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

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**FORM 20-F**

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(Mark One)

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

OR

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

For the fiscal year ended December 31, 2016.

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: 001-34238

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**THE9 LIMITED**

(Exact name of Registrant as specified in its charter)

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N/A

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

**Building No. 3, 690 Bibo Road  
Zhang Jiang Hi-Tech Park  
Pudong New Area, Pudong  
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(Address of principal executive offices)**

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People's Republic of China**

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

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
<b>American Depositary Shares, each representing one ordinary share, par value US\$0.01 per share</b>	<b>Nasdaq Global Market</b>

**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:

**57,283,929 ordinary shares, par value US\$0.01 per share, as of December 31, 2016.**

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

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

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

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

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

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## INTRODUCTION

In this annual report, unless otherwise indicated, (1) the terms “we,” “us,” “our company,” “our” and “The9” refer to The9 Limited and, as the context may require, its subsidiaries and our consolidated affiliated entities, (2) the terms “affiliated entities” and “affiliated PRC entities” refer to our consolidated affiliated PRC entities, including, among others, Shanghai The9 Information Technology Co., Ltd., or Shanghai IT, in which we do not have direct equity interests but over which we effectively control through a series of contractual arrangements as described under “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions—Arrangements with Affiliated PRC Entities,” (3) the terms “shares” and “ordinary shares” refer to our ordinary shares, and “ADSs” refers to our American depositary shares, each of which represents one ordinary share, (4) “China” and “PRC” refer to the People’s Republic of China, and solely for the purpose of this annual report, excluding Taiwan, Hong Kong and Macau, (5) all references to “RMB” and “Renminbi” are to the legal currency of China and all references to “U.S. dollars,” “dollars,” “US\$” and “\$” are to the legal currency of the United States, (6) all discrepancies in any table between the amounts identified as total amounts and the sum of the amounts listed therein are due to rounding, and (7) all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual report were made at a rate of RMB6.9430 to US\$1.00, based on the H.10 weekly statistical release of the Federal Reserve Bank of New York as of December 30, 2016. Such translations have been provided for the convenience of the reader only and should not be construed as representations that the RMB amounts represent, or have been or could be converted into, United States dollars at that or any other rate.

## 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 Information

The following table presents selected consolidated financial information for our company. You should read the following information in conjunction with “Item 5. Operating and Financial Review and Prospects” below. The selected consolidated statement of operations data for the years ended December 31, 2014, 2015 and 2016 and the selected consolidated balance sheet data as of December 31, 2015 and 2016 have been derived from our audited consolidated financial statements and should be read in conjunction with those statements, which are included in this annual report beginning on page F-1. The selected consolidated statement of operations data for the years ended December 31, 2012 and 2013 and the selected consolidated balance sheet data as of December 31, 2012, 2013 and 2014 have been derived from our audited consolidated financial statements, which are not included in this annual report. The consolidated financial statements were prepared and presented in accordance with United States generally accepted accounting principles, or U.S. GAAP.

	For the Year Ended December 31,					
	2012	2013	2014	2015	2016	
	RMB	RMB	RMB	RMB	RMB	US\$ <sup>(1)</sup>
	<i>(in thousands, except for per share and per ADS data)</i>					
<b>Consolidated Statement of Operation Data</b>						
Revenues	163,581	106,627	64,840	46,610	56,286	8,107
Sales taxes	(9,147)	(1,851)	(563)	(199)	(86)	(12)
Net revenues	154,434	104,776	64,277	46,411	56,200	8,095
Cost of revenue	(69,416)	(107,803)	(85,783)	(67,744)	(48,519)	(6,988)
Gross profit (loss)	85,018	(3,027)	(21,506)	(21,333)	7,681	1,107
Operating expenses	(677,529)	(527,341)	(139,404)	(303,604)	(306,892)	(44,202)
Other operating income (expenses)	120	120	75	(1,563)	3,605	519
Loss from operations	(592,391)	(530,248)	(160,835)	(326,500)	(295,606)	(42,576)

	For the Year Ended December 31,					
	2012	2013	2014	2015	2016	
	RMB	RMB	RMB	RMB	RMB	US\$ <sup>(1)</sup>
<b>Consolidated Statement of Operation Data</b>						
Impairment on available-for-sale investment	—	—	—	—	(244,798)	(35,258)
Impairment on other investment	—	(47,971)	—	—	(2,807)	(404)
Interest income	21,786	8,376	3,415	775	161	23
Interest expenses	—	—	—	(6,397)	(56,472)	(8,135)
Fair value change on warrants liability	—	—	—	(7,129)	48,057	6,922
Gain (loss) on disposal of equity investee and available-for-sale investment	15,726	—	33,154	—	(1,217)	(175)
Other income (expenses), net	4,644	9,302	(963)	(1,917)	(9,952)	(1,433)
Loss before income tax expense and share of loss in equity method investments	(550,235)	(560,541)	(125,229)	(341,168)	(562,634)	(81,036)
Impairment loss on investments	(3,244)	—	—	—	—	—
Income tax benefit (expense)	—	—	—	—	6,079	876
Share of loss in equity investments	(6,347)	(2,376)	(3,713)	(13,014)	(110,535)	(15,921)
Net loss for the year	(559,826)	(562,917)	(128,942)	(354,182)	(667,090)	(96,081)
Net loss attributable to:						
Noncontrolling interest	(45,824)	(36,655)	(21,443)	(16,656)	(58,584)	(8,438)
Redeemable noncontrolling interest	—	—	(20,877)	(32,698)	(14,724)	(2,121)
The9 Limited	(514,002)	(526,262)	(86,622)	(304,828)	(593,782)	(85,522)
Change in redemption value of redeemable noncontrolling interest	—	—	21,077	79,806	82,890	11,939
Net loss attributable to holders of ordinary shares	(514,002)	(526,262)	(107,699)	(384,634)	(676,672)	(97,461)
Other comprehensive income (loss):						
Unrealized loss on available-for-sale investment	(57)	(16)	—	—	—	—
Currency translation adjustments	(980)	(689)	(1,204)	5,009	(1,755)	(253)
Total comprehensive loss	(560,863)	(563,622)	(130,146)	(349,173)	(668,845)	(96,334)
Comprehensive loss attributable to:						
Noncontrolling interest	(46,118)	(35,084)	(22,995)	(16,913)	(58,584)	(8,438)
Redeemable noncontrolling interest	—	—	(20,877)	(32,698)	(14,724)	(2,121)
The9 Limited	(514,745)	(528,538)	(86,274)	(299,562)	(595,537)	(85,775)
Change in redemption value of redeemable noncontrolling interest	—	—	21,077	79,806	82,890	11,939
Net loss attributable to holders of ordinary shares per share						
Basic	(20.98)	(22.71)	(4.65)	(16.55)	(28.34)	(4.08)
Diluted	(20.98)	(22.71)	(4.65)	(16.55)	(28.34)	(4.08)
Net loss attributable to holders of ordinary shares per ADS <sup>(2)</sup>						
Basic	(20.98)	(22.71)	(4.65)	(16.55)	(28.34)	(4.08)
Diluted	(20.98)	(22.71)	(4.65)	(16.55)	(28.34)	(4.08)

	As of December 31,					
	2012	2013	2014	2015	2016	
	RMB	RMB	RMB	RMB	RMB	US\$ <sup>(1)</sup>
<b>Consolidated Balance Sheet Data</b>						
Cash and cash equivalents	554,279	156,987	181,482	49,011	38,878	5,600
Non-current assets	447,730	328,617	261,477	460,837	262,854	37,859
Total assets	1,112,345	546,679	517,331	538,095	350,892	50,539
Total current liabilities	317,713	330,092	296,591	427,966	573,749	82,637
Total equity	749,212	190,133	64,888	(241,076)	(702,054)	(101,117)
Redeemable noncontrolling interest	—	—	131,497	178,605	246,771	35,542
Total liabilities, redeemable noncontrolling interest and equity	1,112,345	546,679	517,331	538,095	350,892	50,539

- (1) Translation from RMB amounts into U.S. dollars was made at a rate of RMB6.9430 to US\$1.00 for the convenience of the reader only. See “Item 3. Key Information—A. Selected Financial Information—Exchange Rate Information.”
- (2) Each ADS represents one ordinary share.

### Exchange Rate Information

Our business is primarily conducted in China and a significant portion of our revenues are denominated in RMB. This annual report contains translations of RMB amounts into U.S. dollars based on the exchange rate set forth in the H.10 statistical release of the Federal Reserve Bank of New York. For the convenience of the readers only, this annual report contains translations of some RMB or U.S. dollar amounts for 2016 at US\$1.00 to RMB6.9430, which was the noon buying rate in effect as of December 30, 2016. The prevailing rate on March 31, 2017 was US\$1.00 to RMB6.8832. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, the rates stated below, or at all. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Future movements in exchange rates between the U.S. dollar and the RMB may adversely affect the value of our ADSs.”

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

Period	Noon Buying Rate			
	Period end	Average <sup>(1)</sup>	Low	High
2012	6.2301	6.2990	6.3879	6.2221
2013	6.0537	6.1412	6.2438	6.0537
2014	6.2046	6.1704	6.2591	6.0402
2015	6.4778	6.2827	6.4896	6.1870
2016	6.9430	6.6400	6.9580	6.4480
October	6.7735	6.7303	6.7819	6.6685
November	6.8837	6.8402	6.9195	6.7534
December	6.9430	6.9198	6.9580	6.8771
2017				
January	6.8768	6.8907	6.9575	6.8360
February	6.8665	6.8694	6.8821	6.8517
March	6.8832	6.8940	6.9132	6.8687

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

### B. Capitalization and Indebtedness

Not Applicable.

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

Not Applicable.

## **D. Risk Factors**

### **Risks Related to Our Company and Our Industry**

*We may continue to incur losses, negative cash flows from operating activities and net current liabilities in the future. If we are not able to return to profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern.*

We incurred a net loss of RMB128.9 million, RMB354.2 million and RMB667.1 million (US\$96.1 million) for the years ended December 31, 2014, 2015 and 2016, respectively, as we continue to incur product development and sales and marketing expenses for our new products and general and administrative expenses while we have not generated significant revenues from our new games or other operations in those periods and since 2009. Our product development, sales and marketing and general and administrative expenses may increase in the future as we continue to explore various opportunities of new product development and business expansion in order to grow our revenues. In 2014 and 2015, we recorded a gross loss of RMB21.5 million and RMB21.3 million, respectively, reflecting lower revenues generated coupled with the continued incurrence of a relatively fixed portion of our costs, such as overhead, depreciation and rental charges. In 2016, we had a gross gain of RMB7.7 million (US\$1.1 million), primarily due to a decrease in cost of revenue, which was resulted from a decrease in amortization of intangible assets following an impairment of intangible assets in 2016. Our ability to achieve profitability depends on the competitiveness of our products and services as well as our ability to control costs and to provide new products and services to meet the market demands and attract new customers. Due to the numerous risks and uncertainties associated with our business, we may not be able to achieve profitability in the short-term or long-term.

In addition, our cash and cash equivalents have significantly and generally decreased since 2009, primarily due to the cash outflows from operating activities associated with our product development and sales and marketing efforts for our new games. Our cash and cash equivalents continued to decrease from RMB49.0 million as of December 31, 2015 to RMB38.9 million (US\$5.6 million) as of December 31, 2016, primarily due to cash outflows to operating activities for product development and sales and marketing, offset by net proceeds from a loan provided by a financial services company, a bank loan provided by Bank of Shanghai and loans from related parties in 2016. We recorded negative operating cash flow of RMB269.1 million, RMB175.6 million and RMB181.0 million (US\$26.1 million) for the years ended December 31, 2014, 2015 and 2016, respectively. Furthermore, as of December 31, 2014, 2015 and 2016, we recorded net current liabilities of RMB40.7 million, RMB350.7 million and RMB485.7 million (US\$70.0 million), respectively. Our net current liabilities positions as of December 31, 2014, 2015 and 2016 were primarily due to the continuous cash outflow in connection with our product development and sales and marketing activities. See “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Results of Operations.” We cannot assure you that our liquidity position will improve in the future. We may continue to incur losses, negative cash flows from operating activities and net current liabilities, which may materially and adversely affect our business, prospects, liquidity, financial condition and results of operations.

We have an accumulated deficit of approximately RMB2,897.8 million (US\$417.4 million) and total current liabilities exceeded total assets by approximately RMB222.9 million (US\$32.1 million) as of December 31, 2016. If we are unable to achieve profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern. There can be no assurance that we can obtain additional financing. Our ability to obtain additional financing is subject to a number of factors, which may be beyond our control. See “—We may not be able to obtain additional financing to support our business and operations, and our equity or debt financings may have an adverse effect on our business operations and share price.”

Our consolidated financial statements for each of the three years ended December 31, 2016 included in this annual report beginning on page F-1 have been prepared based on the assumption that we will continue on a going concern basis. The auditors of our consolidated financial statements have included in their audit reports an explanatory paragraph relating to substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts of liabilities that might result from the outcome of this uncertainty.



***Our business is intensely competitive and “hit” driven. If we do not deliver new “hit” products to the market, or if consumers prefer our competitors’ products or services over those we provide, our operating results will suffer.***

We operate in a highly competitive and dynamic market, and our future success depends not only on the popularity of our existing online games but also, in a large part, on our ability to develop and introduce new games that are attractive to our customers. To achieve this, we need to anticipate and effectively adapt to rapidly changing consumer tastes and preferences and technological advances. The development of new games and the procurement of licenses from third-party developers can be very difficult and requires high levels of innovation and significant investments. We currently focus on and have made significant investment in developing our own proprietary games, primarily mobile games and a web game. However, we do not have a proven track record of developing such games or other online games. We also expect to invest a significant amount of financial and personnel resources in launching and operating CrossFire 2 in China, which was licensed by Smilegate Entertainment Inc., or Smilegate, to our joint venture and is being developed by Smilegate. While new products are regularly introduced, only a small number of “hit” titles account for a significant portion of total revenues in our industry. We may decide to cease to operate or develop any game that is no longer profitable. There is no assurance that any new game, proprietary, licensed or otherwise, to be introduced by us from time to time, including those named in “Item 4. Information on the Company—B. Business Overview—Products and Services,” could become “hit” products and widely accepted by the customers and the market. We may continue to incur losses, and experience net cash outflow from operating activities, decrease in cash and cash equivalents balance and net current liabilities if we fail to introduce “hit” games or products which gain substantial market acceptance. In addition, “hit” products offered by our competitors may take a larger share of the market than we anticipate, which could cause revenues generated by our products to fall below expectations. Our competitors may develop more successful products, or offer similar products at lower price points or pursuant to payment models viewed as offering a better value than we do. Any such negative development may materially and adversely affect our business, financial condition and results of operations.

***We currently depend on a limited number of games, and we may not be able to successfully implement our growth strategies.***

We currently depend on a limited number of games for substantially all of our revenues. In addition, we currently focus on developing a number of proprietary games and obtaining licenses to games to grow our business. For example, in November 2015, our joint venture Oriental Shiny obtained an exclusive license from Smilegate to publish and operate CrossFire 2 in China for an initial term of three years. Smilegate is currently in the process of developing CrossFire 2. We have also invested in developing our proprietary online games on different platforms, including a new mobile game that we are developing based on the intellectual property relating to CrossFire, or the CrossFire New Mobile Game, and our web game called Soul Awake. In addition, in June 2016, our subsidiary Asian Way Development Limited obtained a right from T3 Entertainment Co., Ltd., or T3 Entertainment, to develop a game using augmented reality (AR) technologies based on the intellectual property relating to a game called Audition. However, there is no assurance that we or Smilegate can successfully develop the games we invest in, that we may successfully launch the games as expected on a timely basis, or at all, or if any newly launched games such as CrossFire 2 would be widely accepted by game players. In particular, the development and operation of a game usually involves significant investments and dedication of time and resources, but the resulting game product may not yield the financial return that we anticipate. Our business strategies may also involve the development and marketing of new products and services for which there are no established markets in China or in which we lack experience and expertise. If any of our games encounters any adverse development or if we are unable to develop, purchase or license additional games that are attractive to users, our business, financial condition and results of operations may be materially and adversely affected. We cannot assure you that we will be able to launch new games or continue operating existing games on a commercially viable basis or in a timely manner, or at all, or that we will be able to implement our other growth strategies. If any of these occur, our competitiveness may be harmed and our business, financial condition and results of operations may be materially and adversely affected.

***We may not be able to obtain additional financing to support our business and operations, and our equity or debt financings may have an adverse effect on our business operations and share price.***

We may continue to experience material decrease in cash and cash equivalents balance and we may require additional cash resources to fund our working capital and expenditure needs, such as product developments expenses, payment of license fees and royalties, sales and marketing activities, as well as investment or acquisition transactions. We expect to continue to incur product development costs to develop our proprietary online games, including mobile games and a web game, and license fees and royalties to obtain game licenses from third-party developers. If our internal financial resources are insufficient to satisfy our cash requirements, we may seek additional financing through the issuance of equity securities or through debt financing, such as borrowings from commercial banks or other financial institutions or lenders. To meet our anticipated capital needs, we have engaged and are considering multiple alternatives, including but not limited to additional equity financings, debt financings, launch of new games, other financing transactions, and cost control. See “Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” There can be no assurance that we will be able to successfully complete any such transaction or conduct any cost control measure with results favorable to us, or at all. If we are unable to obtain the necessary financing, we may need to license or sell our assets, seek to be acquired by another entity and/or cease operations.

Any equity or debt financing may result in dilution to our existing shareholders’ interests or an increase in our debt service obligations. For example, in December 2015, we issued and sold senior secured convertible notes, or the Convertible Notes, in an aggregate principal amount of US\$40,050,000 to Splendid Days Limited, or Splendid Days, in three tranches at initial conversion prices of US\$2.6, US\$5.2 and US\$7.8 per ADS, respectively. In connection with the sale of Convertible Notes, we also issued warrants, or the Warrants, in an aggregate principal amount of US\$9,950,000 to Splendid Days in four tranches at initial exercise prices of US\$1.5, US\$2.6, US\$5.2 and US\$7.8 per ADS, respectively. In addition, in December 2015, we obtained an entrusted loan of approximately RMB31.6 million from a third party. In 2016, we obtained bank loans of approximately RMB25.0 million (US\$3.6 million). See “Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” The Convertible Notes and the aforesaid loans significantly increased our debt obligations and any conversion or exercise, as applicable, of the Convertible Notes and Warrants by Splendid Days may cause significant dilution to our existing shareholders’ interest in our company.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance, our indebtedness, including the Convertible Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. For example, in June 2016, Asian Development Limited, or Asian Development, our wholly-owned subsidiary, borrowed a loan of HK\$92.3 million (US\$11.9 million) from a financial services company, which is secured by a pledge of shares of L&A International Holding Limited, or L&A. As Asian Development is currently in default of the loan due to a sharp decline in the share price of L&A, the lender is entitled to foreclose the pledged L&A shares. If the market value of the pledged shares cannot cover the total outstanding amount owed by Asian Development to the lender, the lender may also make a claim against Asian Development for any outstanding amounts of the loan. Our business may not generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations. Incurrence of additional indebtedness could also result in operating and financing covenants restricting our business operations. In addition, we cannot assure you that any such future financing will be available to us in amounts or on terms acceptable to us, if at all. If we fail to obtain sufficient financing to fund our capital needs, our business, financial condition and results or operations could be materially and adversely affected.

***The Convertible Notes are subject to redemption rights by holders upon a change of control of our company or an event of default, and they contain covenants that may restrict our ability to declare dividends and our operational and financial flexibility.***

In December 2015, we completed the issuance and sale of the Convertible Notes. Pursuant to the terms of the Convertible Notes, if we undergo a change of control, holders of the Convertible Notes will be entitled to require us to redeem all or part of the Convertible Notes, at a price payable in cash equal to 100% of the outstanding principal amount of the Convertible Notes, plus all accrued and unpaid interests thereon, if any. The Convertible Notes define a “change of control” to include: (1) our company’s consolidation with, or merger with or into, any other company, and vice versa; (2) our company disposing of all or substantially all of its assets; (3) the adoption of a plan relating to the liquidation or dissolution of our company; or (4) Mr. Jun Zhu, our chairman and chief executive officer, ceasing to directly or indirectly own 20% or more of the total outstanding and issued shares of our company on a fully-diluted and as-converted basis. In addition, pursuant to the terms of the Convertible Notes, if there is a continuing event of default, the holders will be entitled to declare any of the Convertible Notes immediately due and payable, and request redemption by us at a price equal to the outstanding principal amount plus all accrued and unpaid interests thereon, if any. “Events of default” as defined in the Convertible Notes include, among other things, an event of default of any indebtedness of our company or our principal subsidiaries in the amount exceeding US\$500,000, and the delisting of our ADSs from the Nasdaq Global Market. If there is a change of control of our company and any event of default under the Convertible Notes, and our cash flows and capital resources are insufficient to fund our debt service obligation, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations, which could cause a material and adverse impact on our operations and financial results.

In addition, the Convertible Notes contains covenants that may limit our financial and operating flexibility. The covenants restrict our ability to, among other things, (1) make dividend or other distribution to our shareholders, and (2) sell or dispose of certain assets, if such action would result in an event of default under the Convertible Notes. As a result of the covenants, our ability to pay dividends or other distributions on our ordinary shares, including those represented by ADSs, may be limited. These covenants could also restrict our ability to raise additional capital in the future through bank borrowings and debt and equity issuances and may restrict our ability to engage in some transactions that we expect to be of benefit to us.

