made in Section (1) of this Article shall govern:

- (1) Transferor may withdraw the right to use the construction land with compensation;
- (2) The formalities in respect of changing the purpose of the land shall be gone through according to law, an agreement on amending the contract on transfer of the right to use the State-owned construction land shall be signed or a new contract on transfer of the right to use the State-owned construction land shall be executed. In the case, Transferee shall retrospectively pay the balance between the assessed price of the right to use the construction land with a new purpose on market and that of the price of the right to use the construction land for original purpose and go through land change registration.

Article 20 During the term of the parcel under this Contract, the government reserves the right to adjust the planning of the parcel under this Contract. In case of any change to the original planning, the existing buildings on the parcel shall not be affected; provided that the reconstruction, renovation, restructuring of the constructions, buildings and their ancillary facilities on the parcel within the term for use or the application for renewal after expiry of the term for use shall be made in accordance with the planning for the time being in force.

Article 21 Transferor shall not withdraw the right to use the State-owned land if Transferee exercises such rights according to law before the expiry of the term for use agreed in this Contract. Under special circumstances, if such rights shall be withdrawn in advance for the purpose of social public interests, Transferor shall apply for approval according to statutory procedures and compensate the land user in the amount based on the value of the above-ground constructions, buildings and their ancillary facilities and the value of the right to use the State-owned construction land within the residual term assessed on market and the assessed and determined direct loss thereof.

Article 22 After completion of the construction project on the parcel under this Contract, Transferee shall apply to the land administration department executed related contract for checking and inspecting the use of the land for construction project under this Contract and the performance of the contents of this Contract. If the inspection turns out to be qualified, the land administration department shall issue a completion work acceptance certificate. Among which:

If the actually-measured capacity building area exceeds the total agreed in this Contract but it is still within the tolerable error of planning, land transfer price for the exceeding portion of the area shall be paid retrospectively and such area shall be inspected for acceptance thereafter.

If the actually-measured total building area exceeds the tolerable error of the planning, the exceeding portion may be inspected for acceptance only to the extent that it has been handled according to law based on the procedures for dealing with illegal construction. If it is decided that land transfer price shall be paid retrospectively for illegal area, such price shall be paid after collective decision-making, based on the price of all the exceeding area (including the area within the tolerable error of the planning) assessed at the time of the retrospective payment on market and the land price agreed in this Contract, whichever is higher.

Article 23 Transferee shall submit a geotechnical engineering investigation report, perform geological disaster prevention obligations, and maintain the ground subsidence monitoring and prevention facilities and shallow geothermal energy monitoring facilities distributed within the scope of the land.

Chapter 4 Assign, lease or mortgage of the right to use State-owned construction land

Article 24 After Transferee pays the price for transfer of the right to use State-owned construction land pursuant to this Contract and collects the certificate for the use of State-owned construction land, it has the right to assign, lease, or mortgage the rights to use State-owned construction land under this Contract in whole or in part. For the first assignment, the requirements made in Section (1) of this Article shall be satisfied:

- (1) Carrying out investment and development pursuant to this Contract, and completing 25% or more of the total development investment;
- (2) Carrying out investment and development pursuant to this Contract, and establishing the conditions for industrial land other construction land.

Any industrial land transferred under this Contract shall be used by Transferee pursuant to this Contract, and shall not be divided for transfer or lease. Projects in the nature of standard industrial plants may be transferred or leased based on related requirements.

Article 25 The contract on the assignment, lease and mortgage of the right to use State-owned construction land shall not violate the laws and regulations of the State and the agreement made in this Contract.

Article 26 After assignment of the right to use State-owned construction land in whole or in part, the rights and obligations set forth in this Contract and land registration documents will be assigned accordingly. The term for use of the rights to use State-owned construction land shall be the term for use agreed under this Contract net the term for use elapsed.

After lease of the rights to use State-owned construction land under this Contract in whole or in part, Transferee shall have the rights and fulfill the obligations set forth in this Contract and land registration documents.

Article 27 In case of assignment or mortgage of the rights to use State-owned construction land, the parties in respect of the assignment or mortgage shall take this Contract and corresponding assignment or mortgage contract and the certificate for the use of State-owned land to land and resources management department for applying for land change registration.

Chapter 5 Expiry of term

Article 28 Where term agreed under this Contract expires and land user needs to continue to use the parcel under this Contract, it shall apply to Transferor for renewal of term at least one year prior to the expiry. In the case Transferor shall approve the approval unless the parcel under this Contract shall be withdrawn for social and public interests.

Where the term for the rights to use residential construction land expires, a renewal will be automatically effected.

If Transferor agrees to the renewal, land user shall go through such formalities in respect of transfer and lease according to law and execute a new transfer and lease contract for use of land with compensation, and pay the land transfer price, rent and other compensations for the use of the land.