***The Convertible Notes are secured by, among other things, a pledge of our 100% equity interest in The9 Computer, which may result in our loss of control over Shanghai IT if we default under the Convertible Notes.***

The Convertible Notes are secured by a pledge of our 100% equity interest in each of The9 Computer Technology Consulting (Shanghai) Co., Ltd., or The9 Computer, and China The9 Interactive (Shanghai) Limited, or C9I Shanghai, our wholly-owned subsidiaries in China. Each of The9 Computer and C9I Shanghai holds a significant portion of our assets and operations in China, and The9 Computer possesses the effective control over Shanghai IT, the affiliated PRC entity that operates our online game business and other ICP related businesses, through a series of contractual arrangements. If we default under the Convertible Notes in the future, the holders may enforce their claims against our equity interests in these two wholly-owned subsidiaries to satisfy our obligations under the Convertible Notes. In such an event, the holders could gain ownership of all the equity interests in The9 Computer and C9I Shanghai, and, as a result, own and control these subsidiaries as well as Shanghai IT. As we conduct substantially all of our operations in China through Shanghai IT, if we default under the Convertible Notes, we could lose control or ownership of our assets and operations in China, which would materially and adversely affect our operations and financial results. In addition, the Convertible Notes are also secured by a mortgage over our office building in Shanghai, which we currently use as our principal executive offices.

***Illegal game servers, unauthorized character enhancements and other infringements of our intellectual property rights, as well as theft of in-game goods, could harm our business and reputation and materially and adversely affect our results of operation.***

With the increase in the number of online game players in China, we face the risks of illegal game servers, unauthorized character enhancements and other infringements of our intellectual property rights as well as the risk of theft of in-game goods purchased by our customers. Although we have adopted a number of measures to address illegal server usage, misappropriation of our game server installation software and the establishment of illegal game servers could harm our business and reputation and materially and adversely affect our results of operations.

From time to time, we have detected a number of players who have gained an unfair advantage by installing tools that fraudulently facilitate character progression. We have installed software patches designed to prevent unauthorized modifications to our execution files. However, we cannot assure you that we will be able to identify and eliminate new illegal game servers, unauthorized character enhancements or other infringements of our intellectual property rights in a timely manner, or at all. The deletion of unauthorized character enhancements requires the affected players to restart with a new character from the starting level, and this may cause some of these players to cease playing the game altogether. If we are unable to eliminate illegal servers, unauthorized character enhancements or suffer other infringement of our intellectual property rights, our players' perception of the reliability of our games may be negatively impacted, which may reduce the number of players using our games, shorten the lifespan of our games and adversely affect our results of operations.

***Our business, financial condition and results of operations may be adversely affected by the downturn in the global or Chinese economy.***

Our operations are primarily conducted in China and a significant majority of our revenues are sourced from China. Accordingly, our results of operations, financial condition and prospects are influenced by economic, political and legal developments in China. Although the Chinese economy has grown significantly in the past decade, it has started to slow down since 2012. Economic conditions in China are sensitive to global economic conditions, as well as changes in domestic economic and political policies and the expected or perceived overall economic growth rate in China. Subsequent to the financial crisis in 2008, there has been considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies adopted by the central banks and financial authorities of some of the world's leading economies, including the United States and China. There have been concerns over unrest and terrorist threats in the Middle East and Africa, which have resulted in volatility in oil and other markets, and over the conflicts involving Ukraine and Syria. There have also been concerns on the relationship among China and other Asian countries, which may result in or intensify potential conflicts in relation to territorial disputes. Any prolonged slowdown in the global or Chinese economy the recurrence of any financial disruptions in any jurisdiction may significantly restrict our ability to obtain financing in the capital markets or from financial institutions on commercially reasonable terms, or at all. In addition, our customers may reduce, delay or cease discretionary spending on our products and services, while we may have difficulty expanding our customer base fast enough, or at all, to offset the impact of decreased spending by our existing customers.

***We face the risks of changing consumer preferences and uncertainty about market acceptance of our new products.***

The online game industry is constantly evolving in China. Customer demand for and market acceptance of our online games is subject to a high degree of uncertainty. Our future operating results will depend on numerous factors beyond our control. These factors include, among others:

- the ability of our existing and new online games to gain popularity;
- customer demand for mobile games and web games;
- our ability to adopt and stay abreast of any new gaming technologies;
- competition against game developers and operators in and outside China;
- general economic conditions, particularly economic conditions affecting discretionary consumer spending;
- our ability to anticipate and timely and successfully adapt our product and service offerings constantly changing customer tastes and preferences;
- the availability of other forms of entertainment;
- customer demand for our in-game items; and
- critical reviews and public reception of our new products.

Our ability to plan for product development and distribution and promotional activities will be significantly affected by our ability to anticipate and adapt to relatively rapid changes in consumer tastes and preferences. We currently offer and develop online games, primarily a massively multiplayer online first-person shooter game, or MMOFPS, mobile games and a web game, as well as TV games. A decline in the popularity of the types of games we offer or develop could adversely affect our business and prospects.

***We may not be able to recover our market share and profitability as we operate in a highly competitive industry with numerous competitors.***

There are numerous online game operators in China. Given the relatively low entry barriers, an increasing number of companies have entered the online game industry in China and a wider range of online games have been introduced to the Chinese market, and we expect this trend to continue. Our competitors vary in size and include large companies, many of which have significantly greater financial, marketing and game development resources and name recognition than we have, such as Tencent Holdings Limited, Shanda Games Limited, NetEase, Inc., Giant Interactive Group Inc., Changyou.com Limited and Perfect World Co., Ltd. As a result, we may not be able to devote the same degree of resources as our competitors do to designing, developing, licensing or acquiring new games, undertaking extensive marketing campaigns, adopting aggressive pricing policies, paying high compensation to game developers or compensating independent game developers. Our competitors may introduce new business methods, technologies or gaming platforms from time to time. If these new business methods, technologies or gaming platforms are more attractive to customers than what we offer, our customers may switch to our competitors' games, and we may lose market share. We cannot assure you that we will be able to compete successfully against new or existing competitors, or against new business methods, technologies or gaming platforms implemented by them. In addition, the increasing competition we experience in the online game industry may also reduce the number of our users or the growth rate of our user base or reduce the game points spending for in-game premiums. All of these competitive factors could materially and adversely affect our business, financial condition and results of operations and prevent us from recovering market share and profitability.

***If we or our joint ventures fail to renew or acquire new online game licenses on favorable terms or at all, our future results of operations and profitability may be materially impacted.***

In addition to developing and offering our own proprietary games, we and our joint ventures also seek to offer games licensed from game licensors. For example, in November 2015, our joint venture Oriental Shiny obtained an exclusive license from Smilegate to publish and operate CrossFire 2 in China for an initial term of three years. Smilegate is currently in the process of developing CrossFire 2. Historically, we have operated a number of games licensed from game licensors, most of which already expired. There is no assurance that we or our joint ventures will be able to acquire new online game licenses or favorable terms or at all, or that we or our joint ventures will be able to renew the game licenses upon their expiration.

We and our joint ventures need to renew existing licenses and may need to obtain new online game licenses, and any failure to do so on favorable terms or at all may materially and adversely affect our business, financial condition and results of operations. Online game developers may not grant or continue to grant licenses to us or our joint ventures due to commercial or other reasons. If we or our joint ventures are unable to maintain a satisfactory relationship with the online game developers that have licensed games to us or our joint ventures, resulting in licenses not being renewed or licenses being prematurely terminated, or should any of these game developers either establish similar or more favorable relationships with our competitors in violation of their contractual arrangements with us or our joint ventures, or otherwise, our operating results and our business would be harmed. We cannot assure you that online game developers will renew their license agreements with us or our joint ventures, or grant us or our joint ventures a license for any new online games that they will develop or make available to us or our joint ventures expansion packs for existing games. Any failure to obtain or renew online game licenses from online game operators could harm our future results of operations or the growth of our business.

***If we and our joint venture Oriental Shiny are unable to successfully launch and operate CrossFire 2 in China, our future results of operations may be materially and adversely affected.***

We plan to invest a significant amount of financial and personnel resources in launching and operating CrossFire 2 in China, which was licensed by Smilegate to our joint venture Oriental Shiny in November 2015 for an initial term of three years, subject to an extension to five years. Oriental Shiny is a joint venture formed by Smilegate and Globe Wealthy Link Limited, or Globe Wealthy, a wholly-owned subsidiary of System Link Corporation Limited, or System Link, our 50%-owned joint venture that we formed with Qihoo 360. CrossFire 2 is the sequel of CrossFire, a first-person-shooter PC online game in China, and Smilegate is the developer of both games. Smilegate is currently in the process of developing CrossFire 2. There is no assurance that CrossFire 2 can be successfully developed, localized, tested and launched, or that once CrossFire 2 is launched, Oriental Shiny will be able to continue to operate the game at a profit or at all. The relevant Chinese governmental authorities may delay or deny the granting of the approvals required for the open beta test, commercial launch or operation of CrossFire 2 due to the content of the game or other factors. Furthermore, there is no assurance that CrossFire 2 will attract sufficient users and be commercially successful.

In addition, we have made and may continue to make significant financial commitments under the CrossFire 2 license agreement. Pursuant to the CrossFire 2 license agreement, Oriental Shiny and Beijing Zhi'ao Network Technology Co., Ltd., or Beijing Zhi'ao, the PRC entity established to operate CrossFire 2 in China, has paid an initial license fee of US\$50 million to Smilegate and may pay additional license fees of up to US\$450 million subject to certain development milestones of CrossFire 2 and extension of the term of the license. The payment of license fee is partly guaranteed by us based on our equity interest in System Link. Oriental Shiny and Beijing Zhi'ao are also required to pay to Smilegate royalties, and Globe Wealthy is required to make additional cash contributions to Oriental Shiny as may be necessary for publishing, operating and marketing CrossFire 2. See "Item 4. Information on the Company—B. Business Overview—Arrangements with Smilegate regarding CrossFire 2." If Oriental Shiny loses the exclusive CrossFire 2 license for failure to meet its financial obligations or other reasons, or if Oriental Shiny is unable to successfully launch and operate CrossFire 2 and generate revenues therefrom enough to offset our CrossFire 2-related costs and expenses, our results of operations and financial position may be materially and adversely affected.

***Future acquisitions may have an adverse effect on our ability to manage our business and our results of operations.***

Selective acquisitions was a part of our strategy to expand our business in the past. Although we currently may not have the necessary capital to conduct future acquisitions given the significant net loss and negative operating cash flow we have been experiencing, we may opportunistically acquire or invest in assets, businesses or companies that we believe would be beneficial for our company. Any acquisition or investment that we make may divert the attention of our management away from our ordinary course of business and any difficulties encountered in the integration process could have an adverse effect on our ability to manage our business. In addition, our ability to grow through future acquisitions, investments or organic means will also depend on the availability of suitable acquisitions and investment targets at an acceptable cost as well as our ability to compete effectively to attract these candidates. We may face significant competition in acquiring new businesses or companies, which may hinder the execution of our growth strategy. Future acquisitions or investments could result in a potential dilutive issuance of equity securities or the incurrence of debt, contingent liabilities, impairment losses or amortization expenses related to goodwill and other intangible assets, each of which could adversely affect our financial condition and results of operations. The benefits of an acquisition or investment may also take considerable time to develop and we cannot be certain that any particular acquisition or investment will produce its intended benefits. Future acquisitions would also expose us to potential risks, including risks associated with the assimilation of new operations, technologies and personnel, unforeseen or hidden liabilities, the diversion of resources from our existing businesses, sites and technologies, the inability to generate sufficient revenue to offset the costs and expenses of acquisitions, and potential loss of, or harm to, our relationships with employees, customers, licensors and other suppliers as a result of the integration of new businesses.

***Our equity investments or establishment of joint ventures and any material disputes with our investment or joint venture partners may have an adverse effect on our financial results, business prospects and our ability to manage our business.***

From time to time, subject to the availability of the necessary financial resources, we make equity investments into selected targets, such as online game developers, operators or application platforms, or establish joint venture with business partners, to seek business growth opportunities. For example, in August 2014, we formed a joint venture company, System Link, with Qihoo 360, for publishing and operating Firefall, a MMOFPS, in China. In the same month, System Link licensed Firefall from our subsidiary Red 5 Singapore Pte. Ltd., or Red 5 Singapore, for a term of five years. In November 2015, our joint venture Oriental Shiny, which is majority-owned by System Link, obtained an exclusive license from Smilegate to publish and operate CrossFire 2 in China for an initial term of three years, subject to an extension to five years. We may have limited power to direct or otherwise participate in the management of operations and strategies of the companies in which we invest or the joint venture we establish. The diversion of our management's attention away from our business and any difficulties encountered in managing our interests in the respective investees or joint ventures could have an adverse effect on our ability to manage our business. Any material disputes with our investment or joint venture partners and existing shareholders may also require us to allocate significant corporate and other resources. Red 5 is currently in dispute with Qihoo 360 and its affiliates regarding System Link and Firefall. If our relationship with Qihoo 360 continues to deteriorate and if we fail to identify an alternative partner with similar resources, we may no longer be able to continue to carry out the business conducted through System Link, including the operation of CrossFire 2, and our operating results, business prospect and reputation may be materially and adversely affected. In addition, we may not recover our equity investments if the companies in which we invest do not perform well and equity investments could result in the incurrence of impairment losses, which could materially and adversely affect our results of operations.

***Undetected programming errors or flaws in our games could harm our reputation or decrease market acceptance of our games, which would materially and adversely affect our results of operations.***

Our games may contain errors or flaws, which may only be discovered after their release, particularly as we launch new games or introduce new features to existing games under tight time constraints. If our games contain programming errors or other flaws, our customers may be less inclined to continue playing our games or to recommend our games to other potential customers, and may switch to our competitors' games. Undetected programming errors and game defects can disrupt our operations, adversely affect the gaming experience of our users, harm our reputation, cause our customers to stop playing our games, divert our resources and delay market acceptance of our games, any of which could materially and adversely affect our results of operations.

***We may not be able to prevent others from infringing upon our intellectual property rights, which may harm our business and expose us to litigation.***

We regard our proprietary software, domain names, trade names, trademarks and similar intellectual properties as critical to our business. Intellectual property rights and confidentiality protection in China may not be as effective as in the United States or other countries. Monitoring and preventing the unauthorized use of proprietary technology is difficult and expensive. The steps we have taken may be inadequate to prevent the misappropriation of our proprietary technology. Any misappropriation could have a negative effect on our business and operating results. We may need to resort to court proceedings to enforce our intellectual property rights in the future. Litigation relating to our intellectual property might result in substantial costs and diversion of resources and management attention away from our business. See “—Risks Related to Doing Business in China— Uncertainties with respect to the PRC legal system could adversely affect us.”

***Any delay or failure by the online game platforms or distributors to successfully market or sell our products and services could adversely affect our business and results of operations.***

We primarily rely on game platforms and distributors to distribute, promote, market and sell our games in China and overseas markets, such as North America and Southeast Asia. End users can purchase our virtual currencies and prepaid cards through such game platforms and distributors. A substantial portion of our sales are carried out via such game platforms and distributors. We do not have long-term agreements with any online game platforms or distributors. A delay or failure by the online game platforms or distributors to successfully market or sell our prepaid cards or products may adversely affect our business and results of operations. We cannot assure you that we will continue to maintain favorable relationships with the online game platforms and distributors, and any failure to do so could materially and adversely affect our business and results of operations could be materially and adversely affected.

***We rely on services and licenses from third parties to carry out our businesses, and if there is any negative development in these services or licenses, our end users may cease to use our products and services.***

We rely on third parties for certain services and licenses for our business, including game platforms and distributors for the distribution our games, and other services and licenses for our operations. For example, we rely on third-party licenses for some of the software underlying our technology platform, and on China Telecom's Internet data centers for hosting our servers. See “Item 4. Information on the Company—B. Business Overview—Pricing, Distribution and Marketing.”

Any interruption or any other negative development in our ability to rely on these services and licenses, such as material deterioration of quality of the third-party services or the loss of intellectual property relating to licenses held by our licensors, could have a material and adverse impact on our business operations. In particular, our game licensors may be subject to intellectual property rights claims with respect to the games or software licensed to us. If such licensors cannot prevail on the legal proceedings brought against them, we could lose the right to use the licensed games or software. Furthermore, if our arrangements with any of these third parties are terminated or modified against our interest, we may not be able to find alternative solutions on a timely basis or on terms favorable to us. If any of these events occur, our end users may cease using our products and services, and our business, financial condition and results of operations may be materially and adversely affected.

***Unexpected network interruptions caused by system failures or other internal or external factors may lead to user attrition, revenue reductions and may harm our reputation.***

Any failure to maintain satisfactory performances, reliability, security and availability of our network infrastructure may cause significant harm to our reputation and our ability to attract and maintain users. The system hardware for our operations is located in several cities in China. We maintain our backup system hardware and operate our back-end infrastructure in Shanghai and Wuxi. Server interruptions, breakdowns or system failures in the cities where we maintain our servers and system hardware, including failures that may be attributable to sustained power shutdowns, or other events within or outside our control that could result in a sustained shutdown of all or a material portion of our services, could adversely impact our ability to service our users.

Our network systems are also vulnerable to damage from computer viruses, fire, flood, earthquake, power loss, telecommunications failures, computer hacking and similar events. We maintain property insurance policies covering our servers, but do not have business interruption insurance.

***Our business may be harmed if our technology becomes obsolete or if our system infrastructure fails to operate effectively.***

The online game industry is subject to rapid technological change. We need to anticipate the emergence of new technologies and games, assess their acceptance and make appropriate investments. If we are unable to do so, new technologies in online game programming or operations could render our games obsolete or unattractive. In addition, our business may be harmed if we are unable to upgrade our systems fast enough to accommodate fluctuations in future traffic levels, avoid obsolescence or successfully integrate any newly developed or acquired technology with our existing systems. Capacity constraints could cause unanticipated system disruptions and slower response times, affecting data transmission and game play. These factors could, among other things, cause us to lose existing or potential customers and existing or potential game development partners.

***We have been and may be subject to future intellectual property rights claims or other claims, which could result in substantial costs and diversion of our financial and management resources away from our business.***

There is no assurance that our online games, including our mobile games, or other content posted on our websites, whether proprietary or licensed from third parties, do not 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. For example, in May 2012, the People's Supreme Court of China affirmed a judgment against us and other defendants in a lawsuit filed by Beijing Founder Electronics Co., Ltd., which ruled that WoW client installation packages sold by us in 2007 contained fonts that infringed Beijing Founder Electronics Co., Ltd.'s intellectual property rights. Based on the People's Supreme Court's judgment, we were required to compensate Beijing Founder Electronics Co., Ltd. an aggregate amount of RMB2.2 million, which we have fully settled. In June 2013, Beijing No.1 People's Intermediate Court issued a judgment against us in a lawsuit filed by Diego Maradona, a former Argentina soccer player, which ruled that we infringed Maradona's personal right by using his name and photos on our game "Winning Goal," a web and social game we previously operated, without proper authorization. We were required to compensate Maradona an aggregate amount of RMB3.0 million and any accrued interests thereof for late payment. In February 2015, we agreed with the plaintiff to settle the claim with RMB3.3 million, which we have fully paid. See "Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings."

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 product development and technical support teams. To the extent these employees have been involved in research at our company similar to research in which they had been involved at their former employers, we may become subject to claims that such employees have used or disclosed trade secrets or other proprietary information of their former employers. In addition, our competitors may file lawsuits against us in order to gain an unfair competitive advantage over us.



If any such claim arises in the future, litigation or other dispute resolution proceedings may be necessary to retain our ability to offer our current and future games, which could result in substantial costs and diversion of our financial and management resources. Furthermore, if we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, incur additional costs to license or develop alternative games and be forced to pay fines and damages, each of which may materially and adversely affect our business and results of operations.

***Our operating results may fluctuate due to various factors, and therefore may not be indicative of our future results.***

Our operating results have experienced fluctuations from time to time and will likely continue to fluctuate in the future. These fluctuations in operating results depend on a variety of factors, including the timing of new game launches, the expiration of existing game licenses, and acquisition or disposal of subsidiaries. Other factors include the demand for our products and the products of our competitors, the level of usage of illegal game servers, the level of usage of the Internet, the size and rate of growth of the online game market and development and promotional expenses related to the introduction of new products. In addition, because our game software is susceptible to unauthorized character enhancements, we may periodically delete characters that are enhanced with unauthorized modifications. This has caused some affected customers to stop playing the respective game, which, in the aggregate, may cause our operating results to fluctuate.

To a significant degree, our operating expenses are based on planned expenditures and our expectations regarding prospective customer usage. Failure to meet our expectations could disproportionately and adversely affect our operating results in any given period. As a result, our historical operating results may not necessarily be indicative of our future results.

***Our business depends substantially on the continuing efforts of our senior executives, and our business may be severely disrupted if we lose their services.***

Our business and prospect depend heavily upon the continued services of our senior executives. We rely on their expertise in business operations, technology support and sales and marketing and on their relationships with our shareholders and distributors. We do not maintain key-man life insurance for any of our key executives. If one or more of our key executives are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all. As a result, our business may be severely disrupted, our financial condition and results of operations may be materially and adversely affected, and we may incur additional expense to recruit and train personnel.