Article 29 Where land user applies for renewal after expiry of the term of land transfer and such application is not approved due to social and public interests, land user shall return the certificate for the use of State-owned land and deregister the right to use State-owned construction land in accordance with related requirements, and Transferor may reclaim the rights to use State-owned construction land without compensation. Transferor and land user agree that the constructions, buildings and their ancillary facilities erected on the parcel under this Contract shall be dealt with pursuant to Section (1) of this Article:

- (1) Transferor will own the above-ground constructions, buildings and their facilities, and pay land user corresponding compensations based on the residual value of such constructions, buildings and their facilities;

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- (2) Transferor will own the above-ground constructions, buildings and their facilities without paying any compensations.

Article 30 If land user does not apply for renewal upon expiry of term of land transfer, the land user shall return the certificate on the rights to use State-owned land and deregister the rights to use State-owned construction land. And the rights to use State-owned construction land will be withdrawn by Transferor without any compensation. The constructions, buildings and their ancillary facilities will be owned by Transferor without compensation, and land user shall maintain the normal function of constructions, buildings and their ancillary facilities, without any damage due to human factors. If the above-ground constructions, buildings and their ancillary facilities lose normal functions, Transferor may require the land user to remove or demolish the above-ground constructions, buildings and their ancillary facilities, to reinstate the land to cleared land.

Chapter 6 Force majeure

Article 31 Where this Contract cannot be performed in whole or in part due to force majeure on the part of any parties hereto, such party may be exempted from liabilities; provided that such party shall use its best efforts to take necessary remedial measures to mitigate the loss due to such force majeure. If the party concerned suffers force majeure during delayed performance, such party shall not be exempted from liabilities.

Article 32 Any party affected by force majeure shall notify the other party of the same in such written forms as letter, telegraph and fax within seven days of the occurrence of the force majeure and provide the other party with a report and certificate proving the inability to perform this Contract in whole or in part or the requirements for delayed performance within fifteen days of the occurrence of the force majeure.

Chapter 7 Liabilities for breach of contract

Article 33 Transferee shall pay the price for the use of State-owned construction land as agreed under this Contract. If Transferee fails to do so, it shall pay to Transferor the liquidated damages in the amount of 1.00% of the delayed payment on a daily basis as of the date of delayed payment. If the payment of the price for the use of State-owned construction land is delayed for more than sixty days and is still not made after Transferor demands payment, Transferor has the right to terminate this Contract. In the case, Transferee does not have the right to require refund, and Transferor may require Transferee to make

compensations.

Article 34 If Transferee terminates the construction of the investment project due to any reason on its own part and applies to Transferor for termination of the performance of this Contract and redelivery of land, and if the people's government to which Transferor applied for approval of the original land transfer plan grants an approval, except for the earnest money agreed under this Contract, all or a portion of the transfer price for the right to use State-owned construction land (interest free) shall be refunded based on the following agreement to reclaim the rights to use State-owned construction land, without making compensations for any erected constructions, buildings and their ancillary facilities within the scope of the parcel. Transferor may also require Transferee to remove any erected constructions, buildings and their ancillary facilities within the scope of the parcel and restore the land to cleared status; provided that if Transferor wishes to continue to use erected constructions, buildings and their ancillary facilities within the scope of the parcel, it shall pay Transferee corresponding compensations.

- (1) If Transferee applies to Transferor at least sixty days prior to a year before the expiry of the date agreed under this Construction for the commencement of construction, Transferor shall refund the price for the rights to use State-owned construction land paid by Transferee after deducting earnest money;
 - (2) If Transferee applies to Transferor at least sixty days prior to more than a year but less than two years after the date of commencement of construction agreed in this Contract, Transferor shall refund Transferee the price for the rights to use State-owned construction land paid by Transferee after deducting earnest money and the fees for laying land idle.
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Article 35 Where Transferee lays the land idle for more than a year but less than two years, Transferee shall pay the fees for laying land idle. If the construction of the land has not commenced after the land has been laid idle for more than two years Transferor has the right to reclaim the rights to use State-owned construction land without any compensation.

Article 36 If Transferee fails to commence construction at the date agreed under this Contract or agrees to do so at any date otherwise agreed, for each day so delayed, Transferee shall pay to Transferor 1.00‰ of the total price for the rights to use State-owned construction land as liquidated damages, and Transferor has the right to require Transferee to continue the performance of this Contract.

If Transferee fails to complete construction on the date agreed under this Contract or any delayed date otherwise agreed by the two parties, it shall pay to Transferor the liquidated damages in the amount of 1.00‰ of the total price of the rights to use State-owned construction land.

Article 37 If the total investment of fixed assets, investment intensity and total development investment for the project herein fail to meet the standards agreed under this Contract, Transferor may require Transferee to pay certain ratio of the price for the rights to use State-owned construction land as liquidated damages. Such ratio is the percentage the actual investment shortfall accounts for in total investment and investment intensity agreed under this Contract. Furthermore, Transferor has the right to require Transferee to continue the performance of this Contract.

Article 38 Where the building plot ratio or building intensity for the parcel under this Contract is under the minimum standards agreed in this Contract, Transferor has the right to require Transferee to pay certain ratio of the price for the rights to use State-owned construction land as liquidated damages. Such ratio is that the actual different accounts for in the minimum standards. In addition, Transferor has the right to require Transferee to continue to perform this Contract. Where the building plot ratio or building intensity for the parcel under this Contract is above the minimum standards agreed in this Contract, Transferor has the right to possess the portion of area exceeding the maximum standards and has the right to require Transferee to pay certain ratio of the price for the rights to use State-owned construction land as liquidated damages. Such ratio is that the actual balance accounts for in the agreed standards.

Article 39 If the ratio of green space for industrial construction project, that of internal office and life service facilities for enterprise or the building area of internal office and life service facilities for enterprise exceeds the standards agreed in this Contract, Transferee shall pay to Transferor the liquidated damages in the amount of 1.00‰ of the transfer price of the parcel and be solely responsible for removing corresponding greening and construction facilities.

Article 40 Where Transferee pays the price for the rights to use State-owned construction land as agreed under this Contract, Transferor must deliver land as agree hereunder. If the possession of the parcel under this Contract by Transferee is delayed as a result of Transferor's failure to deliver the transferred land in time, for each day so delayed, Transferor shall pay to Transferee the liquidated damages in the amount of 1.00‰ of price for the rights to use State-owned construction land paid by Transferee, and the term for use of land shall commence on the date the land is actually delivered. If Transferor delays the delivery of land for more than sixty days and still fails to do so after Transferee demands delivery, Transferee has the right to terminate this Contract and Transferor shall pay double amount of the earnest money and refund the other portion of the price paid for the rights to use State-owned construction land. Furthermore, Transferee may require Transferor to indemnify related loss.

Article 41 If Transferor fails to deliver land in time or the land it delivered fails to satisfy the land requirements made in this Contract or it changes the conditions for use of the land at its sole discretion, Transferee has the right to require Transferor to perform its duties based on specified conditions and indemnify Transferee against any direct losses due to delayed performance. The term for land use shall commence on the date the land conditions have been met.

Chapter 8 Applicable law and dispute resolution

Article 42 The formation, effectiveness, construction, performance and dispute resolution of this Contract shall be governed by the laws of the People's Republic of China.

Article 43 Special provisions:

- (1) In accordance with the requirements of *Several Provisions on the Administration of Transfer of Industrial Land within Shanghai Municipality* (For Trial Implementation), the parcel under this Contract shall be managed based on full life circle, subject to the agreement made in Appendix 4 to this Contract. Appendix 4 to this Contract has the same legal force as the main body of this Contract. If there is any conflict between Article 13, 17, 18, 19, 20, 21, 24, 25, 26, 27, 28, 29, 34, 35, 36, 37, 39 and 42 of this Contract and Appendix 4 to this Contract, the provisions of Appendix 4 to this Contract shall prevail.
- (2) In case of any discrepancy between the Basic Information Sheet of Projects and this Contract with regard to the time of commencement of construction, the provisions of Appendix 4 to this Contract shall prevail.
- (3) Total capacity of the land area is 24,426.00 square meters

Chapter 9 Supplementary provisions

Article 44 The transfer plan for the parcel under this Contract has been approved by the People's Government of Songjiang District, and this Contract shall take effect on the date the two parties set their hands hereto.

Article 45 The two parties hereto warrant that the name, contract address, telephone, fax, bank of deposit, agent and other contents they filled out herein are true and effective. In case of any change to such information, the party concerned shall notify the other party in writing within 15 days of the change; otherwise such party shall take any responsibilities caused due to such change.

Article 46 This Contract and its appendixes have thirteen pages in total and are made in Chinese.

Article 47 The price, amount and area mentioned in this Contract shall be expressed both in words and figures. The words and figures shall conform to each other. In case of any discrepancy, the expression in words shall prevail.

Article 48 Any matters not specified herein shall be agreed by the two parties in Appendixes, which shall have the same legal force as this Contract.

Article 49 This Contract shall be made in quadruplicate, and both Transferee and Transferor shall respectively hold two copies, each of the copies has the same legal force.