Each of our executive officers has entered into an employment agreement with us, which contains confidentiality and non-competition provisions. If any disputes arise between our executive officers and us, we cannot assure you the extent to which any of these agreements could be enforced in China, where these executive officers reside and hold most of their assets, in light of uncertainties with the PRC legal system. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Uncertainties with respect to the PRC legal system could adversely affect us.”

***If we are unable to attract, train and retain key individuals and highly skilled employees, our business may be adversely affected.***

Our business relies on our ability to hire and retain additional qualified employees, including skilled and experienced online game developers. 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 game developers or other key personnel that we will need to achieve our business objectives.

***PRC laws and regulations restrict foreign ownership of Internet content provision, Internet culture operation and Internet publishing licenses, and substantial uncertainties exist with respect to the application and implementation of PRC laws and regulations.***

We are a Cayman Islands company and, as such, we are classified as a foreign enterprise under PRC laws. Various regulations in China currently restrict foreign or foreign-owned entities from holding certain licenses required in China to provide online game operation services over the Internet, including Internet content provision, or ICP, Internet culture operation and Internet publishing licenses. In light of such restrictions, we primarily rely on Shanghai IT, one of our affiliated PRC entities, to hold and maintain the licenses necessary for the operation of our online games in China.

In July 2006, the Ministry of Information Industry (which has subsequently been reorganized as the Ministry of Industry and Information Technology), or MIIT, issued a notice entitled “Notice on Strengthening Management of Foreign Investment in Operating Value-Added Telecommunication Services,” or the MII Notice, which prohibits ICP license holders from leasing, transferring or selling a telecommunications business operating license to foreign investors in any form, or providing resources, sites or facilities to any foreign investors for their illegal operation of a telecommunications business in China. The notice also requires that ICP license holders and their shareholders directly own the domain names and trademarks used by such ICP license holders in their daily operations. The notice further requires each ICP 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 telecommunication service providers are required to maintain network and information security in accordance with the standards set forth under relevant PRC regulations. The local authorities in charge of telecommunications services are required to ensure that existing ICP license holders conduct a self-assessment of their compliance with the MII Notice and submit status reports to MIIT before November 1, 2006. Since the MII Notice was issued, we have transferred to Shanghai IT all of the domain names used in our daily operations and certain trademarks used in our daily operations, as required under the MII Notice. All relevant transfers have been completed and relevant approvals have been obtained.

In September 2009, the General Administration of Press and Publication, Radio, Film and Television, or GAPP (formerly known as the General Administration of Press and Publication, or GAPP), promulgated the Circular Regarding the Implementation of the Department Reorganization Regulation by State Council and Relevant Interpretation by State Commission Office for Public Sector Reform to Further Strengthen the Administration of Pre-approval on Online Games and Approval on Import Online Games, or the GAPP Circular, which provides that foreign investors shall not control or participate in PRC online game operation businesses indirectly or in a disguised manner by establishing joint venture companies or entering into relevant agreements with, or by providing technical supports to, such PRC online game operation companies, or by inputting the users’ registration, account management or game card consumption directly into the interconnected gaming platform or fighting platform controlled or owned by the foreign investor. In addition, on February 4, 2016, the GAPP and the MIIT jointly issued the Administrative Measures on Network Publication, or the Network Publication Measures, which took effect in March 2016. Pursuant to the Network Publication Measures, wholly foreign-owned enterprises, Sino-foreign equity joint ventures and Sino-foreign cooperative enterprises shall not engage in the provision of web publishing services, including online game services. Project cooperation involving internet publishing services between an internet publishing service provider and a wholly foreign-owned enterprise, Sino-foreign equity joint venture, or Sino-foreign cooperative enterprise within China or an overseas organization or individual shall be subject to prior examination and approval by the GAPP. It is unclear whether the authorities will deem our VIE structure as a kind of such “matters of cooperation” by foreign investors to gain control over or participate in domestic online game operators, and it is not clear whether GAPP and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China.

Subject to the interpretation and implementation of the GAPP Circular and the Network Publication Measures, the ownership structure and the business operation models of our PRC subsidiaries and affiliated PRC entities comply with all applicable PRC laws, rules and regulations, and no consent, approval or license is required under any of the existing laws and regulations of China for their ownership structure and business operation models except for those which we have already obtained or which would not have a material adverse effect on our business or operations as a whole. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, we cannot assure you that PRC government authorities will ultimately take a view that is consistent with the opinion of our PRC legal counsel.

For example, the Ministry of Commerce, or MOFCOM, promulgated the Rules of Ministry of Commerce on Implementation of Security Review System of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors in August 2011, or the MOFCOM Security Review Rules, to implement the Notice of the General Office of the State Council on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors promulgated on February 3, 2011, or Circular No. 6. The MOFCOM Security Review Rules came into effect on September 1, 2011 and replaced the Interim Provisions of the Ministry of Commerce on Matters Relating to the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors promulgated by MOFCOM in March 2011. According to these circulars and rules, a security review is required for mergers and acquisitions by foreign investors having “national defense and security” concerns and mergers and acquisitions by which foreign investors may acquire the “de facto control” of domestic enterprises having “national security” concerns. In addition, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to the security review, MOFCOM will look into the substance and actual impact of the transaction. The MOFCOM Security Review Rules further prohibit foreign investors from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. There is no explicit provision or official interpretation stating that our online game operation services falls into the scope subject to the security review, and there is no requirement for foreign investors in those merger and acquisition transactions already completed prior to the promulgation of Circular No. 6 to submit such transactions to MOFCOM for security review. As we have already obtained the “de facto control” over our affiliated PRC entities prior to the effectiveness of these circulars and rules, we do not believe we are required to submit our existing contractual arrangement to MOFCOM for security review. However, we are advised by our PRC legal counsel that, as there is a lack of clear statutory interpretation on the implementation of these circulars and rules, there is no assurance that MOFCOM will have the same view as we do when applying these national security review-related circulars and rules.

We have been further advised by our PRC counsel that if we, any of our PRC subsidiaries or affiliated PRC entities are found to be in violation of any existing or future PRC laws or regulations, including the MII Notice, the GAPP Circular and the Network Publication Measures, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities, would have broad discretion in dealing with such violations, including:

- revoking the business and operating licenses of Shanghai IT;
- confiscating our income or the income of Shanghai IT;
- discontinuing or restricting the operations of any related-party transactions among us and Shanghai IT;
- limiting our business expansion in China by way of entering into contractual arrangements;
- imposing fines or other requirements with which we may not be able to comply;
- requiring Shanghai IT or us to restructure our corporate structure or operations; or
- requiring Shanghai IT or us to discontinue any portion or all of our operations related to online games.

The imposition of any of these penalties could result in a material and adverse effect on our ability to conduct our business and on our results of operations. If any of these penalties results in our inability to direct the activities of Shanghai IT that most significantly impact its economic performance, and/or our failure to receive the economic benefits from Shanghai IT, we may not be able to consolidate Shanghai IT in our consolidated financial statements in accordance with U.S. GAAP.

***We rely on contractual arrangements for our operations and operating licenses in China, which may not be as effective in providing operational control as direct ownership.***

Because the PRC government restricts our ownership of ICP, Internet culture operation and Internet publishing businesses in China, we primarily depend on Shanghai IT, in which we have no ownership interest, to operate our online game business and other ICP related businesses, and hold and maintain the requisite licenses. We have relied and expect to continue to rely on contractual arrangements to obtain effective control over Shanghai IT. Such contractual arrangements may not be as effective as direct ownership in providing us with control over the Shanghai IT. From the legal perspective, if Shanghai IT fails to perform its obligations under the contractual arrangements, we may have to incur substantial costs and spend other resources to enforce such arrangements, and rely on legal remedies under PRC law, including seeking specific performance or injunctive relief and claiming damages. For example, if the shareholders of Shanghai IT were to refuse to transfer their equity interests in Shanghai IT to us or our designee when we exercise the call option pursuant to the Call Option Agreement, or if such shareholders otherwise act in bad faith toward us, we may have to take legal action to compel it to fulfill their contractual obligations, which could be time consuming and costly.

These contractual arrangements are governed by PRC law and provide for the resolution of disputes through arbitration in the PRC. The legal environment in the PRC is not as developed as in some other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. In particular, a recently released draft version of the PRC Foreign Investment Law from the MOFCOM may have a substantial impact on our corporate structure as well as our business operations. See “—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.” We have historically derived significant revenues from Shanghai IT. For the years ended December 31, 2014, 2015 and 2016, Shanghai IT contributed 66.4%, 74.1% and 60.4%, respectively, of our total revenues. In the event we are unable to enforce the contractual arrangements, we may not be able to have the power to direct the activities that most significantly affect the economic performance of Shanghai IT, and our ability to conduct our business may be negatively affected, and we may not be able to consolidate the financial results of Shanghai IT into our consolidated financial statements in accordance with U.S. GAAP.

We believe that our option to purchase all or part of the equity interests in Shanghai IT, when and to the extent permitted by PRC law, or request any existing shareholder of Shanghai IT to transfer all or part of the equity interest in Shanghai IT to another PRC person or entity designated by us at any time in our discretion, and the rights under the Shareholder Voting Proxy Agreement that the shareholders of Shanghai IT have granted to us, effectively enable us to have the ability to cause the related contractual arrangements to be renewed when needed. However, if we are not able to effectively enforce these agreements or otherwise renew the relevant agreements when they expire, our ability to receive the economic benefits of Shanghai IT may be adversely affected.

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

Pursuant to the Equity Pledge Agreements with the shareholders of Shanghai IT, such shareholders agreed to pledge their equity interests in Shanghai IT to secure their performance under the relevant contractual arrangements. The equity pledges of Shanghai IT under these Equity Pledge Agreements have been registered with the relevant local 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 IT or its 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 pledgors to sell the equity interests of Shanghai IT in an auction or private sale and remit the proceeds to our wholly-owned subsidiaries 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 IT. 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 The9 Computer, our PRC wholly-owned subsidiary and a party to the Call Option Agreement, to replace or designate another PRC person or entity to replace the existing shareholders of Shanghai IT 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 Pledge Agreements, the amount of registered equity interests in Shanghai IT pledged to us was stated as RMB23.0 million, which represent 100% of the registered capital of Shanghai IT. The Equity Pledge Agreements with the shareholders of Shanghai IT 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 and the scope of pledge shall not be limited by the amount of the registered capital of Shanghai IT. However, it is possible that a PRC court may take the position that the amount listed on the equity pledge registration forms represents the full amount of the collateral that has been registered and perfected. If this is the case, the obligations that are supposed to be secured under the Equity Pledge Agreements in excess of the amount listed on the equity pledge registration forms could be determined by the PRC court as unsecured debt, which takes last priority among creditors and often does not have to be paid back at all. We do not have agreements that pledge the assets of Shanghai IT for the benefit of us.

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

We could face material and adverse tax consequences if the PRC tax authorities determine that our contractual arrangements with Shanghai IT and our other affiliated entities were not made on reasonable or arm's length commercial terms or otherwise. If this were to occur, they may adjust our income and expenses for PRC tax purposes in the form of a transfer pricing adjustment. A transfer pricing adjustment could result in a reduction, for PRC tax purposes, of costs and expenses recorded by our affiliated entities, which could adversely affect us by: (i) increasing the tax liability of our affiliated entities without reducing our other PRC subsidiaries' tax liability, which could further result in late payment fees and other penalties to our affiliated entities for underpaid taxes; or (ii) limiting the abilities of our affiliated entities to maintain preferential tax treatments and other financial incentives.

***We may not be able to get approval for renewing our current foreign games, or for licensing new foreign games, if the PRC regulatory authorities promote a policy of domestic online or mobile game development and tighten approval criteria for online or mobile game imports.***

We license and operate foreign games and may continue to do so in the near future. In the past, such foreign games mainly included MMORPGs or casual games. With mobile social gaming being one of our new businesses, we also license foreign mobile games. Since 2004, relevant government authorities have promulgated several circulars, according to which the development of domestically developed online games, including mobile games, will be strategically supported by the PRC government. For example, in July 2005, MIIT and the Ministry of Culture issued the Opinion on Development and Management of Online Games, or the Opinion. The Opinion provided that domestic software development companies, network service providers and content providers will be encouraged, guided and supported to develop and promote self-developed and self-owned online games so that such games can take up a leading position in the domestic market and expand into the international market.

The government will also encourage the development of derivative products to domestic online games. In support of this policy, GAPPRFT may tighten approval criteria for online game imports in an effort to protect the development of domestic online game enterprises, as well as to limit the influence of foreign culture on Chinese youth. If GAPPRFT implements such rules and policies, we may not be able to get approval for renewing our current foreign game licenses or for licensing new foreign games, and our business, financial condition and results of operations may be materially and adversely affected.

***Failure to obtain or renew approvals or filings for online games and mobile games we operate may adversely affect our operations or subject us to penalties.***

The Ministry of Culture has promulgated laws and regulations that require, among other things, (i) the review and prior approval of all new online games licensed from foreign game developers and related license agreements, (ii) the review of patches and updates with substantial changes of games which have already been approved, and (iii) the filing of domestically developed online games. Furthermore, online games, regardless of whether imported or domestic, will be subject to content review and approval by GAPPRFT prior to the commencement of games operations in China. Failure to obtain or renew approvals or complete filings for online games, including mobile games, may materially delay or otherwise affect a game operator's plan to launch new games, and the operator may be subject to fines, the restriction or suspension of operations of the related games or revocation of licenses in the event that the relevant governmental authority believes that the violation is severe.

We have obtained all the necessary approvals from, and have completed the necessary filings with, the Ministry of Culture and GAPP for operations of applicable games. Consistent with the general practice of the mobile and TV game industry in China, we have not yet completed filings with the Ministry of Culture and GAPP for our mobile and TV games before we commenced our operations. From time to time, we also rely on certain third-party licensors of domestically developed online games to obtain approvals and complete filings with the PRC regulatory authorities. If we or any such third party licensors fail to obtain the required approvals or complete the filings, we may not be able to continue the operation of such games. If any such negative event occurs, our business, financial condition and results of operations may be materially and adversely affected.

***The principal shareholders of our affiliated PRC entities have potential conflicts of interest with us, which may adversely affect our business.***

Zhimin Lin and Wei Ji, two of our employees, are the principal shareholders of Shanghai IT, one of our affiliated entities. Thus, there may be conflicts of interest between their respective duties to our company as employees and their respective shareholder interests in these affiliated PRC entities. We cannot assure you that when conflicts of interest arise, these persons will act in our best interests or that conflicts of interests will be resolved in our favor. These persons could violate their legal duties, including duties under their non-competition or employment agreements with us, by engaging in activities that are not in the best interest in our company, such as diverting business opportunities from us. In any such event, we would have to rely on the PRC legal system to enforce these agreements. Any legal proceeding could result in the disruption of our business, diversion of our resources and the incurrence of substantial costs. See “—Risks Related to Doing Business in China—Uncertainties with respect to the PRC legal system could adversely affect us.”

***Our subsidiaries in China are subject to restrictions on paying dividends or making other payments.***

From time to time, we may rely on dividends paid by our subsidiaries in China to fund our operations, such as paying dividends to our shareholders or meeting obligations under any indebtedness incurred by us or our overseas subsidiaries. Current PRC regulations restrict our subsidiaries in China from paying dividends in the following two principal aspects: (i) our subsidiaries in China are only permitted to pay dividends out of their respective after-tax profits, if any, determined in accordance with PRC accounting standards and regulations, and (ii) these entities are required to allocate at least 10% of their respective after-tax profits each year, if any, to fund statutory reserve funds until the cumulative total of the allocated reserves reaches 50% of registered capital, and a portion of their respective after-tax profits to their staff welfare and bonus reserve funds as determined by their respective boards of directors or shareholders. These reserves are not distributable as dividends. See “Item 4. Information on the Company—B. Business Overview—Government Regulations.” Further, if these entities incur debt on their behalf in the future, the instruments governing such debt may restrict their ability to pay dividends or make other payments. Our inability to receive dividends or other payments from our PRC subsidiaries may adversely affect our ability to continue to grow our business and make cash or other distributions to the holders of our ordinary shares and ADSs. In addition, failure to comply with relevant State Administration of Foreign Exchange, or SAFE, regulations may restrict the ability of our subsidiaries to make dividend payments to us. See “—Risks Related to Doing Business in China—PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident shareholders or us to penalties and fines, and limit our ability to inject capital into our PRC subsidiaries, limit our subsidiaries’ ability to increase their registered capital, distribute profits to us, or otherwise adversely affect us.”

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

Currently, a portion of our online game operation revenues are generated from sales through third-party online payment platforms. In such transactions, secured transmission of confidential information, such as customers’ credit card numbers and expiration dates, personal information and billing addresses, over public networks, in some cases including our website, is essential to maintain consumer confidence. While we have not experienced any material breach of our security measures to date, we cannot assure you that our current security measures are adequate. We do not have control over the security measures of our third-party online payment vendors and we cannot assure you that these vendors’ security measures are adequate or will be adequate with the expected increased usage of online payment systems. Security breaches of the online payment systems that we use could expose us to litigation and possible liability for failing to secure confidential customer information and could harm our reputation, ability to attract customers and ability to encourage customers to purchase in-game items.

***Existing major shareholders have substantial control over us and could delay or prevent a change in corporate control.***

Incsight Limited, or Incsight, a company wholly-owned by Jun Zhu, our chairman and chief executive officer, and Bosma Limited, or Bosma, the two largest shareholders of our company, collectively own a significant percentage of our outstanding ordinary shares. Incsight and Bosma have entered into a voting agreement to vote together with respect to the election of our directors. See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Voting Agreement.” As a result, these shareholders will continue to exert significant control over all matters requiring shareholder approval, including but not limited to, the election of directors and approval of significant corporate transactions. This voting power could delay or prevent an acquisition of our company on terms that other shareholders may desire. In addition, the rights of minority shareholders and the fiduciary duties of directors in the Cayman Islands may not be as extensive as those in the United States or elsewhere, and the ability to assert shareholder rights may be comparatively limited.

***The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to decrease.***

Our subsidiaries and affiliated entities in the PRC are subject to enterprise income tax, or EIT, on the taxable income as reported in their respective statutory financial statements adjusted in accordance with the Enterprise Income Tax Law of the People’s Republic of China, or EIT Law, which was approved by the National People’s Congress on March 16, 2007. The EIT Law went into effect as of January 1, 2008, which unified the tax rate generally applicable to both domestic and foreign-invested enterprises in the PRC. Our subsidiaries and affiliated entities in the PRC are generally subject to EIT at a statutory rate of 25%. Shanghai IT, our affiliated entity which holds a High and New Technology Enterprise, or HNTE, qualification is entitled to enjoy a 15% preferential EIT rate. However, we cannot assure you that Shanghai IT will meet these criteria and continue to be qualified as an HNTE if we apply to the tax authorities in the future.

Moreover, unlike the tax regulations effective before 2008, which specifically exempted withholding taxes on dividends payable to non-PRC investors from foreign-invested enterprises in the PRC, the EIT Law and its implementation rules provide that a withholding income tax rate of 10% will be applicable to dividends payable by Chinese companies to non-PRC-resident enterprises unless otherwise exempted or reduced according to treaties or arrangements between the PRC central government and the governments of other countries or regions. While the Tax Agreement between the PRC and Hong Kong provides dividends paid by a foreign-invested enterprise in the PRC to its corporate shareholder, which is considered a Hong Kong tax resident, will be subject to withholding tax at the rate of 5% of total dividends, this is limited to instances where the corporate shareholder directly holds at least 25% of the shares of the company that is to pay dividends for at least twelve consecutive months immediately prior to receiving the dividends and meets certain other criteria prescribed by the relevant regulations. Entitlement to a lower tax rate on dividends according to tax treaties or arrangements between the PRC central government and governments of other countries or regions is further subject to approval of the relevant tax authority.

Furthermore, the State Administration of Taxation, or SAT, promulgated the Notice on How to Understand and Determine the Beneficial Owners in Tax Agreement in October 2009, or Circular 601, which provides guidance for determining whether a resident of a contracting state is the “beneficial owner” of an item of income under China’s tax treaties and tax arrangements. According to Circular 601, a beneficial owner generally must be engaged in substantive business activities. An agent or conduit company will not be regarded as a beneficial owner and, therefore, will not be qualified for treaty benefits. A conduit company normally refers to a company that is set up for the purpose of avoiding or reducing taxes or transferring or accumulating profits. In June 2012, SAT further promulgated the Announcement on Determining the Beneficial Owners in Tax Agreement, or Circular 30, which provides that the tax authorities shall make the decision based on a comprehensive consideration of all determining factors provided in Circular 601 rather than the status of a single determining factor. We cannot assure you that any dividends to be distributed by our subsidiaries to us or by us to our non-PRC shareholders and ADS holders, whose jurisdiction of incorporation has a tax treaty with China providing a different withholding arrangement, will be entitled to the benefits under the relevant withholding arrangement.

In addition, the EIT Law deems an enterprise established offshore but having its management organ in the PRC as a “resident enterprise” that will be subject to PRC tax at the rate of 25% of its global income. Under the Implementation Rules of the EIT Law, the term “management organ” is defined as “an organ which has substantial and overall management and control over the manufacturing and business operation, personnel, accounting, properties and other factors.” On April 22, 2009, the SAT further issued a notice regarding recognizing an offshore-established enterprise controlled by PRC shareholders as a resident enterprise according to its management organ, or Circular 82. According to Circular 82, a foreign enterprise controlled by a PRC company or a PRC company group shall be deemed a PRC resident enterprise, if (i) the senior management and the core management departments in charge of its daily operations are mainly located and function in the PRC; (ii) its financial decisions and human resource decisions are subject to the determination or approval of persons or institutions located in the PRC; (iii) its major assets, accounting books, company seals, minutes and files of board meetings and shareholders’ meetings are located or kept in the PRC; and (iv) more than half of the directors or senior management with voting rights reside in the PRC. On July 27, 2011, SAT issued the Administrative Measures of Enterprise Income Tax of Chinese-Controlled Offshore Incorporated Resident Enterprises (Trial), or SAT Bulletin 45, which was amended in April 2015 and June 2016. SAT Bulletin 45 further clarified the detailed procedures for determining resident status under Circular 82, competent tax authorities in charge and post-determination administration of such resident enterprises. Although our offshore companies are not controlled by any PRC company or PRC company group, we cannot assure you that we will not be deemed to be a “resident enterprise” under the EIT Law and thus be subject to PRC EIT on our global income.

According to the EIT Law and its implementation rules, dividends are exempted from income tax if such dividends are received by a resident enterprise on equity interests it directly owns in another resident enterprise. However, foreign corporate holders of our shares or ADSs may be subject to taxation at a rate of 10% on any dividends received from us or any gains realized from the transfer of our shares or ADSs if we are deemed to be a resident enterprise or if such income is otherwise regarded as income from “sources within the PRC.” The EIT Law empowers the PRC State Council to enact appropriate implementing rules and measures and there is no guarantee that we or our subsidiaries will be entitled to any of the preferential tax treatments. Nor can we assure you that the tax authorities will not, in the future, discontinue any of our preferential tax treatments, potentially with retroactive effect. Any significant increase in the EIT rate under the EIT Law applicable to our PRC subsidiaries and affiliated entities, or the imposition of withholding taxes on dividends payable by our subsidiaries to us, or an EIT levy on us or any of our subsidiaries or affiliated entities registered outside the PRC, or dividends or capital gains received by our shareholders due to shares or ADSs held in us will have a material adverse impact on our results of operations and financial conditions and the value of investments in us.

***We are required to pay value added tax as a result of tax reforms in various regions in China and we may be subject to similar tax treatments elsewhere in China.***

On November 16, 2011, the Ministry of Finance and the SAT jointly issued the Circular on the Pilot Program for the Collection of Value Added Tax Instead of Business Tax, or Circular 110, and the Circular on the Pilot Program for the Collection of Value Added Tax Instead of Business Tax in the Transportation and Certain Modern Service Sectors in Shanghai, or Circular 111, which became effective on January 1, 2012. Pursuant to Circular 110 and Circular 111, a tax reform pilot program came into effect in Shanghai, which was chosen by the PRC government as the first pilot city for such reform. Starting from January 1, 2012, companies which are designated by Shanghai local tax authorities as operating in certain modern service sectors are required to pay value added tax, or VAT, in lieu of business tax. On July 31, 2012, the Ministry of Finance and the SAT jointly issued the Circular on the Pilot Program for the Collection of Value Added Tax Instead of Business Tax in the Transportation and Certain Modern Service Sectors in Eight Cities and Provinces such as Beijing, or Circular 71, which further extended areas subject to the pilot program to cover eight more provinces. On December 12, 2013, the Ministry of Finance and the SAT jointly issued the Interim Implementation Rules on the Pilot Program for the Collection of Value Added Tax Instead of Business Tax and a series of other rules, which annulled the preceding trial rules and extended applicable areas of the pilot program to the whole country. As a result of such Implementation Rules, some of our services provided by Shanghai IT and The9 Computer are subject to VAT at the rate of 6%. Shanghai IT and The9 Computer, as General VAT Payers under the applicable tax regulations, may reduce their VAT payable amount by the VAT which they paid in connection with its purchasing activities, or its Input VAT. Certain services provided by Wuxi The9 Chuangyou Technology Co. Ltd. and our other PRC subsidiaries or affiliated PRC entities shall be subject to VAT at the rate of 3%, and these companies as Small-scale VAT Payers under the applicable tax regulations may not reduce their VAT payable by their Input VAT. There is significant uncertainty relating to the interpretation and enforcement of such circulars by the national and the local tax authorities and other relevant authorities. Beginning from August 1, 2013, the VAT reform was expanded to all regions in the PRC. As a result, we may be subject to more unfavorable tax treatment with respect to our business operations as a result of the VAT reform, and our business, financial condition and results of operations could be materially and adversely affected.



On March 23, 2016, the Ministry of Finance and the SAT jointly issued the Circular on the Pilot Program for Overall Implementation of the Collection of Value Added Tax Instead of Business Tax, or Circular 36, which took effect on May 1, 2016. Pursuant to Circular 36, all companies operating in construction, real estate, finance, modern service or other sectors which were required to pay business tax are required to pay VAT in lieu of business tax. As a result of Circular 36, the services provided by Shanghai IT, The9 Computer, C9I Shanghai, Shanghai Fire Wing and The9 Education as general VAT payers will be subject to VAT at the rate of 6%, and the services provided by our other PRC subsidiaries and affiliated PRC entities as small-scale VAT payers will be subject to VAT at the rate of 3%.

***Strengthened scrutiny over acquisition transactions by the PRC tax authorities may have a negative impact on our acquisition strategy.***

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

On February 3, 2015, the SAT issued the Notice on Several Issues regarding Enterprise Income Tax for Indirect Property Transfer by Non-resident Enterprises, or SAT Circular 7, which further specifies the criteria for judging reasonable commercial purpose, and the legal requirements for the voluntary reporting procedures and filing materials in the case of indirect property transfer. SAT Circular 7 has listed several factors to be taken into consideration by tax authorities in determining whether an indirect transfer has a reasonable commercial purpose. However, despite these factors, an indirect transfer satisfying all the following criteria shall be deemed to lack reasonable commercial purpose and be taxable under the PRC laws: (i) 75% or more of the equity value of the intermediary enterprise being transferred is derived directly or indirectly from the PRC taxable properties; (ii) at any time during the one year period before the indirect transfer, 90% or more of the asset value of the intermediary enterprise (excluding cash) is comprised directly or indirectly of investments in the PRC, or 90% or more of its income is derived directly or indirectly from the PRC; (iii) the functions performed and risks assumed by the intermediary enterprise and any of its subsidiaries that directly or indirectly hold the PRC taxable properties are limited and are insufficient to prove their economic substance; and (iv) the foreign tax payable on the gains derived from the indirect transfer of the PRC taxable properties is lower than the potential PRC tax on the direct transfer of such assets. Nevertheless, the indirect transfer falling into the scope of the safe harbor under SAT Circular 7 may not be subject to PRC tax and such safe harbor includes qualified group restructuring, public market trading and tax treaty exemptions. Under SAT Circular 7, the entities or individuals obligated to pay the transfer price to the transferor shall be the withholding agent and shall withhold the PRC tax from the transfer price. If the withholding agent fails to do so, the transferor shall report to and pay the PRC tax to the PRC tax authorities. In case neither the withholding agent nor the transferor complies with the obligations under SAT Circular 7, other than imposing penalties such as late payment interest on the transferors, the tax authority may also hold the withholding agent liable and impose a penalty of 50% to 300% of the unpaid tax on the withholding agent, provided that such penalty imposed on the withholding agent may be reduced or waived if the withholding agent has submitted the relevant materials in connection with the indirect transfer to the PRC tax authorities in accordance with SAT Circular 7.

Since we may pursue acquisition as one of our growth strategies, and have conducted and may conduct acquisitions involving complex corporate structures, the PRC tax authorities may, at their discretion, adjust the capital gains and impose tax return filing obligations on us or request us to submit additional documentation for their review in connection with any of our acquisitions, thus causing us to incur additional acquisition costs.

***We have adopted a shareholders rights plan, which, together with the other anti-takeover provisions of our articles of association, 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.***

On January 8, 2009, our board of directors adopted a shareholder rights plan. Under the rights plan, one right was distributed with respect to each of our ordinary shares outstanding at the close of business on January 22, 2009. In the event that, subject to limited exceptions, a person or group obtains beneficial ownership of 15% or more of our voting securities (including by acquisition of our ADSs representing ordinary shares), or enters into an acquisition transaction without the approval of our board of directors, such person or group will become the acquiring person under the plan. As a result, these rights will entitle the holders, other than the acquiring person, to purchase upon the exercise of such right the number of our ordinary shares having a market value of two times the then current purchase price associated with the right. For example, at a purchase price of US\$19.50 per right, each right not owned by an acquiring person would entitle its holder to purchase US\$39.00 worth of our ordinary shares for US\$19.50.

This rights plan and the other anti-takeover provisions of our amended and restated memorandum and articles of association 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. Our existing authorized ordinary shares confer on the holders of our ordinary shares equal rights, privileges and restrictions. The shareholders have, by virtue of adoption of our amended and restated memorandum and articles of association, authorized the issuance of shares of par value of US\$0.01 each without specifying any special rights, privileges and restrictions. Therefore, our board of directors may, without further action by our shareholders, issue ordinary shares, or issue shares of such class and attach to such shares special rights, privileges or restrictions, which may be different from those associated with our ordinary shares. Preferred shares could also 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 ordinary shares or 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 have limited business insurance coverage in China.***

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

***Some of our subsidiaries, affiliated entities and joint ventures in China engaged in certain business activities beyond the authorized scope of their respective licenses, and if they are subject to administrative penalties or fines, our operating results may be adversely affected.***

Some of our subsidiaries, affiliated entities and joint ventures in China engaged in business activities that were not within the authorized scope of their respective licenses in the past. The relevant PRC authorities may impose administrative fines or other penalties for the non-compliance with the authorized scope of the business licenses, which may in turn adversely affect our operating results.

***Failure to achieve and maintain effective internal controls could have a material adverse effect on our business, results of operations and the trading price of our ADSs.***

We are subject to reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, has adopted rules requiring public companies to include a report of management in its annual report that contains management's assessment of the effectiveness of such company's internal controls over financial reporting.

Our management has concluded that our internal controls over financial reporting were effective as of December 31, 2016. We however were not subject to the requirement to provide an attestation report on our management's assessment of our internal control over financial reporting as we were not an accelerated filer or a large accelerated filer (as defined in § 240.12b-2 under the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of December 31, 2016.

However, if we fail to maintain effective internal controls over financial reporting in the future, our management and, if applicable, our independent registered public accounting firm may not be able to conclude that we have effective internal controls over financial reporting at a reasonable assurance level. This could result in a loss of investor confidence in the reliability of our financial conditions which in turn could negatively impact the trading price of our ADSs and result in lawsuits being filed against us by our shareholders or otherwise harm our reputation. Furthermore, we have incurred and 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 and other requirements of the Sarbanes-Oxley Act.

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

As an auditor of companies that are traded publicly in the United States and as an audit firm registered with the Public Company Accounting Oversight Board, or PCAOB, our independent registered public accounting firm is required by the laws of the United States to undergo regular inspections by the PCAOB. As our auditor is located in the PRC, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the PRC authorities, our auditor, like other independent registered public accounting firms operating in the PRC, is not currently inspected by the PCAOB. On May 24, 2013, the PCAOB announced that it had entered into a memorandum of understanding on enforcement and cooperation with the CSRC and the PRC Ministry of Finance, or the MOF, which establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the United States and China. However, direct PCAOB inspections of independent registered accounting firms in China are still not permitted by Chinese authorities.

The lack of direct PCAOB inspections in China prevents the PCAOB from regularly evaluating audit documentation located in China and its related quality control procedures. As a result, our investors may be deprived of the benefits of the PCAOB's oversight of our auditors through such inspections. The inability of the PCAOB to conduct inspections of our auditors' work papers 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 consequently lose confidence in our reported financial information and procedures and the quality of our financial statements.

On December 3, 2012, the SEC issued an order instituting administrative proceedings against five of the largest global public accounting firms relating to work performed in the PRC and such firms' failure to provide audit work papers to the SEC in this regard. Our independent registered public accounting firm is not one of the accounting firms referenced in the order. On January 22, 2014, an initial administrative law decision was issued, censuring the five accounting firms and suspending four of the five firms from practicing before the SEC for a period of six months. On February 12, 2014, four of these PRC-based accounting firms appealed to the SEC against this decision. In February 2015, each of the four PRC-based accounting firms agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC. The settlement requires the firms to follow detailed procedures to seek to provide the SEC with access to Chinese firms' audit documents via the CSRC. If the firms do not follow these procedures, the SEC could impose penalties such as suspensions, or it could restart the administrative proceedings.

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

If our independent registered public accounting firm was denied, 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 to not be in compliance with the requirements of the Exchange Act. Such a determination could ultimately lead to the delisting of our ordinary shares from Nasdaq or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

***We face risks related to health epidemics and other natural disasters.***

Our business could be adversely affected by swine or avian influenza, severe acute respiratory syndrome, or SARS, or another epidemic or outbreak. Any prolonged recurrence of swine or avian influenza, SARS or other adverse public health developments in China may have a material adverse effect on our business operations. Our operations may be impacted by a number of health-related factors, including, among other things, quarantines or closures of our offices which could severely disrupt our operations, the sickness or death of our key officers and employees and closure of Internet cafés and other public areas where people access the Internet. Any of the foregoing events or other unforeseen consequences of public health problems could adversely affect our business and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of swine or avian influenza, SARS or any other epidemic. In addition, other major natural disasters may also adversely affect our business by, for example, causing disruptions of the Internet network or otherwise affecting access to our games, or resulting in damages to our facilities.

**Risks Related to Doing Business in China**

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

Currently, most of our recurring users are young males, including students. Due to the higher degree of user loyalty to MMORPGs, easy access to personal computers and Internet cafés, and lack of more appealing forms of entertainment in China, many teenagers frequently play online games. This may result in these teenagers spending less time on, or refraining from, other activities, including education and sports. Internet cafés, which are currently the most important outlets for online games, have been criticized by the general public in China as exerting a negative influence on young people. Due primarily to such adverse public reaction, some local governments in China have tightened their regulation of Internet café operations through, among other things, limiting the number of new operating licenses issued and further reducing the hours during which Internet cafés are permitted to be open for business. Also, local and higher-level governmental authorities may from time to time decide to more strictly enforce the customers' age limit and other requirements relating to Internet cafés as a result of the occurrence of, and the media attention on, gang fights, arson or other incidents in or related to Internet cafés. As a significant portion of our customers' access our games from Internet cafés, any restrictions placed on Internet café operations could result in a reduction of the amount of time our customers spend on our online games or a reduction or slowdown in the growth of our customer base, thus adversely affecting our business and results of operations.

In April 2007, various governmental authorities, including GAPP, MIIT, the Ministry of Education, the Ministry of Public Security, and other relevant authorities jointly issued a circular concerning the mandatory implementation of an “anti-fatigue system” in online games, which aims to protect the physical and psychological health of minors. This circular required all online games to incorporate an “anti-fatigue system” and an identity verification system, both of which have limited the amount of time that a minor or other user may continuously spend playing an online game. We have implemented such “anti-fatigue” and identification systems on all of our online games as required. Since March 2011, various governmental authorities, including MIIT, the Ministry of Education, the Ministry of Public Security, and other relevant authorities have jointly launched the “Online Game Parents Guardianship Project for Minors,” which allows parents to require online game operators to take relevant measures to limit the time spent by the minors playing online games and the minors’ access to their online game accounts. On February 5, 2013, the Ministry of Culture, MIIT, GAPP and various other governmental authorities, jointly issued the Working Plan on the Comprehensive Prevention Scheme on Online Game Addiction of Minors, which further strengthens the administration of Internet cafés, reinstates the importance of the “anti-fatigue system” and “Online Game Parents Guardianship Project for Minors” as prevention measures against the online game addiction of minors and orders all relevant governmental authorities to take all necessary actions in implementing such measures. In addition, on December 1, 2016, MOC issued the Circular on Regulating Online Game Operations and Strengthening Interim and Ex Post Regulation, or the MOC Online Games Regulation, which will become effective on May 1, 2017. Pursuant to the MOC Online Games Regulation, an enterprise engaged in online game operations shall strictly comply with the provisions of the “Online Game Parents Guardianship Project for Minors,” and online game operators are encouraged to set upper limits on the consumption by users who are minors, limit the amount of time that such users are allowed to spend on online games, and take technical measures to block scenes and functions, among other things, that are not suitable for users who are minors. Further strengthening of these systems, or enactment by the PRC government of any additional laws to further tighten its administration over the Internet and online games or its supervision of Internet cafés may result in less time spent by customers or fewer customers playing our online games, which may materially and adversely affect our business results and prospects for future growth.

***Adverse 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.***

We conduct substantially all of our business operations in China. As the gaming industry is highly sensitive to business and personal discretionary spending, it tends to decline during general economic downturns. Accordingly, our results of operations, financial condition and prospects are subject to a significant degree to economic, political and legal developments in China. China’s economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past twenty years, growth has slowed down since 2012 and has been uneven across different regions and among various economic sectors of China. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. While some of these measures benefit the overall PRC economy, they may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. As the PRC economy is increasingly intricately linked to the global economy, it is affected in various respects by downturns and recessions of major economies around the world. The various economic and policy measures the PRC government enacts to forestall economic downturns or shore up the PRC economy could affect our business.

Although the PRC government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in China are still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over China’s economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. These actions, as well as future actions and policies of the PRC government, could materially affect our liquidity and access to capital and our ability to operate our business.

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

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

We are required to obtain applicable permits or approvals from different regulatory authorities in order to provide online games to our customers. For example, an Internet content provider must obtain a value-added telecommunications business operating license for ICP, or ICP License, in order to engage in any commercial ICP operations within China. In addition, an online games operator must also obtain a license from the Ministry of Culture and a license from GAPPRFT in order to distribute games through the Internet. Furthermore, an online game operator is required to obtain approval from the Ministry of Culture in order to distribute virtual currencies for online games such as prepaid value cards, prepaid money or game points. If we fail to obtain or maintain any of the required filings, permits or approvals in the future, 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 financial condition and results of operations.

As the online games industry is at an early stage of development 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, and may address new issues that arise from time to time. As a result, substantial uncertainties exist regarding the interpretation and implementation of current and any future PRC laws and regulations applicable to the online gaming industry. We cannot assure you that we will be able to timely obtain any new license required in the future, or at all. While we believe that we are in compliance in all material respects with all applicable PRC laws and regulations currently in effect, we cannot assure you that we will not be found in violation of any current or future PRC laws and regulations.

***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.

The Ministry of Culture has promulgated laws and regulations that reiterate the government's policies to prohibit the distribution of games with violence, cruelty or other elements that are believed to have the potential effect of instigating crimes, and to prevent the influx of harmful cultural products from overseas.

The Ministry of Culture has promulgated laws and regulations that require, among other things, (i) the review and prior approval of all new online games licensed from foreign game developers and related license agreements, (ii) the review of patches and updates with substantial changes of games which have already been approved, and (iii) the filing of domestically developed online games. Furthermore, online games, regardless of whether imported or domestic, will be subject to content review and approval by GAPPRFT prior to the commencement of games operations in China. Failure to obtain or renew approvals or to complete filings for online games, including mobile games, may materially delay or otherwise affect game operator's plans to launch new games, and the operator may be subject to fines, restriction or suspension of operations of the related games or revocation of licenses in the event that the relevant governmental authority believes that the violation is severe. We obtained the necessary approvals from and completed necessary filings with the Ministry of Culture and GAPP for operations of our games as applicable. Consistent with the general practice of the mobile and TV game industry in China, we have not yet completed filings with the Ministry of Culture and GAPPRFT for our mobile and TV games before we commenced our operations. If any such negative event occurs, our business, financial condition and results of operations may be materially and adversely affected.

In addition, 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 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.

***Future movements in exchange rates between the U.S. dollar and the RMB may adversely affect the value of our ADSs.***

We are exposed to foreign exchange risk arising from various currency exposures. A portion of our financial assets, the Convertible Notes and our profit or loss in Red 5 are denominated in U.S. dollars while currently a significant portion of our revenues are denominated in RMB, the legal currency in China. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency risk. 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 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 the new policy, the RMB is permitted to fluctuate within a managed band based on market supply and demand and by reference to a basket of certain foreign currencies. Since the change in policy in July 2005, the RMB appreciated more than 20% against the U.S. dollar over the following three years. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the RMB and the U.S. dollar remained within a narrow band. In June 2010, the People's Bank of China announced that the PRC government would reform the RMB exchange rate regime and increase the flexibility of the exchange rate. Between June 30, 2010 and December 30, 2011, the value of the RMB appreciated approximately 7.2% against the U.S. dollar. On April 16, 2012, the People's Bank of China further enlarged the floating band of RMB's trading prices against the U.S. dollar in the inter-bank spot foreign exchange market from 0.5% to 1% around the middle rate released by the China Foreign Exchange Trade System each day. There remains significant international pressure on the PRC government to adopt a more lenient RMB policy, which could result in further appreciation of RMB against other major currencies. It is difficult to predict how long the current situation may last and when and how RMB exchange rates may change going forward. Renminbi was added to its group of global reserve currencies by The International Monetary Fund on November 30, 2015, which makes Renminbi to some extent more susceptible to market forces.