Transferor (seal)	Special seal for Contracts of Songjiang Planning and Land Administration Bureau of Shanghai Municipality	Transferee (seal)	Shanghai Taomee Wireless Technology., Ltd.
Legal representative (authorized agent)		Legal representative (authorized agent)	
(Signature)	Chen Jun	(Signature)	Chen Xi
			December 3, 2014

Project No.:  20145C172738

Songjiang Planning and Land Administration Bureau of Shanghai Municipality (Letter)

Hu Song Chu (2014) CB31011720144113

Letter on Verification and Issue the Planning and Design Requirements of the Parcel JT-13-001-1 of Caohejing Development Zone of Jiuting Town Songjiang District

To: Office of Shanghai Songjiang for Bid Invitation, Auction Or Listing For Sale of Land Use Right

We hereby acknowledge the receipt of the documents, drawings and data (No.2014052248128) you submitted in respect of the parcel numbered JT-13-001-1 of Caohejing Development Zone in Jiuting Town Songjiang District. We are requested to provide the design requirements for the parcel numbered JT-13-001-1 of Caohejing Development Zone in Jiuting Town Songjiang District. Based on our study and related requirements regarding planning management of the Shanghai Municipality, we hereby issue the planning and design requirements (Hu Song Chu [2014]CB31011720144113), to verify the planning and design requirements as follows:

- I. Name of constructing unit: Office of Shanghai Songjiang for Bid Invitation, Auction Or Listing For Sale of Land Use Right
 - II. Name of construction project: Parcel JT-13-001-1 of Caohejing Development Zone in Jiuting Town Songjiang District
 - III. Location of construction project: Jiuting Town, Songjiang District. East: Gaoke 2nd Road; south: Land 05-09; west: riverway. Road; north: riverway.
 - IV. Nature of the construction project: industrial plant
 - V. Nature of the planned use of the land: Grade 1 industrial land
 - VI. Building area of construction; 12212.70 square meters (subject to actual measurement);
 - VII. Capacity building area: 24425.40 square meters.
 - VIII. Plot ratio: no more than 2 but no less than 1.2.
 - IX. Height limit: no more than 50 meters.
 - X. Planning and management requirements:
-

1. Outdoor ground elevation of the construction site: 0.3 meters or more higher than the elevation of central line of Gaoke 2nd Road;
2. Concession road restriction line control: the fences shall make a concession of three meters to Gaoke 2nd road. The concessions made by buildings to Gaoke 1st road and Gaoke 2nd road red line shall satisfy the requirements made in Articles 34 of technical specifications;
3. Requirements on concession of green line: buildings shall make a concession to the estuary of Miaojing River with a distance of more than 10 meters;
4. Requirements on control of building width: the requirements of Article 50 of planning technical specifications shall be satisfied;
5. Storey height control requirements: it shall satisfy the requirements of control and calculation of storey height of industrial building regarding planning;
6. Building concession control: it is required to satisfy the requirements of planning technical specifications and fire control requirements;
7. Building space and sunshine control: it is required to satisfy the requirements of planning technical specifications and fire control requirements;
8. Setup of main exits at sites: setting up along Gaoxin 2nd Road and parking lots shall be arranged based on related requirements;
9. Other design requirements:
 - (1) The nature of the land is for industrial use and the land will be built into industrial plant. Without adjustment based on statutory procedures, the nature of building shall not be altered;
 - (2) The area for administration and office and life services within the land area shall not exceed 7% of the total land area. It is prohibited to build complete set of residential houses, expert apartments, hotel, guesthouse, training center and other non-production supporting facilities in the land area. It is also prohibited to build any single building with an area of 150 to 500 square meters or similar villas with three detached walls (in case of double houses) or four walls;

These planning and design requirements shall have term of validity of six months. If the Contract on Transfer of State-Owned Land is not signed within the term and an application for extending such term is not submitted, these planning and design requirements shall be invalid. If it is required to renew these planning and design requirements, an application shall be submitted to our bureau 30 days prior to the expiry of the term of validity.

The foregoing requirements shall be written in related land transfer contracts, and the Transferee of the rights to use land shall be notified to apply to our bureau for a *Construction Land Planning Permit* based on the requirements of the *Regulations on Urban Planning for Shanghai Municipality*.

Appendix: Topographic map of approved planning scope



May 27, 2014

Special Seal for Planning Management of the Planning and Land Administration Bureau of Songjiang District of Shanghai

Copy to: Planning Management of the Planning and Land Administration Bureau of Songjiang District of Shanghai

Printed on May 27, 2014

Appendix 4

Registered address of Transferee:

1. In order to ensure that Transferee may commence and complete construction and put the project into operation in time, Transferee agrees to pay the project time performance security deposit (or submitted in the form of letter of guarantee) in the amount of 20% of land transfer price to Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, within five working days of the execution of this Contract.

The project time performance security deposit consists of three parts. Among which, construction commencement time performance security deposit accounts for 20% of the project time performance security deposit, completion time performance security deposit accounts for 30% of the project time performance security, and operation time performance security deposit accounts for 50% of the project time performance security.

If it is determined that Transferee commences construction in time, Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, shall, within five working days of the determination, i.e., prior to August 7, 2015, refund the commencement time performance security deposit in full amount and the interests thereof.

If it is determined that Transferee completes construction in time, Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, shall, within five working days of the completion, i.e., prior to August 7, 2017, refund the completion time performance security deposit in full amount and the interests thereof.

If it is determined that Transferee put the construction into operation in time, Shanghai Caohejing Development Zone Songjiang Emerging Industrial Park Development Co., Ltd., an organization designated by the People's Government of Xinqiao Town of Songjiang District, Shanghai, shall, within five working days of the determination, i.e., prior to February 7, 2018, refund the operation time performance security deposit in full amount and the interests thereof.

2. If Transferee builds any new constructions, buildings and their ancillary facilities within the scope of the parcel under this Contract, the planning requirements made by the planning and administration department at municipal (county) level shall be satisfied (see Appendix 3). Among which:

With regard to the above-ground space, the main building above-ground is in the nature of industrial building and above-ground ancillary building is in the nature of supporting facilities in relation to industrial production; above-ground building plot ratio is 2.0 and above-ground building area is 24,426.00 square meters; the above-ground height limit is 50 meters; the above-ground building intensity shall be subject to the approved design plan; the ratio of green space shall also be subject to the approved design plan.

As to underground space, the planned nature of underground construction land shall be : \ ; the maximum horizontal projection of underground constructions (buildings): \ ; the minimum and maximum depth: \ square meters; total area of the use of underground land: \ square meters; total underground building area: \ square meters; among which, building area for commercial purpose: \ square meters; building area for industrial purpose: \ square meters; building area for warehousing \ square meters. If it is not specified in this Contract but it is required to develop underground space for operating purpose, Transferee shall sign a supplementary transfer contract with Transferor and pay land transfer price prior to applying for a project planning permit.

Other land utilization requirements \ .

3. Transferee shall use land based on the purpose and plot ratio agreed under this Contract, without any change. Without authorization, no change shall be made to the industry type of the industrial projects under this Contract.
4. Transferee agrees that the construction project on the parcel under this Contract shall commence within six months after delivery of land (i.e., prior to July 31, 2015) and completes within twenty four months after delivery of land (i.e., prior to January 31, 2017), and shall be put into operation within thirty six months after delivery of land (i.e., prior to January 31, 2018).

If Transferee cannot commence construction in time, it shall apply to Transferor thirty days in advance for postponement. If Transferor agrees to the postponement of construction, the postponement shall not exceed three months, and the time of completion of the construction shall be extended correspondingly.

If transferee cannot complete the construction in time, it shall apply to Transferor thirty days in advance for postponement. If Transferor agrees to the postponement of completion, the postponement shall not exceed three months.

5. Transferee agrees that within five years of delivery of the land for the construction project on the parcel under this Contract (i.e., prior to January 26, 2020), the sales revenue after achieving designed capacity shall be no less than two hundred and fifty nine million two hundred and ten thousand yuan (259,210,000.00 yuan), the annual total tax revenue after achieving designed capacity shall be no less than fourteen million six hundred and forty thousand yuan (14,640,000.00 yuan), and the annual tax production intensity for each square meters after achieving designed capacity shall be no less than RMB twelve thousand (1,200.00) yuan.
6. With regard to the right to use the land exercised by Transferee in accordance with law and the agreement of this Contract, Transferor shall not withdraw such rights before the expiry of the term for use agreed under this Contract, unless otherwise agreed in this Contract. If the rights to use land shall be withdrawn in advance for the purpose of social and public interests under special circumstances, Transferor shall apply for approval based on statutory procedures and compensate Transferee based on the residual value of constructions, buildings and their ancillary equipment on the parcel under this Contract and the land transfer price for the rest term of the rights to use the land.
7. Where Transferee carries out construction within the parcel under this Contract, the connection of water, gas, sewage and other facilities to main pipelines outside the parcel and interface and introduction of substation shall be dealt with based on related requirements.

Transferee agrees that the subway, tunnel, comprehensive pipe trench, underground road, civil air defense works, underground pipes and pipelines constructed by the government for the purpose of public utilities may enter, exit, pass, and traverse the transferred land. If the functions for the use of the land are so affected, the government of the entities in charge of the operation and construction of the public utilities shall make reasonable compensation.

8. Transferee shall properly collect and arrange the data and archives in respect of the completion of the construction project on the parcel under this Contract and submit the same to the urban construction archives management department based on related requirements.
9. The rights to use land under this Contract shall not be transferred in whole or in part. The houses within the scope of industrial land parcel under this Contract shall not be transferred by building storey or house. In case of any change to the contribution ratio of the person having the rights to use the land and equity structure of related project company, Transferor's consent shall be obtained in advance.