A significant portion of our revenues and costs are denominated in RMB, while a portion of our financial assets are denominated in U.S. dollars. We rely substantially on dividends and other fees paid to us by our subsidiaries and affiliated entities in China. Any significant appreciation of RMB against the U.S. dollar may 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. For example, an appreciation of the RMB against the U.S. dollar would make any new RMB denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into RMB for such purposes. An appreciation of RMB against the U.S. dollar would also result in foreign currency translation losses for financial reporting purposes when we translate our U.S. dollar denominated financial assets into RMB, as RMB is our reporting currency. Conversely, a significant depreciation of the RMB against the U.S. dollar may significantly reduce the U.S. dollar equivalent of our earnings, which in turn could adversely affect the price of our ADSs.

***Restrictions on currency exchange in China limit our ability to utilize our revenues effectively, make dividend payments and meet our foreign currency denominated obligations.***

Currently, a significant portion of our revenues are denominated in RMB. Restrictions on currency exchange in China limit our ability to utilize revenues generated in RMB to fund our business activities outside China, make dividend payments in U.S. dollars, or obtain and remit sufficient foreign currency to satisfy our foreign currency-denominated obligations, such as paying license fees and royalty payments. The principal regulation governing foreign currency exchange in China is the Foreign Exchange Administration Rules (1996), as amended. Under such rules, the RMB is generally freely convertible for trade and service-related foreign exchange transactions, but not for direct investment, loans or investment in securities outside China unless the prior approval of SAFE is obtained. Although the PRC government regulations now allow greater convertibility of RMB for current account transactions, significant restrictions still remain. For example, foreign exchange transactions under our PRC subsidiaries' capital account, including principal payments in respect of foreign currency-denominated obligations, remain subject to significant foreign exchange controls and the approval of SAFE. These limitations could affect our ability to obtain foreign exchange for capital expenditures. We cannot be certain that the PRC regulatory authorities will not impose more stringent restrictions on the convertibility of the RMB, especially with respect to foreign exchange transactions.

***PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident shareholders or us to penalties and fines, and limit our ability to inject capital into our PRC subsidiaries, limit our subsidiaries' ability to increase their registered capital, distribute profits to us, or otherwise adversely affect us.***

On July 4, 2014, SAFE issued the Circular on Several Issues Concerning Foreign Exchange Administration of Domestic Residents Engaging in Overseas Investment, Financing and Round-Trip Investment via Special Purpose Vehicles, or SAFE Circular 37. SAFE Circular 37 and its detailed guidelines require PRC residents to register with the local branch of SAFE before contributing their legally owned onshore or offshore assets or equity interest into any special purpose vehicle, or SPV, directly established, or indirectly controlled, by them for the purpose of investment or financing. SAFE Circular 37 further requires that when there is (a) any change to the basic information of the SPV, such as any change relating to its individual PRC resident shareholders, name or operation period or (b) any material change, such as increase or decrease in the share capital held by its individual PRC resident shareholders, a share transfer or exchange of the shares in the SPV, or a merger or split of the SPV, the PRC resident must register such changes with the local branch of SAFE on a timely basis.

We have requested all of our shareholders who, based on our knowledge, are PRC residents or whose ultimate beneficial owners are PRC residents to comply with all applicable SAFE registration requirements. However, we have no control over our shareholders. We cannot assure you that the PRC beneficial owners of our company and our subsidiaries have completed the required SAFE registrations or complied with other related requirements. Nor can we assure you that they will be in full compliance with the SAFE registration in the future. Any non-compliance by the PRC beneficial owners of our company and our subsidiaries may subject us or such PRC resident shareholders to fines and other penalties. It may also limit our ability to contribute additional capital to our PRC subsidiaries and our subsidiaries' ability to distribute profits or make other payments to us.

***Uncertainties with respect to the PRC legal system could adversely affect us.***

We conduct our business primarily through our subsidiaries and affiliated entities incorporated in China. These entities are generally subject to laws and regulations applicable to foreign investment in China and, in particular, laws applicable to wholly-foreign owned enterprises. Almost all of these agreements are governed by PRC law and disputes arising out of these agreements are expected to be decided by arbitration in China. The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. PRC legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China for the past decades. However, since the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involves uncertainties, which may limit legal protections available to us. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

***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. 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. However, 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 the ultimate controlling person(s) is/are of PRC nationality (either PRC citizen, or PRC government and its branches or agencies). 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. For example, our actual controlling person, Mr. Jun Zhu, is a citizen of Singapore, which could be one of the significant factors for purposes of determining whether we are ultimately controlled by persons that are of PRC nationality under the Draft FIL. 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, 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.

***We may not be able to pursue growth through strategic acquisitions in China due to complicated procedures under PRC laws and regulations for foreign investors to acquire PRC companies.***

In recent years, certain PRC laws and regulations have established procedures and requirements that are expected to make merger and acquisition activities in China by foreign investors more time-consuming and complex. These laws and regulations include, without limitation, the Rules on the Merger and Acquisition of Domestic Enterprises by Foreign Investors, or the M&A Rules, and the Anti-Monopoly Law and the MOFCOM Security Review Rules. In some instances, MOFCOM needs to be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise. The approval by MOFCOM may also need to be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies. PRC laws and regulations also require certain merger and acquisition transactions to be subject to merger control review or security review. The MOFCOM Security Review Rules, effective from September 1, 2011, provide that, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors shall be subject to the security review by MOFCOM, the principle of substance over form shall be applied. In particular, foreign investors are prohibited from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions.

If the business of any target company that we expect to acquire becomes subject to the security review, we may not be able to successfully complete the acquisition of such company, either by equity or asset acquisition, capital contribution or through any contractual arrangement. Complying with the requirements of the PRC laws and regulations to complete acquisition transactions could become more time-consuming and complex. Any required approval, such as approval by MOFCOM, may delay or inhibit our ability to complete such transactions, which could affect our ability to grow our business or increase our market share. Furthermore, it is uncertain whether the M&A Rules, security review rules or the other PRC regulations regarding the acquisitions of PRC companies by foreign investors will be amended when the Draft FIL becomes effective in the future.

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

Although the use of personal computers in China has increased in recent years, the penetration rate for personal computers in China is significantly lower than in the United States and other developed countries. Furthermore, despite a decrease in the cost of Internet access in China due to a decrease in the cost of personal computers and the introduction and expansion of broadband access, the cost of Internet access in China still remains relatively high compared to the average per capita income. The limited use of personal computers in China and the relatively high cost of Internet access may limit the growth of our business. In addition, there is no assurance that there will not be any increase in Internet access or telecommunication fees in China. If that happens, the number of our users may decrease and the growth of our user base may be materially impeded.

***The continued growth of China's Internet market depends on the establishment of adequate telecommunications infrastructure.***

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

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

***We currently fail to meet two of the continued listing requirements for the Nasdaq Global Market. If we fail to regain compliance with the listing requirement on a timely basis or fail to meet other listing requirements for the Nasdaq Global Market, our ADSs may be delisted from the Nasdaq Global Market or need to be transferred to other stock exchanges or trading venues, which may materially and adversely affect the market liquidity of our ADSs and our ability to obtain financing.***

Our ADSs are currently listed on the Nasdaq Global Market under the symbol "NCTY." We must continue to meet the relevant continued listing requirements in order to remain listed on the Nasdaq Global Market. The listing standards of the NASDAQ Global Market provide that a company, in order to qualify for continued listing, must maintain a minimum ADS price of US\$1.00 and satisfy standards relative to minimum shareholders' equity, minimum market value of publicly held shares (MVPHS), minimum market value of listed securities (MVLS) and various additional requirements. On January 20, 2017, we received a written notification from Nasdaq indicating that we no longer met the continued listing requirement of minimum MVLS for the Nasdaq Global Market because the market value of our total outstanding shares for the last 30 consecutive business days was below the minimum requirement of US\$50 million. On February 22, 2017, we received a second written notification from Nasdaq indicating that we no longer met the continued listing requirement of minimum MVPHS for the Nasdaq Global Market because our MVPHS for the last 30 consecutive business days was below the minimum requirement of US\$15 million. Pursuant to the relevant Nasdaq listing rules, we have a compliance period of 180 calendar days, or until July 19, 2017 and August 21, 2017, respectively, to regain compliance with the minimum MVLS and MVPHS requirements. If at any time during the applicable compliance period our MVLS and MVPHS close at or above US\$50 million and US\$15 million, respectively, for a minimum of ten consecutive business days, Nasdaq will notify us and the relevant matter will be closed. If we do not regain compliance prior to the expiration of the applicable compliance period, we will receive written notification that our securities are subject to delisting from the NASDAQ Global Market, at which time we may appeal the delisting determination to a hearings panel. Our management is looking into various options available to regain compliance and maintain our continued listing on the Nasdaq Global Market, and is also considering other options, including a potential transfer of its listing of securities to the Nasdaq Capital Market. If we fail to regain compliance with either of the above-said requirements on a timely basis or fail to satisfy other Nasdaq Global Market's continued listing requirements, our ADSs could be delisted from Nasdaq Global Market, and we may need to transfer the listing or trading of our ADSs to other stock exchanges or trading venues, which may materially and adversely affect the market liquidity and the price of our ADSs and our ability to obtain financing for our operations.

***There can be no assurance that we will not be classified as a passive foreign investment company for any taxable year, 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 the value and composition of our assets and liabilities, we believe we were not a "passive foreign investment company," or PFIC, for U.S. federal income tax purposes for our taxable year ended December 31, 2016. However, as previously disclosed, although not free from doubt, we believed that we were a PFIC for U.S. federal income tax purposes for prior years. In addition, it is possible that one or more of our subsidiaries were also PFICs for such year for U.S. federal income tax purposes.

A non-U.S. corporation will be a PFIC for any taxable year if either (1) at least 75% of its gross income for such year consists of certain types of passive income, or (2) at least 50% of the average quarterly value of its assets (as generally determined on the basis of fair market value) during such year produce or are held for the production of passive income. We must make a separate determination 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 by reference to the market price of our ADSs or ordinary shares, our PFIC status will depend in part on the market price of the ADSs or ordinary shares, which may fluctuate significantly, and the composition of our assets and liabilities.

If we were treated as a PFIC for any taxable year during which a U.S. Holder (as defined in Item 10. Additional Information—E. Taxation—U.S. Federal Income Taxation) holds our ADSs or ordinary shares, such U.S. Holders may incur significantly increased U.S. income tax on gain recognized on the sale or other disposition of the ADSs or ordinary shares and on the receipt of distributions on the ADSs or ordinary shares to the extent such gain or distribution is treated as “excess distribution” under the U.S. federal income tax rules. Further, a U.S. Holder will generally be treated as holding an equity interest in a PFIC in the first taxable year of the U.S. Holder’s holding period in which we become classified as a PFIC and subsequent taxable years (“PFIC-Tainted Shares”) even if, we in fact, cease to be a PFIC in subsequent taxable years. See “Item 10. Additional Information—E. Taxation—U. S. Federal Income Taxation—Passive Foreign Investment Company.”

You are strongly urged to consult your tax advisors regarding the impact of our being a PFIC in any taxable year on your investment in our ADSs and ordinary shares as well as the application of the PFIC rules.

***Substantial future sales or the perception of sales of our ADSs or ordinary shares could adversely affect the price of our ADSs.***

If our shareholders sell or are perceived by the market to 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 or are perceived by the market to sell a substantial amount of ordinary shares, the prevailing market price for our ADSs could be adversely affected. In December 2015, we issued and sold the Convertible Notes in an aggregate principal amount of US\$40,050,000 to Splendid Days in three tranches at initial conversion prices of US\$2.6, US\$5.2 and US\$7.8 per ADS, respectively. In connection with the sale of Convertible Notes, we also issued the Warrants in an aggregate principal amount of US\$9,950,000 to Splendid Days in four tranches at initial exercise prices of US\$1.5, US\$2.6, US\$5.2 and US\$7.8 per ADS, respectively. See “Item 5—Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” Pursuant to the relevant agreement, we registered the ordinary shares into which the Convertible Notes are convertible and the Warrants are exercisable on a registration statement on F-3, which was declared effective by the SEC on June 17, 2016. Upon registration, any ordinary shares that Splendid Days would acquire by conversion of the Convertible Notes or exercise of the Warrants will become freely tradable.

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

***The market price for our ADSs may be volatile.***

The market price for our ADSs is likely to be highly volatile and subject to wide fluctuations in response to factors including the following:

- actual or anticipated fluctuations in our operating results;
- announcements of new games by us or our competitors;

- changes in financial estimates by securities analysts;
- price fluctuations of publicly traded securities of other China-based companies engaging in Internet-related services or other similar businesses;
- conditions in the Internet or online game industries;
- changes in the economic performance or market valuations of other Internet or online game companies;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- fluctuations in the exchange rates between the U.S. dollar and the RMB;
- addition or departure of key personnel; and
- pending and potential litigation.

In addition, the securities market has from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our ADSs.

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

Our corporate affairs are governed by our memorandum and articles of association and by the Companies Law (2016 Revision) and common law of 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 the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States, and provides significantly less protection to investors. Therefore, our public shareholders may have more difficulties protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States. 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, our shareholders may not be able to protect their interests if they are harmed in a manner that would otherwise enable them to sue in a United States federal court.

***Your ability to bring an action against us or against our directors and officers, or to enforce a judgment against us or them, will be limited because we are incorporated in the Cayman Islands, because we conduct a substantial portion of our operations in China and because the majority of our directors and officers reside outside of the United States.***

We are an exempted company incorporated in the Cayman Islands, and we conduct a substantial portion of our operations through our wholly-owned subsidiaries and affiliated entities in China. Most of our directors and officers reside outside of the United States and most of the assets of those persons are located outside of the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the United States in the event that you believe that your rights have been infringed under the 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.

***You may not be able to exercise your right to vote.***

As a holder of ADSs, you may instruct the depository of our ADSs to vote the shares underlying your ADSs but only if we ask the depository to request your instruction. Otherwise, you will not be able to exercise your right to vote unless you withdraw the shares. However, you may not know about a shareholders' meeting enough in advance to withdraw the shares. Pursuant to our amended and restated memorandum and articles of association, a shareholders' meeting may be convened by us on seven business days' notice. If we ask for your instructions, the depository 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 ensure that you can instruct the depository to vote your shares. Pursuant to the amended and restated Deposit Agreement dated November 2010 that we entered into with our depository, if after complying with the procedures set forth in the agreement, the depository does not receive instructions from the owner of a receipt on or before the instruction date, the depository shall vote such deposited securities in accordance with the recommendations of our board of directors as advised by our company in writing. In addition, the depository and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions, if any such action or non-action is in good faith. This means that you may not be able to exercise your right to vote and there may be nothing you can do if the shares underlying your ADSs are not voted as you request.

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

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. However, we cannot make rights available to you in the United States unless we register the rights and the securities to which the rights relate under the Securities Act of 1933, as amended, or the Securities Act, or an exemption from the registration requirements is available. Also, under the deposit agreement, the depository bank will not make rights available to you unless the distribution to ADS holders of both the rights and any related securities are either registered under the Securities Act, or exempt from registration under the Securities Act. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. The depository may, but is not required to, sell such undistributed rights to third parties in this situation. Accordingly, you may be unable to participate in our rights offerings and may experience dilution in your holdings.

***You may not receive distributions on ordinary shares or any value for them if it is illegal or impractical to make them available to you.***

The depository of our ADSs has agreed to pay to you the cash dividends or other distributions it or the custodian receives on ordinary shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of ordinary shares your ADSs represent. However, the depository is not responsible if it decides that it is unlawful or impractical to make a distribution available to any holders of ADSs. We have no obligation to register ADSs, ordinary shares, rights or other securities under U.S. securities laws. We also have no obligation to take any other action to permit the distribution of ADSs, ordinary shares, rights or anything else to holders of ADSs. This means that you may not receive the distribution we make on our ordinary shares or any value for them if it is illegal or impractical for us to make them available to you. These restrictions may have a material adverse effect on the value of your ADSs.

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

Your ADSs are transferable on the books of the depository. However, the depository may close its 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 because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

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

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

We were incorporated in the Cayman Islands on December 22, 1999 under the name GameNow.net Limited as a company limited by shares and were renamed The9 Limited in February 2004. We formed GameNow.net (Hong Kong) Limited, or GameNow, on January 17, 2000 in Hong Kong, as a wholly-owned subsidiary. We have historically conducted our operations in large part through The9 Computer, a direct wholly-owned subsidiary of GameNow in China.

Due to the current restrictions on foreign ownership of ICP and Internet culture operation in China, currently, we primarily rely on Shanghai IT, one of our affiliated PRC entities, in holding certain licenses and approvals necessary for our business online game operations through a series of contractual arrangements with Shanghai IT and its shareholders. See “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions—Arrangements with Affiliated PRC Entities” for details of the contractual arrangements with Shanghai IT and its shareholders. We do not hold any equity interest in Shanghai IT.

We operated WoW, a MMORPG licensed from Blizzard Entertainment, Inc., in China between June 2005 and June 2009 and had relied on the game as a major source of revenue during that period. After the non-renewal of the WoW license, we continued to operate our other licensed and proprietary games.

In April 2010, we acquired a controlling interest in Red 5 Studios, Inc., or Red 5, an online game developer based in the United States. In June 2016, we completed a share exchange transaction with L&A International Holding Limited, or L&A, a Cayman Islands company with shares publicly listed on the Growth Enterprise Market of the Hong Kong Stock Exchange (Stock Code: 8195), and certain other shareholders of Red 5, whereby we exchanged approximately 30.6% equity interest (on a fully-diluted basis) that we owned in Red 5 for a total of 769,481,940 (after a one-to-five stock split) newly issued shares of L&A, which are held by Asian Development, our wholly-owned subsidiary.

In July 2014, we and Qihoo 360 entered into an agreement to form a joint venture in which each party shall own 50% equity interest in the joint venture and share profits based on the respective equity interests in the joint venture. The joint venture, System Link Corporation Limited, or System Link, was formed in August 2014. In August 2014, our subsidiary Red 5 Singapore Pte. Ltd., or Red 5 Singapore, a wholly-owned subsidiary of Red 5, entered into a license agreement with System Link for publishing and operating Firefall, a MMOFPS game, for a five-year term in China. In April 2016, System Link ceased to operate Firefall in China. We do not consolidate the results of System Link into our results of operations and treat it as an equity investee.

In February 2013, we established a new joint venture, namely Zhongxing The9 Network Technology Co., Ltd., or ZTE9, in cooperation with Shanghai Zhongxing Communication Technology Enterprise Co., Ltd. and Shanghai Ruigao Information Technology Co., Ltd., in Wuxi, Jiangsu province of China, to develop and operate the business of “Fun Box,” a home entertainment set top box. In February 2014, Guangdong Hongtu Guangdian Investment Limited Company made a capital investment of RMB12.5 million to acquire 10% equity interests in ZTE9. As of December 31, 2016, we held 28.8% equity interest of ZTE9. We do not consolidate the results of ZTE9 into our results of operations and treat it as an equity investee.

In August 2014, Shanghai IT sold 100% equity interest in Huopu Cloud Computing Terminal Technology Co., Ltd., or Huopu Cloud, to Shanghai Zhengwu Investment Center (Limited Partnership), a third party, for a total consideration of RMB200 million in cash. Huopu Cloud developed and held a web game QiJiGuiLai.

In August 2015, Globe Wealthy Link Limited, or Globe Wealthy, a wholly-owned subsidiary of System Link, entered into an agreement with Smilegate Entertainment Inc., or Smilegate, a Korean game developer, to form a joint venture. The joint venture, Oriental Shiny Star Limited, or Oriental Shiny, was formed in August 2015. Smilegate shall hold nominal shares in Oriental Shiny upon the incorporation of Oriental Shiny. In November 2015, Oriental Shiny entered into a license agreement with Smilegate for publishing and operating CrossFire 2 in China on an exclusive basis for an initial term of three years, subject to an extension to five years. See “Item 4. Information on the Company—B. Business Overview—Arrangements with Smilegate regarding CrossFire 2.” Smilegate is currently in the process of developing CrossFire 2. We do not consolidate the results of Oriental Shiny into our results of operations and treat it as an equity investee.

In November 2015, we disposed of 58% equity interest in Shanghai Jiucheng Advertisement Co., Ltd., or Shanghai Jiucheng Advertisement, which operates a mobile advertising platform and was wholly-owned by Shanghai IT prior to such disposal. We account for Shanghai Jiucheng Advertisement as an equity investment after such disposal.

In April 2016, Shanghai The9 Education Technology Co., Ltd., one of our consolidated affiliated entities, listed its shares on the National Equities Exchange and Quotations, commonly known as the New Third Board, an emerging over-the-counter market in China.

On January 20, 2017, we received a written notification from the Nasdaq Stock Market, Inc. indicating that we no longer met the continued listing requirement of minimum market value of listed securities (MVLS) for the Nasdaq Global Market because the market value of our total outstanding shares for the last 30 consecutive business days was below the minimum requirement of US\$50 million. On February 22, 2017, we received a second written notification from Nasdaq indicating that we no longer met the continued listing requirement of minimum market value of publicly held shares (MVPHS) for the Nasdaq Global Market because our MVPHS for the last 30 consecutive business days was below the minimum requirement of US\$15 million. We have a compliance period of 180 calendar days, or until July 19, 2017 and August 21, 2017, respectively, to regain compliance. If at any time during the applicable compliance period our MVLS and MVPHS close at or above US\$50 million and US\$15 million, respectively, for a minimum of ten consecutive business days, Nasdaq will notify us and the relevant matter will be closed. If we do not regain compliance prior to the expiration of the applicable compliance period, we will receive written notification that our securities are subject to delisting from the NASDAQ Global Market, at which time we may appeal the delisting determination to a hearings panel. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Shares and ADSs—We currently fail to meet two of the continued listing requirements for the Nasdaq Global Market. If we fail to regain compliance with the listing requirement on a timely basis or fail to meet other listing requirements for the Nasdaq Global Market, our ADSs may be delisted from the Nasdaq Global Market or need to be transferred to other stock exchanges or trading venues, which may materially and adversely affect the market liquidity of our ADSs and our ability to obtain financing.”

Our principal executive office is located at Building No. 3, 690 Bibo Road, Zhangjiang Hi-Tech Park, Pudong New Area, Shanghai 201203, People’s Republic of China, and our telephone number is +86-21-5172-9999. Our registered office in the Cayman Islands is located at the offices of CARD Corporate Services Ltd, c/o Collas Crill Corporate Services Limited, Floor 2, Willow House, Cricket Square, PO Box 709, Grand Cayman KY1-1107 Cayman Islands. Our agent for service of process in the United States is CT Corporation System located at 111 Eighth Avenue, New York, New York 10011.

## **B. Business Overview**

We primarily operate and develop proprietary and licensed online games. We have developed proprietary games, including Song of Knights, and are developing several proprietary mobile games and a web game. We have also obtained an exclusive license to operate CrossFire 2, an MMOFPS in development, in China through a joint venture. We also develop and operate the business of “Fun Box,” a home entertainment set top box, which enables online video and video games on TV, through a joint venture.

We generate our online game service revenues primarily through an item-based revenue model, under which players play games for free, but they are charged for in-game items, such as performance-enhancing items, clothing and accessories. Our customers typically access our online games through personal computers, mobile devices or TVs.

## **Products and Services**

### ***Online Games***

We operate and develop proprietary or licensed online games, primarily a MMOFPS, mobile games, a web game and TV games.

As of the date of this annual report, we or our joint ventures own or have licenses to operate or develop the following online games in China and other countries:

<u>Game</u>	<u>Developer/ Licensor</u>	<u>Description</u>	<u>Status</u>
Song of Knights	The9	Mobile game	Commercialized in China
CrossFire 2	Smilegate Entertainment Inc.	3D MMOFPS	Under development by Smilegate
CrossFire New Mobile Game	The9 / Smilegate	Mobile game	Under development by The9
Soul Awake	The9	Web game	Under development by The9
Firefall	Red 5	3D MMOFPS	Commercially launched in North America and Europe
Audition AR	Asian Way Development Limited / T3 Entertainment	AR game	Under development by Asian Way Development Limited

- *Song of Knights*. Developed in 2014, Song of Knights is a proprietary mobile game that we have commercialized in China. We also licensed Song of Knights to different game operators for distribution in Korea, Taiwan, Malaysia, Thailand and Canada.
- *CrossFire 2*. In November 2015, our joint venture Oriental Shiny obtained an exclusive license from Smilegate to publish and operate CrossFire 2 in China for an initial term of three years, subject to an extension to five years. CrossFire 2 is the sequel of CrossFire, a first-person-shooter PC online game in China. Smilegate is currently in the process of developing CrossFire 2. We do not consolidate the results of Oriental Shiny into our results of operations and treat it as an equity investee. See “—Arrangements with Smilegate regarding CrossFire 2.”

In a typical MMOFPS, thousands of players play in the same game world at the same time. MMOFPS players can select a specific character to compete within the game with which they develop experience and enhance game attributes, which can be carried over into the next higher game levels. MMOFPSs incorporate many cutting-edge technology features, including:

- sophisticated 3D graphics which create captivating screen scenes;
- player upgrading system which allows players to attain higher game attributes with their characters as they develop experience and enhanced game capabilities over time; and
- instant messaging system which allows players to communicate with each other during the game and form groups with other players, thereby coordinating their game skills to achieve collective objectives.
- *CrossFire New Mobile Game*. In January 2016, we obtained a right from Smilegate to develop a mobile game based on the intellectual property relating to CrossFire, or the CrossFire New Mobile Game. The development of the game is financed with funding through Inner Mongolia Culture Assets and Equity Exchange. See “Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.”
- *Soul Awake*. We have been developing our own proprietary web game, Soul Awake, since 2015. We plan to commercialize the game in China in the first half of 2017.
- *Firefall*. Firefall was commercially launched in North America and Europe in July 2014.
- *Audition AR*. In June 2016, Asian Way Development Limited obtained a right from T3 Entertainment to develop a game using augmented reality (AR) technologies based on the intellectual property relating to a game called Audition.

In preparation for the commercial launch of a new game, we conduct “closed beta testing” of the game to resolve operational issues, which is followed by “limited commercial release” and “open beta testing.” In both limited commercial release and open beta testing, we allow our registered users to play without removing their in-game data to ensure the performance consistency and stability of our operating systems. While we limit the number of users allowed to play the game in limited commercial release, we do not set such a limit in open beta testing. We can choose to start charging users in limited commercial release or open beta testing or at a later stage at our discretion.



Our online games are available 24 hours a day, seven days a week. Our users can access our online games from any location with an Internet connection. Substantially all of our users in China access the game servers either from cell phones, personal computers at home or at Internet cafés equipped with multiple personal computers that have Internet access.

*TV Game Platform.* In February 2013, we established ZTE9, a joint venture, with Shanghai Zhongxing Communication Technology Enterprise Co., Ltd. and Shanghai Ruigao Information Technology Co., Ltd. in Wuxi, Jiangsu Province of China. In February 2014, Guangdong Hongtu Guangdian Investment Limited Company made capital investment to ZTE9. The joint venture operates the business of “Fun Box,” a home entertainment set top box, which enables online video and video games on TV.

### ***Other Products and Services***

Our other products and services mainly consist of training services, primarily smartphone application programming trainings provided to college students in China.

### **Arrangements with Smilegate regarding CrossFire 2**

In 2015, Globe Wealthy, a wholly-owned subsidiary of System Link, our 50%-owned joint venture, and Smilegate formed Oriental Shiny as a joint venture company for publishing and operating CrossFire 2 in China on an exclusive basis for an initial term of three years, subject to an extension to five years. Certain principal terms of the contractual arrangements are described below.

*Joint Venture Agreement dated August 20, 2015 by and between Globe Wealthy and Smilegate.* Pursuant to this agreement, Globe Wealthy shall contribute to Oriental Shiny an initial capital of US\$50 million, and additional capital of US\$70 million and US\$180 million after closed beta testing and commercial launch of CrossFire 2, respectively. Such capital shall be used to pay the license fee for the initial three-year term under the CrossFire 2 license agreement between Oriental Shiny and Smilegate. In addition, Globe Wealthy will make additional cash contributions to Oriental Shiny as may be necessary for publishing, operating and marketing CrossFire 2. If the CrossFire 2 license is extended for two years for an additional license fee of US\$200 million pursuant to the terms of the license agreement, Globe Wealthy will be required to make an additional capital contribution of US\$200 million to Oriental Shiny for the payment of such additional license fee. Smilegate shall hold nominal shares in Oriental Shiny upon the incorporation of Oriental Shiny. Pursuant to the agreement, in the event of a successful commercial launch of CrossFire 2, Smilegate will be entitled to a 30% equity interest (inclusive of the initial nominal shares) in Oriental Shiny on a fully diluted basis.

Pursuant to the joint venture agreement, Oriental Shiny shall establish a wholly-owned subsidiary in China, which will operate CrossFire 2 through a PRC entity that it effectively controls through a series of contractual arrangements. The wholly-owned subsidiary, Oriental Shiny Star Information Technology (Beijing) Co., Ltd., or Oriental IT, was formed in February 2016, and the operating PRC entity, Beijing Zhi’ao Network Technology Co., Ltd., or Beijing Zhi’ao, was formed in October 2015. Oriental IT has entered into contractual arrangements with Beijing Zhi’ao and the shareholders of Beijing Zhi’ao to obtain effective control over Beijing Zhi’ao. The board of Oriental Shiny consists of three directors, including two directors nominated by Globe Wealthy and one director nominated by Smilegate. Certain matters of Oriental Shiny require the unanimous consent of the directors, including, among other things, appointment and removal of senior management, disposal of material assets, the entering into, amendment or termination of material contracts, transfer or licensing of intellectual property or technology, declaration of dividend, and making or extension of loans. Certain matters of Oriental Shiny require consents of both Globe Wealthy and Smilegate, including, among other things, amendment to the articles of association, change in capital structure and merger and acquisition with other companies. The initial term of the joint venture is 20 years, and may be terminated at any time by written agreement between Globe Wealthy and Smilegate.

*Exclusive License and Distribution Agreement dated November 24, 2015 by and among Oriental Shiny, Beijing Zhi’ao and Smilegate.* Pursuant to this agreement, Smilegate granted to Oriental Shiny and Beijing Zhi’ao an exclusive, non-sublicenseable and non-transferable license to publish and operate CrossFire 2 in China. Oriental Shiny and Beijing Zhi’ao shall pay an initial license fee of US\$50 million, and additional license fees of US\$70 million and US\$180 million after closed beta testing and commercial launch of CrossFire 2, respectively. The payment of license fee is guaranteed by Qihoo 360 and our company based on the respective equity interests of the parties in System Link. Oriental Shiny and Beijing Zhi’ao are also required to pay royalties to Smilegate. This agreement has an initial term of three years after the commercial launch of CrossFire 2, and will be extended for two years (i) automatically if the total gross revenue is larger than the total costs and expenses incurred by Oriental Shiny and Beijing Zhi’ao for the initial three-year term, or (ii) at the option of Oriental Shiny and Beijing Zhi’ao. In either case, any extension for a two-year term will be subject to an additional license fee of US\$200 million. This agreement may be terminated upon agreement by the parties.

*Guarantee Letter dated November 24, 2015 by and among the our company, Shanghai IT and Smilegate.* Our company and Shanghai IT agreed to jointly and severally guarantee the payment of license fee by Globe Wealthy under the Exclusive License and Distribution Agreement proportional to our equity interest in System Link. The remaining licensing fee is guaranteed by Qihoo 360 under a separate guarantee letter.

### **Customer Service**

Since our inception, we have continuously focused on providing excellent customer service in order to retain our existing customers and to attract new customers. Our online games customers can access our customer service center via phone or e-mail at any time, or visit our visitor center in Shanghai during regular business hours. We have in-game game masters dedicated to each of the online games that we operate. Game masters are responsible for organizing in-game events, troubleshooting and actively and continuously monitoring the online game environment. Game masters are available to respond to players' inquiries, to initiate the bug reporting and removal processes, as well as to identify, record and deal with players' inappropriate behavior such as dishonesty, fraud or other conducts that violates our rules and policies. We believe that positioning game masters to monitor the gaming environment is important to us to maintain customer loyalty and to efficiently address any technical problems that may arise.

### **Purchase of In-game Items**

A customer can access online games free of charge and buy in-game items online by charging a payment directly to Alipay, or by credit card or debit card.

### **Pricing, Distribution and Marketing**

***Pricing.*** We price our in-game virtual items near the end of the free testing period based on several factors, including the prices of other comparable games, the technological and other features of the game, and the targeted marketing position of the game. Our prepaid game cards are offered in a variety of denominations to provide users with maximum flexibility.

***Distribution.*** We primarily rely on game platforms and distributors to distribute, promote, market and sell our games in China and overseas markets, such as North America and Southeast Asia. End users can purchase our virtual currencies and prepaid cards through such game platforms and distributors. A substantial portion of our sales are carried out via such game platforms and distributors. We do not have long-term agreements with any online game platforms or distributors. In addition, we also directly sell game points through our game players' online accounts.

***Marketing.*** Our overall marketing strategy is to rapidly attract new customers and increase revenues from recurring customers. The marketing programs and promotional activities that we employ to promote our games include:

***Advertising and Online Promotion.*** We place advertisements in many game magazines and on online game sites, which are updated regularly.

***Cross-Marketing.*** We have cross-marketing relationships with major consumer brands, technology companies and major telecom carriers. We believe that our cross-marketing relationships with well-known companies will increase the recognition of our online game brands.

*On-Site Promotion.* We distribute free game-related posters, promotional prepaid cards for beginners, game-related souvenirs such as watches, pens, mouse pads and calendars at trade shows, selected Internet cafés and computer stores.

*In-Game Marketing.* We conduct “in-game” marketing programs from time to time, including online adventures for grand prizes.

## **Game Development and Licensing**

We believe that the online game industry in China will continue its pattern of developing increasingly sophisticated online games tailored to the local market. In order to remain competitive, we focus on continuing to develop new proprietary online games, including mobile games and a web game. Our product development team is responsible for game design, technical development and art design. We also plan to further enhance our game development capability and diversify our game portfolio and pipeline.

Our game licensing process begins with a preliminary screening, review and testing of a game, followed by a cost analysis, negotiations and ultimate licensing of a game, including all regulatory and approval processes. A team is then designated to conduct “closed beta testing” of the game to resolve operational matters, followed by “open beta testing” during which our registered users may play the game without removing their in-game data to ensure performance consistency and stability of our operation systems. Testing generally takes three to six months, during which time we commence other marketing activities.

## **Technology**

We aim to build a reliable and secure technology infrastructure to fully support our operations, and we maintain separate technology networks for each of our games. Our current technology infrastructure consists of the following:

- servers and network devices located in two Internet data centers in China as of December 31, 2016;
- proprietary software, including game monitor tools, that are integrated with our websites and customer service center operations; and
- hardware platform and server sites primarily consisting of IBM storage systems, HP, H3C and Cisco network equipment.

We have a network operation team responsible for the stability and security of our network. The team monitors our server and works to detect, record, analyze and solve problems that arise from our network. In addition, we frequently upgrade our game server software to ensure the stability of our operations and to reduce the risks of hacking.

## **Competition**

Our major competitors include, but are not limited to, online game operators in China. These include Tencent Holdings Limited (which operates CrossFire, League of Legends and Dungeon & Fighter), Shanda Games Limited (which operates Wool, Mir II and Dragon Nest), NetEase, Inc. (which operates Fantasy Westward Journey, World of Warcraft and Hearthstone: Heroes of Warcraft), Giant Interactive Group Inc. (which operates ZT Online and Passion Leads Army Online), Changyou.com Limited (which operates Dragon Oath 3D and The Legend of Qin II), Perfect World Co., Ltd. (which operates Perfect World II, Zhu Xian3 and DOTA2).

Our existing and potential competitors may compete with us on marketing activities, quality of online games and sales and distribution networks. Some of our existing and potential competitors have greater financial and marketing resources than us. For a discussion of risks relating to competition, see “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—We may not be able to recover our market share and profitability as we operate in a highly competitive industry with numerous competitors.”

## Intellectual Property

Our intellectual property rights include trademarks and domain names associated with the name “The9” in China and copyright and other rights associated with our websites, technology platform, self-developed software and other aspects of our business. We regard our intellectual property rights as critical to our business. We rely on trademark and copyright law, trade secret protection, non-competition and confidentiality agreements with our employees, and license agreements with our partners, to protect our intellectual property rights. We require our employees to enter into agreements requiring them to keep confidential all information relating to our customers, methods, business and trade secrets during and after their employment with us and assign their inventions developed during their employment to us. Our employees are required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes made by them during their employment are our property.

We have registered our domain names with third-party domain registration entities, and have legal rights over these domain names through Shanghai IT, our affiliated PRC entity. We conduct our business under the “The9 Limited” brand name and “The9” logo.

## Legal Proceedings

See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings.”

## Government Regulations

***Current PRC laws and regulations impose substantial restrictions on foreign ownership of the online gaming and ICP businesses in China. As a result, we conduct our online gaming and ICP businesses in China through contractual arrangements with Shanghai IT, one of our affiliated PRC entities. Shanghai IT is owned by Zhimin Lin and Wei Ji, both of whom are PRC citizens.***

In the opinion of our PRC counsel, Zhong Lun Law Firm, subject to the interpretation and implementation of the GAPP Circular and the Network Publication Measures, the ownership structure and the business operation models of our PRC subsidiaries and our affiliated PRC entities comply with all applicable PRC laws, rules and regulations, and no consent, approval or license is required under any of the existing laws and regulations of China for their ownership structure and business operation models except for those which we have already obtained or which would not have a material adverse effect on our business or operations as a whole.

In the online games industry 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, and address new issues that arise from time to time. As a result, substantial uncertainties exist regarding the interpretation and implementation of current and any future PRC laws and regulations applicable to the online games industry. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—The laws and regulations governing the online game industry in China are developing and subject to future changes. If we fail to obtain or maintain all applicable permits and approvals, our business and operations could be materially and adversely affected.”

## ***Regulations on Internet Content Provision Service, Online Gaming and Internet Publishing***

Our provision of online game-related content on our websites is subject to various PRC laws and regulations relating to the telecommunications industry, Internet and online gaming, and is regulated by various government authorities, including MIIT, the Ministry of Culture, GAPPRT and the State Administration for Industry and Commerce. The principal PRC regulations governing the ICP industry as well as the online gaming services in China include:

- Telecommunications Regulations (2000), as amended in 2014;
- The Administrative Rules for Foreign Investments in Telecommunications Enterprises (2001), as amended in 2008;

- The Administrative Measures for Telecommunications Business Operating License (2009);
- The Administrative Measures for Internet Information Services (2000), as amended in 2011;
- The Tentative Measures for Administration of Internet Culture (2003), as amended and reissued in 2011;
- Administrative Measures on Network Publication (2016);
- The Tentative Measures for Administration of Online Games (2010); and
- The Foreign Investment Industrial Guidance Catalogue (2015).

In July 2006, MIIT issued the MII Notice. The MII Notice prohibits ICP license holders from leasing, transferring or selling a telecommunications business operating license to any foreign investors in any form, or providing any resource, sites or facilities to any foreign investors for their illegal operation of telecommunications businesses in China. The notice also requires that ICP license holders and their shareholders directly own the domain names and trademarks used by such ICP license holders in their daily operations. The notice further requires each ICP 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 the value-added telecommunication service providers are required to maintain network and information security in accordance with the standards set forth under relevant PRC regulations. The local authorities in charge of telecommunications services are required to ensure that existing ICP license holders conduct a self-assessment of their compliance with the MII Notice and submit status reports to MIIT before November 1, 2006. For those which are not in compliance with the above requirements and further fail to rectify the situation, the relevant governmental authorities would have broad discretion in adopting one or more measures against them, including but not limited to revoking their operating licenses. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—PRC laws and regulations restrict foreign ownership of Internet content provision, Internet culture operation and Internet publishing licenses, and substantial uncertainties exist with respect to the application and implementation of PRC laws and regulations.”

Under these regulations, a foreign investor is currently prohibited from owning more than 50% of the equity interest in a PRC entity that provides value-added telecommunications services (except for e-commerce services). ICP services are classified as value-added telecommunications businesses, and a commercial operator of such services must obtain an ICP License from the appropriate telecommunications authorities in order to carry on any commercial ICP operations in China.

With respect to the online gaming industry in China, since online games fall into the definition of “Internet culture products” under The Tentative Measures for Administration of Internet Culture (2011), a commercial operator of online games must, in addition to obtaining the ICP License, obtain an Internet culture operation license from the appropriate culture administrative authorities for its operation of online games. Furthermore, according to The Tentative Measures for Administration of Internet Publication (2002), the provision of online games is deemed an Internet publication activity. Therefore, approval from the appropriate press and publication administrative authorities as an Internet publisher or cooperation with a licensed Internet publisher is required for an online game operator to carry on its online gaming businesses in China. In February 2016, the GAPPRFT and the MIIT jointly issued the Administrative Measures on Network Publication, which took effect in March 2016 and replaced the Tentative Administrative Measures on Internet Publication. The Administrative Measures on Network Publication further strengthen and expand the supervision and management on the network publication service, including online games service. Furthermore, online games, including mobile games, regardless of whether imported or domestic, shall be subject to a content review and approval by or a filing with the Ministry of Culture and GAPPRFT prior to commencement of operations in China.

GAPPRFT and MIIT jointly impose a license requirement for any company that intends to engage in network publishing, defined as any activity of providing network publications to the public through information networks. Network publications refer to the digitalized works with publishing features such as editing, producing and processing. Furthermore, the distribution of online game cards and CD-keys for online gaming programs is subject to a licensing requirement. Shanghai IT holds the license necessary to distribute electronic publications, which allows it to distribute prepaid cards and CD-Keys for the games we operate. We sell our prepaid cards and CD-Keys through third-party distributors, which are responsible for maintaining requisite licenses for distributing our prepaid cards and CD Keys in China.

On February 15, 2007, fourteen governmental authorities, including the Ministry of Culture, MIIT, the State Administration for Industry and Commerce, and the People's Bank of China, or the PBOC, jointly issued a circular entitled Circular for Further Strengthening the Administration of Internet Café and Online Games. This circular gave the PBOC administrative authority over virtual currencies issued by online game operators for use by players in online games to avoid the potential impact such virtual currencies may have on the real-world financial systems. According to this circular, the volume that may be issued and the purchase of such virtual currencies must be restricted, and virtual currency must not be used for the purchase of any physical products, refunded with a premium or otherwise illegally traded. The Notice of Strengthening the Management of Virtual Currency of Online Games promulgated by the Ministry of Culture and MOFCOM on June 4, 2009 and the Tentative Measures for Administration of Online Games promulgated by the Ministry of Culture on June 3, 2010 impose more restrictions and requirements on online game operators that issue virtual currencies. According to the above regulations, an online game operator which issues virtual currency used for online game services shall apply for approval from the Ministry of Culture. An online game operator shall further report detailed rules of issuance for virtual currencies, such as distribution scope, pricing, and terms for refunds and shall make certain periodic and supplementary filings as required by the relevant regulations. In addition, under these rules, online game operators are prohibited from assigning game tools or virtual currency to users by way of drawing lots, random samplings or other arbitrary means in exchange for users' cash or virtual currency. These rules also require that service agreements entered into between online game operators and end users contain the general terms of a standard online game service agreement issued by the Ministry of Culture.