In case of transfer of land and houses under this Contract in whole, an application shall be made to Transferor and the Transferor's consent shall be obtained in advance before implementation according to related laws and regulations.

If the land and the houses erected there shall be transferred together, the transfer shall be implemented on the uniform land transaction market of the Shanghai Municipality.

10. If the rights to use land under this Contract are mortgaged, such rights shall be mortgaged in whole. The principal creditor's right mortgaged by shall only be limited to the loan for the development and construction of the parcel transferred under this Contract and shall not exceed the total amount of land transfer price agreed under this Contract.

In case of pledging houses under construction or newly constructed house together with land, related requirements of the *Measures of the Shanghai Municipality on the Mortgage of Real Estates* shall be implemented.

11. In case of realization of the mortgage in respect of the parcel under this Contract, the qualifications of bidders of the mortgage must be verified by planning and land resources administration department, industry management department and development zone management agency in a comprehensive way to ensure that they shall satisfy the requirements in respect of industry guidance and the planning of the development zone.
12. Except that the parcel under this Contract shall be withdrawn for social and public interests, Transferee needs to continue to use the parcel under this Contract where the term for use agreed under this Contract expires, it shall submit a renewal application to Transferor at least one year prior to expiry of such term if Transferee needs to continue to use the parcel under this Contract.

Where the Transferee makes a renewal application, it shall apply to Shanghai Songjiang Economic Committee for a comprehensive rating. If it is rated to satisfy related requirements by Shanghai Songjiang Economic Committee, Transferee shall grant an approval.

If Transferor agrees to the renewal, Transferee shall go through transfer and lease formalities by paying corresponding compensation. Transferee agrees that the constructions, buildings and their ancillary facilities within the scope of the parcel under this Contract may be taken by Transferor, provided that the Transferor shall pay corresponding compensations to Transferee based on the residual value of the constructions, buildings and their ancillary facilities.

Procedures, re-sign the contract for use of land with compensation such as transfer, lease, etc, and pay land transferring fee, rent and other costs on use of land with compensation.

13. Where, upon expiration of land transferring period, the transferee applies for extension thereof, which is not approved for comprehensive evaluation fails to meet relevant standards or due to needs of public interest, this Contract terminates, the Transferor recovers the land without compensation, and the Transferee shall go through relevant procedures for de-registration of land use right as required and return the certificate on use of land.

For buildings, structures and affiliated facilities thereof completed to the extent of this parcel of land, the Transferor shall recover buildings, structures and affiliated facilities thereof on the land, and indemnify the Transferee according based on the residual value of buildings, structures and affiliated facilities thereof completed to the extent of this parcel of land at the time of recovery.

14. The Transferee shall pay the performance bond on the time of project (or submit a letter of guarantee) on schedule in accordance with this Contract. Where the Transferee is unable to pay the performance bond for time of project in full on schedule, and delays in making payment for more than 60 days, and remains unable to pay the performance bond for time of project in full upon demand by the Transferor, the Transferor is entitled to rescind this Contract, the Transferee is not entitled to claim return of deposit, and the Transferor may claim damages against the Transferee.
15. Where the Transferee terminates investment in construction of the project on this parcel of land hereunder, and proposes for termination of performance of this Contract and claims return of land application against the Transferor within not less than 30 days prior to expiration of agreed date of commencement of land construction, such circumstance shall be handled as follows upon consent by the parties: the Transferor shall return all the land-transferring fee other than the agreed deposit and recover the land use right; the Transferor shall refund the performance bond on time of project in full and interest on bank savings
16. The Transferee agrees that management of time of commencement of the project on construction of this parcel of land hereunder shall be implemented as follows: where the Transferee fails to commence construction on the agreed date or the date otherwise agreed on extended construction, it shall pay 50% of the performance bond on all the time of commencing construction as the liquidated damages; where the extension is beyond six months, the Transferee shall pay 100% of the performance bond on all the time of commencing construction as the liquidated damages. Where the Transferee delays in commencing construction for more than a year, the Transferor is entitled to rescind this Contract, recover the land use right, and upon deduction of the agreed deposit, return the land transfer price for the remaining years, return performance bond on time of completion in full and interest on bank savings, and return the performance bond on time of putting this project into operation in full and interest on bank savings.
17. The Transferee agrees that management of time of completion of the project on construction of this parcel of land hereunder shall be implemented as follows: where the Transferee fails to complete construction on the agreed date or the date otherwise agreed on extended construction, it shall pay 50% of the performance bond on the time of completion as the liquidated damages; where the extension is beyond six months, the Transferee shall pay 100% of the performance bond on all the time of completion as the liquidated damages. Where the Transferee delays in completing construction for more than a year, the Transferor is entitled to rescind this Contract, recover the land use right, and upon deduction of the agreed deposit, return the land transfer price for the remaining years, and return the performance bond on time of putting this project into operation in full and interest on bank savings.