In September 2009, GAPP further promulgated the GAPP Circular, which provides that foreign investors are prohibited from making investment and engaging in online game operation services by setting up foreign-invested enterprises in China. Further, foreign investors shall not control and participate in PRC online game operation businesses indirectly or in a disguised manner by establishing joint venture companies or entering into agreements with or providing technical support to such PRC online game operation companies, or by inputting the users' registration, account management, game cards consumption directly into the interconnected gaming platform or fighting platform controlled or owned by the foreign investor. In addition, on February 4, 2016, the GAPPRFT and the MIIT jointly issued the Administrative Measures on Network Publication, or the Network Publication Measures, which took effect in March 2016. Pursuant to the Network Publication Measures, wholly foreign-owned enterprises, Sino-foreign equity joint ventures and Sino-foreign cooperative enterprises shall not engage in the provision of web publishing services, including online game services. Project cooperation involving internet publishing services between an internet publishing service provider and a wholly foreign-owned enterprise, Sino-foreign equity joint venture, or Sino-foreign cooperative enterprise within China or an overseas organization or individual shall be subject to prior examination and approval by the GAPPRFT. It is not clear whether GAPPRFT and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China. The relevant governmental authorities have broad discretion in adopting one or more of administrative measures against companies now in compliance with these measures, including revoking relevant licenses and relevant registration. See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—PRC laws and regulations restrict foreign ownership of Internet content provision, Internet culture operation and Internet publishing licenses, and substantial uncertainties exist with respect to the application and implementation of PRC laws and regulations."

On December 1, 2016, MOC issued the Circular on Regulating Online Game Operations and Strengthening Interim and Ex Post Regulation, or the MOC Online Games Regulation, which will become effective on May 1, 2017. Pursuant to the MOC Online Games Regulation, MOC further clarified the scope of online game operations. Online game operations shall include technical testing of online games by means of, for example, making the online games available for user registration, opening the fee-charging system of the online games, and providing client-end software with direct server registration and login functions. In addition, enterprises that engage in providing user systems, fee-charging systems, program downloading, publicity and promotion and other services for online game products of other operating enterprises and that share revenue from online game operations shall be deemed as engaging in joint operations, and shall be subject to relevant obligations. In addition, this circular sets the regulatory standard for distributing virtual items, as follows:

- Virtual items distributed by enterprises engaged in online game operations shall be managed pursuant to the provisions regulating virtual currencies of online games.

- Enterprises engaged in online game operations that intend to change a version of an online game, increase the types of virtual items, adjust the functions and consumption period of virtual items or hold intermittent campaigns shall, on the official homepage of the online game or in conspicuous locations within the online game, promptly make public the name, functions, price, exchange rate and expiration date of each relevant virtual items, the means of gifting, transferring or trading the virtual items and other relevant information.
- Enterprises engaged in online game operations that provide random draws of virtual items and value-added services of an online game shall not require users to participate in the random draws with legal tender or virtual currency.
- Enterprises engaged in online game operations shall publish the random draw results on the official website of an online game or in conspicuous locations within the online game, and keep relevant records for at least 90 days for any future inquiries by competent authorities.
- An enterprise engaged in online game operations that provide random draws of virtual items and value-added services of an online game shall concurrently offer users alternative ways to acquire the virtual items and value-added services with the same performance, such as through exchange with virtual items or payment with virtual currency.
- Enterprises engaged in online game operations shall not offer services for the exchange of online game virtual currency with legal tender or physical items, except where the said enterprise terminates its online gaming products and services, and refunds the virtual currency unused by users in the form of legal tender or by other means acceptable to the users.
- Enterprises engaged in online game operations shall not offer services for the exchange of virtual items with legal tender.

In addition, enterprises engaged in online game operations shall require online game users to register their real names by using valid identity documents and shall limit the amount that an online game user may top up each time in each game. Such enterprises shall also send information that requires confirmation by users when they top up or engage in consumption, and shall display their contact details for handling matters relating to use rights protection in conspicuous locations within each online game.

On May 24, 2016, the GAPPRFT issued the Circular on the Administration over Mobile Game Publishing Services to further regulate the administration of mobile game publishing services. Pursuant to this circular, game publishing service entities shall be responsible for examining the contents of their games, applying for publication and applying for game publication numbers. Upgrades or new expansions of a mobile game that have been approved for publication shall be deemed as new works and the relevant publishing service entities shall go through relevant approval formalities again depending on the classification of the new works. Entities engaged in the joint operation of such new works must verify whether such games have gone through all the relevant approval formalities and whether the relevant information has been clearly displayed, or otherwise refrain from the joint operation. Mobile games without the required approval formalities shall be treated as illegal publications and the relevant entities shall be punished accordingly. The operation of SMS in China is classified as a value-added telecommunication business and SMS service providers shall obtain the relevant value-added telecommunication business permits.

### ***Regulations on Internet Content***

The PRC government has promulgated measures relating to Internet content through a number of ministries and agencies, including MIIT, the Ministry of Culture and GAPPRFT. These measures specifically prohibit Internet activities, including the operation of online games 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. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—The laws and regulations governing the online game industry in China are developing and subject to future changes. If we fail to obtain or maintain all applicable permits and approvals, our business and operations could be materially and adversely affected.” If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

In April 2007, various governmental authorities, including GAPP, MIIT, the Ministry of Education, the Ministry of Public Security, and other relevant authorities jointly issued a circular concerning the mandatory implementation of an “anti-fatigue system” in online games, which was aimed at protecting the physical and psychological health of minors. This circular required all online games to incorporate an “anti-fatigue system” and an identity verification system, both of which have limited the amount of time that a minor or other user may continuously spend playing an online game. We have implemented such “anti-fatigue” and identification systems on all of our online games as required. Since March 2011, various governmental authorities, including the Ministry of Culture, MIIT, the Ministry of Education, the Ministry of Public Security, and other relevant authorities have jointly launched the “Online Game Parents Guardianship Project for Minors,” which allows parents to require online game operators to take relevant measures to limit the time spent by the minors on playing online games and the minors’ access to their online game accounts. On February 5, 2013, the Ministry of Culture, MIIT, GAPP and various other governmental authorities, jointly issued the Working Plan on the Comprehensive Prevention Scheme on Online Game Addiction of Minors, which further strengthened the administration of the Internet cafés, reinstated the importance of the “anti-fatigue system” and “Online Game Parents Guardianship Project for Minors” as prevention measures against the online game addiction of minors and ordered all relevant governmental authorities to take all necessary actions in implementing such measures. In addition, pursuant to the MOC Online Games Regulation, which was issued on December 1, 2016 by MOC, an enterprise engaged in online game operations shall strictly comply with the provisions of the “Online Game Parents Guardianship Project for Minors,” and online game operators are encouraged to set upper limits on the consumption by users who are minors, limit the amount of time that such users are allowed to spend on online games, and take technical measures to block scenes and functions, among other things, that are not suitable for users who are minors. Additional requirements for anti-fatigue and identification systems in our games, as well as the implementation of any other measures required by any new regulations the PRC government may enact to further tighten its administration of the Internet and online games, and its supervision of Internet cafés, may limit or slow down our prospects for growth, or may materially and adversely affect our business results. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Our business may be adversely affected by public opinion and government policies in China.”

Internet content in China is also regulated and restricted from a state security standpoint. The National People’s Congress, China’s national legislative body, has enacted a law that may subject to criminal punishment in China any effort to: (1) gain improper entry into a computer or system of strategic importance; (2) disseminate politically disruptive information; (3) leak state secrets; (4) spread false commercial information; or (5) infringe intellectual property rights.

The Ministry of Public Security has promulgated measures that prohibit the use of the Internet in ways which, among other things, results in a leakage of state secrets or a spread of socially destabilizing content. The Ministry of Public Security has supervision and inspection rights in this regard, and we may be subject to the jurisdiction of the local security bureaus. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—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.” If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

### ***Regulations on Privacy Protection***

PRC laws and regulations do not prohibit Internet content providers from collecting and analyzing personal information from their users subject to the user’s prior consent. We require our users to accept a user agreement whereby they agree to provide certain personal information to us. PRC law prohibits Internet content providers from disclosing to any third parties any information transmitted by users through their networks unless otherwise permitted by law. If an Internet content provider violates these regulations, it may be liable for damages caused to its users and it may be subject to administrative penalties such as warnings, fines, confiscation of its unlawful income, revocation of licenses, cancellation of filings, shutdown of their websites or even criminal liabilities.



### ***Import Regulations***

Our ability to obtain licenses for online games from abroad and import them into China is regulated in several ways. We are required to register with MOFCOM any license agreement with a foreign licensor that involves an import of technologies, including online game software into China. Without that registration, we may not remit licensing fees out of China to any foreign game licensor. In addition, the Ministry of Culture requires us to submit for its content review and/or approval any online games we want to license from overseas game developers or any patch or updates for such game if it contains substantial changes. If we license and operate games without that approval, the Ministry of Culture may impose penalties on us, including revoking the Internet culture operation license required for the operation of online games in China. Also, pursuant to a jointly issued notice in July 2004, GAPP and the State Copyright Bureau require us to obtain their approval for imported online game publications. Furthermore, the State Copyright Bureau requires us to register copyright license agreements relating to imported software. Without the State Copyright Bureau registration, we cannot remit licensing fees out of China to any foreign game licensor and we are not allowed to publish or reproduce the imported game software in China.

### ***Regulations on Intellectual Property Rights***

The State Council and the State Copyright Bureau have promulgated various regulations and rules relating to the protection of software in China. Under these regulations and rules, software owners, licensees and transferees may register their rights in software with the State Copyright Bureau or its local branches and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process and registered software rights may receive better protection. We have registered most of our in-house developed online games with the State Copyright Bureau.

### ***Regulations on Foreign Currency Exchange and Dividend Distribution***

*Foreign Currency Exchange.* Foreign currency exchange regulation in China is primarily governed by the following rules:

- Foreign Exchange Administration Rules (1996), as amended in 1997 and 2008; and
- Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996).

Pursuant to the Foreign Exchange Administration Rules (1996), as amended in 1997 and 2008, the RMB is generally freely convertible for trade and service-related foreign exchange transactions, but not for direct investment, loans, investment in securities, or other transactions through a capital account outside China unless the prior approval of SAFE is obtained. Furthermore, foreign investment enterprises in China in general may purchase foreign exchange without the approval of SAFE for trade and service-related foreign exchange transactions by providing commercial documents evidencing these transactions. Foreign investment enterprises that need foreign exchange for the distribution of profits to their shareholders may effect payment from their foreign exchange account or purchase and pay foreign exchange at the designated foreign exchange banks to their foreign shareholders by producing board resolutions for such profit distribution. Under the Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), based on their needs, foreign investment enterprises are permitted to open foreign exchange settlement accounts for current account receipts and payments of foreign exchange along with specialized accounts for capital account receipts and payments of foreign exchange at certain designated foreign exchange banks.

On November 19, 2012, SAFE promulgated the Circular of Further Improving and Adjusting Foreign Exchange Administration Policies on Foreign Direct Investment, or SAFE Circular 59, which became effective on December 17, 2012. The major developments under SAFE Circular 59 were that the opening of various special purpose foreign exchange accounts (e.g. pre-establishment expenses account, foreign exchange capital account, guarantee account) no longer required the approval of SAFE. Furthermore, multiple capital accounts for the same entity may be opened in different provinces, which was not possible before the issuance of SAFE Circular 59. Reinvestment of RMB proceeds by foreign investors in the PRC no longer required SAFE approval or verification, and remittance of foreign exchange profits and dividends by a foreign-invested enterprise to its foreign shareholders no longer required SAFE approval.

On May 10, 2013, SAFE promulgated the Circular on Printing and Distributing the Provisions on Foreign Exchange Administration over Domestic Direct Investment by Foreign Investors and the Supporting Documents, which specifies that the administration by SAFE or its local branches over direct investment by foreign investors in the PRC shall be based on registration. Institutions and individuals shall register with SAFE and/or its branches for their direct investment in the PRC. Banks shall process foreign exchange business relating to the direct investment in the PRC based on the registration information provided by SAFE and its branches.

On February 13, 2015, SAFE issued the Circular on Further Simplifying and Improving the Foreign Exchange Administration Policies on Direct Investments, or SAFE Circular 13, which took effect on June 1, 2015. Pursuant to SAFE Circular 13, the administrative examination and approval procedures with SAFE or its local branches relating to the foreign exchange registration approval for domestic direct investments as well as overseas direct investments have been cancelled, and qualified banks are delegated the power to directly conduct such foreign exchange registrations under the supervision of SAFE or its local branches.

*Dividend Distribution.* The principal regulations governing distribution of dividends of foreign holding companies include:

- The Wholly Foreign Invested Enterprise Law (1986), as amended in 2000; and
- Administrative Rules under the Wholly Foreign Invested Enterprise Law (1990), as amended in 2001 and 2014.

Under these regulations, foreign investment enterprises in China 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 China are required to allocate at least 10% of their respective profits each year, if any, to fund certain reserve funds until the cumulative total of the allocated reserve funds reaches 50% of an enterprise's registered capital and a portion of their respective after-tax profits to their staff welfare and bonus reserve funds as determined by their respective board of directors or shareholders. These reserves are not distributable as dividends.

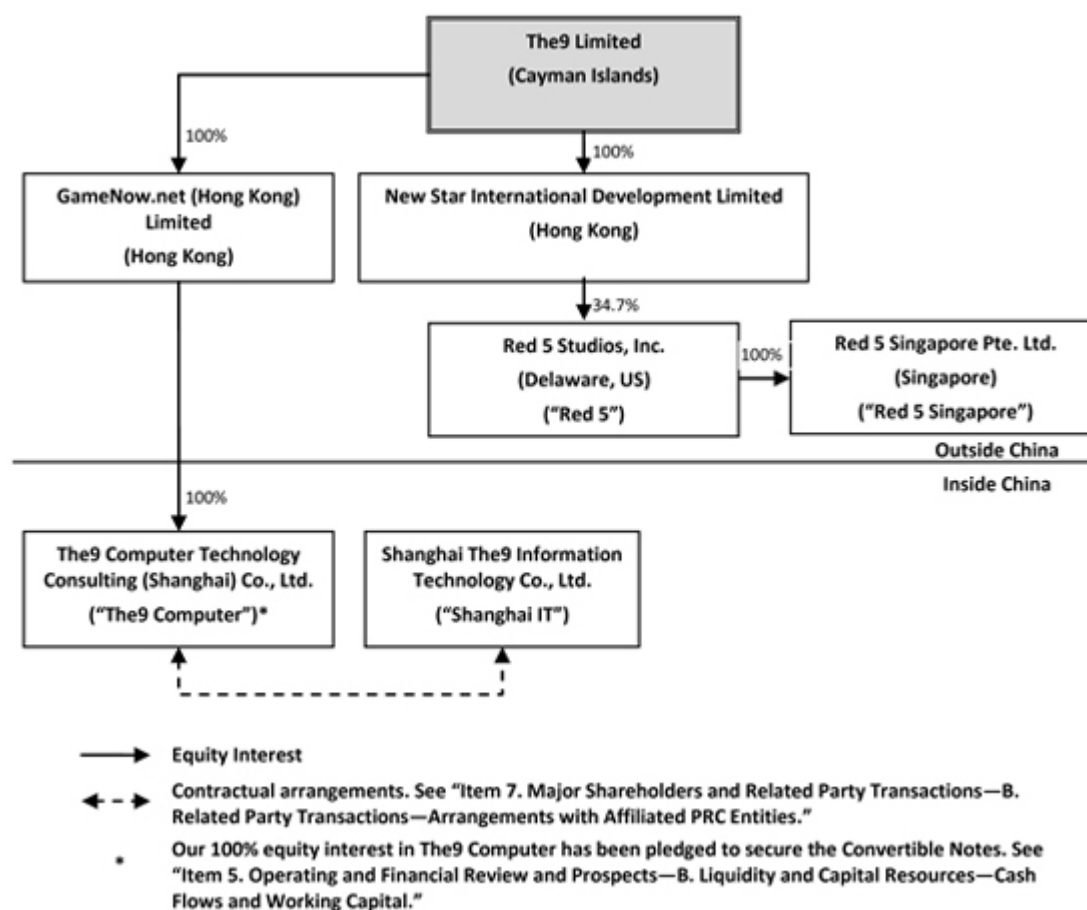
#### ***Regulations on Foreign Exchange in Certain Onshore and Offshore Transactions***

On July 4, 2014, SAFE issued SAFE Circular 37, which is the Circular on Several Issues Concerning Foreign Exchange Administration of Domestic Residents Engaging in Overseas Investment, Financing and Round-Trip Investment via Special Purpose Vehicles. SAFE Circular 37 and its detailed guidelines require PRC residents to register with the local branch of SAFE before contributing their legally owned onshore or offshore assets or equity interest into any SPV directly established, or indirectly controlled, by them for the purpose of investment or financing. In addition, when there is (a) any change to the basic information of the SPV, such as any change relating to its individual PRC resident shareholders, name or operation period or (b) any material change, such as increase or decrease in the share capital held by its individual PRC resident shareholders, a share transfer or exchange of the shares in the SPV, or a merger or split of the SPV, the PRC resident must register such changes with the local branch of SAFE on a timely basis. According to the relevant SAFE rules, failure to comply with the registration procedures set forth in SAFE Circular 37 may result in restrictions being imposed on the foreign exchange activities of the relevant onshore companies of SPVs, including the payment of dividends and other distributions to its offshore parent or affiliate and the capital inflow from such offshore entity, and may also subject the relevant PRC residents and onshore companies to penalties under PRC foreign exchange administration regulations. Further, failure to comply with various SAFE registration requirements described above would result in liability for foreign exchange evasion under PRC laws. On February 13, 2015, SAFE issued SAFE Circular 13, which is the Circular on Further Simplifying and Improving the Foreign Exchange Administration Policies on Direct Investments, which took effect on June 1, 2015. Under SAFE Circular 13, qualified banks are delegated the power to register all PRC residents' investments in SPVs pursuant to SAFE Circular 37, saving for supplementary registration application made by PRC residents who failed to comply with SAFE Circular 37, which shall still fall into the jurisdiction of the local branch of SAFE.

As a result of the uncertainties relating to the interpretation and implementation of SAFE Circular 37 and other regulations of SAFE, we cannot predict how these regulations will affect our business operations or strategies. For example, our present or future PRC subsidiaries' ability to conduct foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, may be subject to compliance with such SAFE registration requirements by relevant PRC residents, over whom we have no control. In addition, we cannot assure you that any such PRC residents will be able to complete the necessary approval and registration procedures required by the SAFE regulations. We have requested all of our shareholders who, based on our knowledge, are PRC residents or whose ultimate beneficial owners are PRC residents to comply with all applicable SAFE registration requirements, but we have no control over our shareholders. We cannot assure you that the PRC beneficial owners of our company and our subsidiaries have completed the required SAFE registrations. Nor can we assure you that they will be in full compliance with the SAFE registration in the future. Any non-compliance by the PRC beneficial owners of our company and our subsidiaries may subject us or such PRC resident shareholders to fines and other penalties. It may also limit our ability to contribute additional capitals to our PRC subsidiaries and our subsidiaries' ability to distribute profits or make other payments to us.

### C. Organizational Structure

The following diagram illustrates our organizational structure, the place of formation, ownership interest of each of our significant subsidiaries and affiliated entities as of the date of this annual report:



### D. Property, Plants and Equipment

Our headquarters are located on premises comprising approximately 14,000 square meters in an office building in Shanghai, China. We purchased the office building in which our headquarters are located, and lease all of our other premises from unrelated third parties. Our office building has been mortgaged to secure the Convertible Notes in the aggregate principal amount of US\$40,050,000 issued and sold to Splendid Days and an entrusted loan of approximately RMB31.6 million (US\$4.6 million) that we obtained from a third party in December 2015. In addition, we have subsidiaries located in the United States, Singapore and South Korea and small branch offices in Beijing, Nanjing, Wuhan, Xi'an, Chengdu and Shenyang, China. Our equipment consists substantially of numerous servers and network devices located in two Internet data centers in China.

#### Item 4A. UNRESOLVED STAFF COMMENTS

None.

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

The following discussion of our financial condition and results of operations is based upon and should be read in conjunction with our consolidated financial statements and their related notes included in this annual report. This report contains forward-looking statements. See “—G. Safe Harbor.” In evaluating our business, you should carefully consider the information provided under the caption “Risk Factors” in this annual report. We caution you that our businesses and financial performance are subject to substantial risks and uncertainties.

##### A. Operating Results

The major factors affecting our results of operations and financial conditions include:

- our revenues’ composition and sources of revenues;
- our cost of revenue; and
- our operating expenses.