Where the project is not completed within more than a year, the Transferor is entitled to rescind this Contract, recover the land use right, and upon deduction of the agreed deposit, return the land transfer price for the remaining years. Where the project on construction of this parcel of land hereunder is not completed within more than a year, and the Transferor rescinds this Contract, the Transferor and

18. If Transferee fails to put the project under this Contract into operation, all the operation time performance security deposit shall be paid as liquidated damages. In the case, Shanghai Songjiang Economic Committee and Transferee will reappoint a date for putting the project into operation. The date shall be within twelve months, i.e., prior to January 31, 2019. If it is determined by Shanghai Songjiang Economic Committee that the date of operation of Transferee exceeds the reappointed date of operation, Transferee has the right to terminate this Contract and take back the right to use land, and refund the land transfer price of the residual term after deducting the earnest money agreed under this Contract.

If the project on the industrial parcel under this Contract is not put into operation after the reappointed date and Transferor decides to rescind this Contract, Transferor and Transferee agrees that Transferor shall take back above ground constructions, buildings and their ancillary facilities and pay Transferee corresponding compensations based on the residual value of the constructions, buildings and their ancillary facilities.

19. After the project on the industrial parcel under this Contract is put into operation, if it is determined by Shanghai Songjiang Economic Committee that the total investment of the fixed assets of the project and investment intensity fail to satisfy the standards agreed under this Contract, Transferee shall, based on the ratio of the inadequate portion in the total investment and investment intensity, pay the liquidated damages in the amount of the same ratio of land transfer price and continue to perform this Contract.

20. Within one month after reaching the designed capacity as agreed under this Contract, the project on the industrial parcel under this Contract shall be subject to the determination of Shanghai Songjiang Economic Committee whether the project has achieved the design capacity.

Where the total tax of the project fails to meet the standards agreed under this Contract but it is no less than 60% of the standards agreed under this Contract, Transferee shall pay the liquidated damages in the amount of 50% of the actual inadequate portion of the tax. Once Transferee pays the liquidated damages, it will be deemed that this provision has been fulfilled.

21. If Transferee proposes to surrender the rights to use land after achieving designed capacity due to any reason on its own part, it shall be dealt with based on the following agreement: the transferor will rescind this Contract, take back the right to use land, and refund the land transfer price for the residual term for use. Transferor and Transferee agree that Transferor may take back the above-ground constructions, buildings and their ancillary facilities; provided that Transferor shall pay to Transferee corresponding compensations based on the residual value of the constructions, buildings and their ancillary facilities.

22. If the ratio of internal administration and office for enterprises and life service facilities of the industrial construction project or the area of internal administration and office for enterprises and life service facilities exceeds the standards agreed under this Contract, Transferee shall pay to Transferor the liquidated damages in the amount of 1.00% of the land transfer price and solely be responsible for taking corresponding building facilities apart.

23. If Transferee is under any of the following circumstances as a result of its use of the parcel under this Contract, transferor has the right to rescind this Contract, take back the right to use land, and refund the land transfer price for the residual term for use:

Transferee violates the requirements in Article 20 of Appendix 4 to this Contract and the total tax revenue fail to reach 60% of the standards agreed under this Contract, as determined by Shanghai Songjiang Economic Committee within one month of the date of achieving the designed capacity set forth herein.

Shanghai Songjiang Economic Committee will comprehensively assess the industrial project on the industrial parcel under this Contract once three years after the third year of the achievement of designed capacity, and the assessment results turn out to be substandard;

Transferee contravenes the requirements of the requirements of the laws and regulations of the PRC and this Contract to transfer or mortgage the land or change the contribution ratio structure of the person having the right to use the land and equity structure of related project company.

Transferee contravenes the requirements of this Article and terminates this Contract, and both Transferor and Transferee agree that Transferor may possess the constructions, buildings and their facilities within the scope of the parcel under this Contract without any compensation.

24. If Transferee of the parcel under this Contract breaches this Contract by changing the purpose of the land without authorization, the case is serious and Transferee fails to make rectification within specified term, Transferor has the right to rescind this Contract and withdraw the right to use land without compensation. Both Transferor and Transferee agree that Transferor may possess the constructions, buildings and their facilities within the scope of the parcel under this Contract without any compensation.
25. Where the use of the parcel under this Contract cause serious environment pollution as determined by competent environment protection department, Transferor has the right to rescind this Contract, withdraw the right to use land without compensation, and require Transferee to undertake all the costs for restoring land and underground water and geological environment. Both Transferor and Transferee agree that Transferor may possess the constructions, buildings and their facilities within the scope of the parcel under this Contract without any compensation.
26. The formation, effectiveness, interpretation, performance and dispute resolution of this Contract shall be governed by the laws of the People's Republic of China the local rules and regulations of the Shanghai Municipality. In case of any dispute arising from the performance of this Contract, Party A and Party B shall settle such dispute based on consultations. Should such consultation fail, any of the parties may file an action before the people's court.
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**List of Subsidiaries
of
Taomee Holdings Limited
(the “Registrant”)**

Beneficially Owned Subsidiaries

Name of Company	Jurisdiction of Incorporation	Percentage of Attributable Equity Interests
1. Taomee Holdings (HK) Limited	Hong Kong	100%
2. Shanghai Shengran Information Technology Co., Ltd.	PRC	100%
3. Shanghai Xinsheng Information Technology Co., Ltd.	PRC	93%
4. Shanghai Taomee Property Service Co., Ltd.	PRC	99%
5. Shanghai Taomee Wireless Technology Co., Ltd.	PRC	99%
6. Shanghai Taomee Software Development Co., Ltd.	PRC	99%
7. Shanghai Junran Information Technology Co., Ltd.	PRC	100%

Affiliated Entities Consolidated in the Registrant’s Financial Statement

Name of Company	Jurisdiction of Incorporation
1. Shanghai Taomee Network Technology Co., Ltd.	PRC
2. Shanghai Taomee Animation Co., Ltd.	PRC
3. Shanghai Qidong Information Technology Co., Ltd.	PRC
4. Guangdong Taomee Animation Technology Co., Ltd.	PRC
5. Shanghai Jushou Wireless Technology Co., Ltd.	PRC
6. Shanghai Shengyu Network and Technology Co., Ltd.	PRC

**Certification by the Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Benson Haibing Wang, certify that:

1. I have reviewed this annual report on Form 20-F of Taomee Holdings Limited (the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
5. The Company’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of the Company’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: April 15, 2015

By:

/s/ Benson Haibing Wang

Name: Benson Haibing Wang

Title: Chief Executive Officer

**Certification by the Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Sam Lawn, certify that:

1. I have reviewed this annual report on Form 20-F of Taomee Holdings Limited (the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
5. The Company’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of the Company’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: April 15, 2015

By:

/s/ Sam Lawn

Name: Sam Lawn

Title: Chief Financial Officer

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Annual Report of Taomee Holdings Limited (the “Company”) on Form 20-F for the fiscal year ended December 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Benson Haibing Wang, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report containing the financial statements fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 15, 2015

By:

/s/ Benson Haibing Wang

Name: Benson Haibing Wang

Title: Chief Executive Officer

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Annual Report of Taomee Holdings Limited (the “Company”) on Form 20-F for the fiscal year ended December 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Sam Lawn, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report containing the financial statements fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 15, 2015

By:

/s/ Sam Lawn

Name: Sam Lawn

Title: Chief Financial Officer

锦天城律师事务所
ALLBRIGHT LAW OFFICES

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电话：+86-21-2326-1888 传真：+86-21-2326-1999
28 Floor, Hong Kong Plaza, No. 283 Huai Hai Middle Road, Shanghai P.R. China 200021
Tel: +86-21-2326-1888 Fax: +86-21-2326-1999

Date: April 15, 2015

Taomee Holdings Limited
16/F, Building No. A-2, No. 1528 Gumei Road
Xuhui District, Shanghai 200233
People's Republic of China

Dear Sirs,

We consent to the reference to our firm under the heading of "Item 3. Key Information - Risk Factors" included in Taomee Holdings Limited's Annual Report on Form 20-F for the fiscal year ended December 31, 2014, which is filed by Taomee Holdings Limited with the Securities and Exchange Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 on the date hereof.

Yours faithfully,

/s/ Allbright Law Offices
Allbright Law Offices

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-183651 on Form S-8 of our report dated April 15, 2015, relating to the consolidated financial statements and financial statement schedule of Taomee Holdings Limited, its subsidiaries and its variable interest entities, appearing in the Annual Report on Form 20-F of Taomee Holdings Limited for the year ended December 31, 2014.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP
Shanghai, China
April 15, 2015

Our ref SHF/661280-000001/8081578v1
Direct tel +852 3690 7507
Email shirley.fu@maplesandcalder.com

Taomee Holdings Limited
16/F, Building No. A-2
No. 1528 Gumei Road
Xuhui District
Shanghai 200233
People's Republic of China

15 April 2015

Dear Sirs

Taomee Holdings Limited

We consent to the reference to our firm under the heading “Item 10.E. Additional Information—Taxation—Cayman Islands Taxation” in Taomee Holdings Limited’s Annual Report on Form 20-F for the year ended 31 December 2014, which is filed with the Securities and Exchange Commission on the date hereof.

Yours faithfully,

/s/ Maples and Calder
Maples and Calder