**Revenue Composition and Sources of Revenue.** In 2014, 2015 and 2016, we generated substantially all of our revenues from online game services, and the remaining portion of our revenues from other services. The following table sets forth our revenues generated from providing online game services and other services, both in absolute amounts and as percentages of total revenues for the periods indicated.

	For the Year Ended December 31,						
	2014		2015		2016		
	RMB	%	RMB	%	RMB	US\$	%
	(in thousands, except percentages)						
Revenue:							
Online game services	55,418	85.5	40,504	86.9	48,566	6,995	86.3
Other revenues	9,422	14.5	6,106	13.1	7,720	1,112	13.7
Total revenues	<u>64,840</u>	<u>100.0</u>	<u>46,610</u>	<u>100.0</u>	<u>56,286</u>	<u>8,107</u>	<u>100.0</u>

**Online Game Services.** In 2014, 2015 and 2016, revenues from our online game services amounted to RMB55.4 million, RMB40.5 million and RMB48.6 million (US\$7.0 million), respectively. We primarily generate our online game service revenues through item-based revenue models. Under an item-based revenue model, players of our games play the games for free, but are charged for purchases of in-game items, such as performance-enhancing items, clothing and accessories. Thus, we generate revenues through the sale of such in-game premium features that players use game points to purchase. The distribution of points to end users is typically made through sales of prepaid online points. Fees from prepaid online points are deferred when initially received. This revenue is recognized over the life of the premium features or as the premium features are consumed. Future usage patterns may differ from the historical usage patterns on which the virtual items and services consumption model is based. We will continue to monitor the operational statistics and usage patterns affecting our recognition of these revenues.

**Other Revenues.** Other revenues mainly included revenues from mobile app training services and, starting in 2016, revenues from the provision of game development and technical services to customers.

**Cost of Revenue.** Our cost of revenue consists of costs directly attributable to rendering our services, including online game royalties, payroll, sharing to third party game platform, telecom carries and other suppliers, depreciation and rental of Internet data center sites, depreciation and amortization of computer equipment and software, intangible assets amortization and other overhead expenses directly attributable to the services we provide.

**Operating Expenses.** Our operating expenses consist primarily of product development expenses, sales and marketing expenses, general and administrative expenses, impairment on intangible assets and impairment on goodwill.

*Product Development Expenses.* Our product development expenses consist primarily of compensation to our product development personnel, outsourced research and development expenses, equipment and software depreciation charges and other overhead expenses for the development of our proprietary games. Our product development expenses amounted to RMB156.3 million, RMB135.0 million and RMB78.0 million (US\$11.2 million) for the years ended December 31, 2014, 2015 and 2016, respectively. Most of our proprietary online games have entered into their final stages of development and we have the ability to control the level of discretionary spending on product development in the near future.

*Sales and Marketing Expenses.* Our sales and marketing expenses consist primarily of advertising and marketing expenses incurred to promote our games and compensation expenses relating to our sales and marketing personnel. Our sales and marketing expenses amounted to RMB51.8 million, RMB31.7 million and RMB21.3 million (US\$3.1 million) for the years ended December 31, 2014, 2015 and 2016, respectively.

*General and Administrative Expenses.* Our general and administrative expenses consist primarily of compensation and travel expenses for our administrative staff, depreciation of property and equipment, entertainment expenses, administrative office expenses, as well as fees paid to professional service providers for auditing and legal services. General and administrative expenses amounted to RMB111.2 million, RMB131.8 million and RMB129.0 million (US\$18.6 million) for the years ended December 31, 2014, 2015 and 2016, respectively. General and administrative expenses continued to decrease from 2015 to 2016, which reflects our cost cutting efforts.

*Impairment on Intangible Assets.* We had impairment charges on certain intangible assets of RMB68.0 million (US\$9.8 million) for the year ended December 31, 2016. We did not have such impairment charges for the years ended December 31, 2014 and 2015.

*Impairment Loss on Goodwill.* We had impairment charges on goodwill of RMB10.6 million (US\$1.5 million) in 2016, which represented the impairment of goodwill in connection with our acquisition of Red 5 in 2010. In 2016, due to the weaker-than-expected operating performance of Red5, we concluded that the goodwill was fully impaired. We did not have such impairment charges for the years ended December 31, 2014 and 2015.

*Other Operating Income(Expenses).* We had operating income of RMB3.6 million (US\$0.5 million) in 2016, including primarily IDC rental fee and office rental fee of RMB4.2 million (US\$0.6 million), which were partially offset by the disposal of property, equipment and software of RMB0.6 million (US\$0.09 million). We had operating expenses of RMB1.6 million in 2015, representing a loss on disposal of property, equipment and software. Our other operating income in 2014, which amounted to RMB75,000, represented rental income.

## **Holding Company Structure**

We are a holding company incorporated in the Cayman Islands and rely primarily on dividends and other distributions from our subsidiaries and our affiliated entities in China for our cash requirements. Current PRC regulations restrict our affiliated entities and subsidiaries from paying dividends in the following two principal aspects: (i) our affiliated entities and subsidiaries in China are only permitted to pay dividends out of their respective accumulated profits, if any, determined in accordance with PRC accounting standards and regulations; and (ii) these entities are required to allocate at least 10% of their respective accumulated profits each year, if any, to fund certain capital reserves until the cumulative total of the allocated reserves reach 50% of registered capital, and a portion of their respective after-tax profits to their staff welfare and bonus reserve funds as determined by their respective boards of directors. These reserves are not distributable as dividends. See “Item 4. Information on the Company—B. Business Overview—Government Regulations.” In addition, failure to comply with relevant SAFE regulations may restrict the ability of our subsidiaries to make dividend payments to us. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident shareholders or us to penalties and fines, and limit our ability to inject capital into our PRC subsidiaries, limit our subsidiaries’ ability to increase their registered capital, distribute profits to us, or otherwise adversely affect us.”

## Income and Sales Taxes

The National People's Congress of the PRC adopted and promulgated the EIT Law on March 16, 2007. The EIT Law went into effect as of January 1, 2008, and unified the tax rate generally applicable to both domestic and foreign-invested enterprises in the PRC. Our company's subsidiaries and affiliated entities in the PRC are generally subject to EIT at a statutory rate of 25%. Our subsidiaries and affiliated entities in the PRC that hold a HNTE qualification are entitled to enjoy a 15% preferential EIT rate.

In addition, under the EIT Law, enterprises organized under the laws of their respective jurisdictions outside the PRC may be classified as either "non-resident enterprises" or "resident enterprises." Non-resident enterprises are subject to withholding tax at the rate of 20% with respect to their PRC-sourced dividend income if they have no establishment or place of business in the PRC or if such income is not related to their establishment or place of business in the PRC, unless otherwise exempted or reduced according to treaties or arrangements between the PRC central government and the governments of other countries or regions. The State Council has reduced the withholding tax rate to 10% in the newly promulgated implementation rules of the EIT Law. As we are incorporated in the Cayman Islands, we may be regarded as a "non-resident enterprise." We hold equity interests in certain PRC subsidiaries through subsidiaries in Hong Kong. According to the Tax Agreement between the PRC and Hong Kong, dividends paid by a foreign-invested enterprise in the PRC to its corporate shareholder in Hong Kong holding 25% or more of its equity interest may be subject to withholding tax at the maximum rate of 5% if certain criteria are met. Entitlement to such lower tax rate on dividends according to tax treaties or arrangements between the PRC central government and governments of other countries or regions is further subject to approval of relevant tax authority.

Furthermore, the SAT promulgated Circular 601 which provides guidance for determining whether a resident of a contracting state is the "beneficial owner" of an Item of income under China's tax treaties and tax arrangements. According to Circular 601, a beneficial owner generally must be engaged in substantial business activities. An agent or conduit company will not be regarded as a beneficial owner and, therefore, will not qualify for treaty benefits. The conduit company normally refers to a company that is set up for the purpose of avoiding or reducing taxes or transferring or accumulating profits. In June 2012, SAT further promulgated Circular 30 which provides that the tax authorities shall make the decision based on comprehensive consideration of all determining factors provided in Circular 601 rather than the status of a single determining factor. We cannot assure you that any dividends to be distributed by us or by our subsidiaries to our non-PRC shareholders and ADS holders whose jurisdiction of incorporation has a tax treaty with China providing a different withholding arrangement will be entitled to the benefits under the relevant withholding arrangement.

The EIT law deems an enterprise established offshore but having its management organ in the PRC as a "resident enterprise" that will be subject to PRC tax at the rate of 25% of its global income. Under the Implementation Rules of the New Enterprise Income Tax Law, the term "management organ" is defined as "an organ which has substantial and overall management and control over the manufacturing and business operation, personnel, accounting, properties and other factors." On April 22, 2009, the SAT further issued Circular 82. According to Circular 82, a foreign enterprise controlled by a PRC company or a PRC company group shall be deemed a PRC resident enterprise, if (i) the senior management and the core management departments in charge of its daily operations are mainly located and function in the PRC; (ii) its financial decisions and human resource decisions are subject to the determination or approval of persons or institutions located in the PRC; (iii) its major assets, accounting books, company seals, minutes and files of board meetings and shareholders' meetings are located or kept in the PRC; and (iv) more than half of the directors or senior management with voting rights reside in the PRC. On July 27, 2011, SAT issued SAT Bulletin 45 which further clarified the detailed procedures for determination of the resident status provided in Circular 82, competent tax authorities in charge and post-determination administration of such resident enterprises. Although our offshore companies are not controlled by any PRC company or PRC company group, we cannot assure you that we will not be deemed to be a "resident enterprise" under the EIT Law and thus be subject to PRC EIT on our global income.

According to the EIT Law and its implementation rules, dividends are exempted from income tax if such dividends are received by a PRC resident enterprise on equity interests it directly owns in another PRC resident enterprise. However, foreign corporate holders of our shares or ADSs may be subject to taxation at a rate of 10% on any dividends received from us or any gains realized from the transfer of our shares or ADSs if we are deemed to be a resident enterprise or if such income is otherwise regarded as income "sourced within the PRC." See "Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to decrease."

With respect to sales taxes, before December 31, 2011, all the services provided by our PRC subsidiaries were subject to business taxes at the rate of 5%. In October, 2011, China's Ministry of Finance and the SAT jointly issued the Circular 110 to launch the VAT reform pilot program in Shanghai. Following the Circular 110, the Ministry of Finance and the SAT jointly issued the Circular 111 in November 2011 to provide detailed implementation rules for the program. The two circulars, which would be effective from January 1, 2012, stipulated that certain services, subject to the pilot programs, shall be subject to VAT instead of business tax. On July 31, 2012, the Ministry of Finance and the SAT jointly issued Circular 71 which further extended areas subject to the pilot program to eight more provinces. On December 12, 2013, the Ministry of Finance and the SAT jointly issued the Interim Implementation Rules on the Pilot Program for the Collection of Value Added Tax Instead of Business Tax and a series of other rules, which annulled the preceding trial rules and extended applicable areas of the pilot program to the whole country. As a result of such Implementation Rules, some of our services provided by Shanghai IT and The9 Computer are subject to VAT at the rate of 6%. Shanghai IT and The9 Computer, as General VAT Payers under the applicable tax regulations, may reduce their Input VAT. Certain services provided by Shanghai The9 Education Technology Co., Ltd. and other PRC subsidiaries or affiliated PRC entities shall be subject to VAT at the rate of 3%, and these companies as Small-scale VAT Payers under the applicable tax regulations may not reduce their VAT payable by their Input VAT.

On March 23, 2016, the Ministry of Finance and the SAT jointly issued the Circular on the Pilot Program for Overall Implementation of the Collection of Value Added Tax Instead of Business Tax, or Circular 36, which took effect on May 1, 2016. Pursuant to Circular 36, all companies operating in construction, real estate, finance, modern service or other sectors which were required to pay business tax are required to pay VAT in lieu of business tax. As a result of Circular 36, the services provided by Shanghai IT, The9 Computer, C9I Shanghai, Shanghai Fire Wing and The9 Education as general VAT payers will be subject to VAT at the rate of 6%, and the services provided by our other PRC subsidiaries or affiliated PRC entities as small-scale VAT payers will be subject to VAT at the rate of 3%.

Our subsidiaries in the United States are registered in California and are subject to U.S. federal corporate marginal income tax at a rate of 34% and state income tax at a rate of 0.23%, respectively.

## **Inflation**

Since our inception, inflation in China has not materially impacted our results of operations. According to the National Bureau of Statistics of China, the year-over-year percent changes in the consumer price index for December 2014, 2015 and 2016 increases of 1.5%, 1.6% and 2.1%, respectively. Although we have not been materially affected by inflation, we may be affected if China experiences higher rates of inflation in the future.

## **Critical Accounting Policies**

We prepare financial statements in conformity with U.S. Generally Accepted Accounting Principles, or U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities on the date of the financial statements, and the reported amounts of revenue and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities 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. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements as their application assists management in making their business decisions.

## ***Consolidation of Variable Interest Entities, or VIEs***

PRC laws and regulations, including the GAPP Circular and the Network Publication Measures, currently prohibit or restrict foreign ownership of Internet-related businesses. We believe, consistent with the view of our PRC legal counsel, that our current structure complies with these foreign ownership restrictions, subject to the interpretation and implementation of the GAPP Circular and the Network Publication Measures. Specifically, we operate our business through Shanghai IT and have entered into a series of contractual arrangements with Shanghai IT and its equity owners. See the contractual arrangements set forth in “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions.” As a result of these contractual arrangements, we are entitled to receive service fees for services provided to Shanghai IT for an amount determined at our discretion, up to 90% of PRC entities’ profits. In addition, the equity owners of record for these entities have pledged all their equity interests in the VIEs to us as collateral for all of their payments due to the wholly-owned foreign enterprise, or WOFE, and to secure performance of all obligations of the VIEs and their shareholders under various agreements. In addition, the agreements provide that any dividend distributions made by the VIEs, if any, are required to be deposited in an escrow account over which we have exclusive control. Moreover, through the Call Option Agreements and Shareholder Voting Proxy Agreements, each shareholder of the VIEs granted WOFE or any third parties designated by the WOFE an irrevocable power of attorney to act on all matters pertaining to the VIEs. We believe that the terms of the Call Option Agreements are currently exercisable and legally enforceable under the PRC laws and regulations. We also believe that the minimum amount of consideration permitted by the applicable PRC law to exercise the options does not represent a financial barrier or disincentive for us to exercise our rights under the Call Option Agreements. A simple majority vote of our board of directors is required to pass a resolution to exercise our rights under the Call Option Agreements, for which consent of the shareholder of the VIEs is not required. As a result of the totality of these arrangements, we have both the power to direct activities that most significantly impact the VIEs economic performance and the obligation to absorb losses of or right to receive benefits from the VIEs that are significant to Shanghai IT. As a result, we concluded we are the primary beneficiary of Shanghai IT and as such Shanghai IT is consolidated VIE of our company.

The GAPP Circular reiterates and reinforces the long-standing prohibition of foreign ownership of Internet-related publication businesses via direct, indirect or disguised methods, and the Network Publication Measures provides that the manner of project cooperation shall be subject to prior examination and approval by the GAPPRFT. However, it is not clear whether GAPPRFT and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China. In addition, the GAPP Circular and the Network Publication Measures do not specifically invalidate VIE agreements, and we are not aware of any online game companies adopting similar contractual arrangements as ours having been penalized or ordered to terminate such arrangements since the GAPP Circular first became effective. Therefore, we believe that our ability to direct the activities of Shanghai IT that most significantly impact our economic performance is not affected by the GAPP Circular. Any changes in PRC laws and regulations that affect our ability to control Shanghai IT might preclude us from consolidating Shanghai IT in the future. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—PRC laws and regulations restrict foreign ownership of Internet content provision, Internet culture operation and Internet publishing licenses, and substantial uncertainties exist with respect to the application and implementation of PRC laws and regulations.”

## ***Revenue Recognition***

### *Online Game Services*

We earn revenue from provision of online game operation services to players on our game servers and third party platform and overseas licensing of the online game to other operators. We recognize revenues when persuasive evidence of an arrangement exists, services are delivered or performed, our price is fixed or determinable and collectability is reasonably assured.

### *Online game services to players on our game server*

We generate revenue primarily from the sale of prepaid online points for our online game services products to distributors who in turn ultimately sell them to players. We also sell the points directly to players via certain online payment platforms.

We utilize a virtual item/service consumption model to recognize revenue. Under this model, we generate online game service revenues through the sale of in-game premium features. In this model, players can access our basic games free of charge and then may purchase game points to acquire in-game premium features. The distribution of points to players is typically made through sales of prepaid online points. Fees for prepaid online points are deferred when initially received. This revenue is recognized over the estimated life of the premium features or as the premium features are consumed.



For in-game premium features that are immediately consumed, revenue is recognized upon consumption. For premium features with a stated expiration time, which ranges from one to 180 days, revenue is recognized ratably over the period starting from when the feature is first used to the expiration time. For perpetual features with no predetermined expiration, revenue is recognized ratably over the estimated average lives of the perpetual features, which are typically less than one year. When estimating the average lives of the in-game perpetual features, we consider the average period that players typically play the game, other player behavior patterns, and factors including the acceptance and popularity of expansion packs, promotional events launched, and market conditions. Future usage patterns of players may differ from the historical usage patterns on which the virtual item / service consumption revenue recognition model is based. We continually monitor the operational statistics and usage patterns.

#### Online game services over third party platform

Certain social games, TV games, certain web games and certain MMOGS, have adopted the virtual item / service consumption model, and are launched on the third party game platforms and telecom carriers. Revenue from social and web games operated through third party game platforms are recognized upon consumption of the in-game premium features with the amount net of remittance to the third party game platforms as we do not set the pricing of the in-game currency of the third party game platforms.

Revenue from TV games operated through telecom carriers and certain MMOGS operated on the third party game platforms are recognized upon consumption of the in-game premium features based on the gross amount paid, as we are the primary obligor of the games operation. The remittance to the telecom carrier and third party game platforms is recognized as costs of revenue when incurred.

#### Licensing revenue

We license our proprietary online games to other game operators and receive license fees and royalty income in connection with their operation of the games. License fee revenue is recognized over the license period upon the commercialization of the game in the overseas market. Royalty income is recognized when earned, provided that collectability is reasonably assured.

#### *Other Revenues*

Other revenues include those generated from mobile app training services and from the provision of game development and technical services to third parties.

#### Training and advertisement

Training and advertisement revenue include revenues generated from providing technical training to college students on mobile application programming and, prior to the sale of our 58% equity interest in our mobile advertising platform, advertising services on our mobile advertising platform. These revenues are recognized when delivery of the website advertisement has occurred or when services have been rendered and the collection of the related fees is reasonably assured.

#### **Income Taxes**

We account for income taxes under the asset and liability method. Deferred taxes are determined based upon the differences between the carrying value of assets and liabilities for financial reporting and tax purposes at currently enacted statutory tax rates for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period of change.

A valuation allowance is provided on deferred tax assets to the extent that it is more likely than not that such deferred tax assets will not be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred tax assets and liabilities. Realization of the future tax benefits related to the deferred tax assets is dependent on many factors, including our ability to generate taxable income within the period during which the temporary differences reverse or our tax loss carry forwards expire, the outlook for the PRC economic environment, and the overall future industry outlook. We consider these factors in reaching our conclusion on the recoverability of the deferred tax assets and determine the valuation allowances necessary at each balance sheet date.

We recognize the impact of an uncertain income tax position at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. Income tax related interest is classified as interest expenses and penalties as income tax expense. As of December 31, 2014, 2015 and 2016, we did not have any material liability for uncertain tax positions. Our policy is to recognize, if any, tax-related interest as interest expenses and penalties as income tax expenses. For the years ended December 31, 2014, 2015 and 2016, we did not have any material interest and penalties associated with tax positions.

### ***Intangible Assets***

Our intangible assets consist primarily of acquired game licenses and acquired game development costs from business combination.

Acquired game licenses are amortized on a straight-line basis over the shorter of the useful economic life of the relevant online game or license period, which range from two to seven years. Amortization of upfront licensing fees commences upon the monetization of the related online game. We recognize intangible assets acquired through business acquisitions as assets separate from goodwill. Acquired in-process research and development costs are initially considered an indefinite-lived asset. Subsequently, they are recorded as acquired game development cost upon completion of the research and development efforts and are amortized on a straight-line basis over the useful economic life of the relevant online game. Amortization of acquired game development cost commences upon the monetization of the related online game.

### ***Goodwill***

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of an acquisition we make. Goodwill is not amortized, but tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired. In December of each year, we test impairment of goodwill at the reporting unit level and recognize impairment in the event that the carrying value exceeds the fair value of each reporting unit. Goodwill impairment assessment requires significant judgment, including assumptions used to determine the fair value of the reporting units. We determine the fair value of our reporting units based on the present value of estimated future cash flows of the reporting units. If the carrying amount is in excess of the fair value, step two requires the comparison of the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. Any excess of the carrying value of the reporting unit's goodwill over the implied fair value of the reporting unit's goodwill is recorded as an impairment loss. After completing our annual impairment reviews during the fourth quarter of 2014 and 2015, the reporting unit that was subject to the annual impairment testing had a fair value which exceeded its respective carrying value by a significant margin with no risk of failing the first step of the impairment test. We concluded that goodwill was not impaired as of December 31, 2014 and 2015. In 2016, due to the weaker-than- expected operating performance of Red 5, we concluded that goodwill was fully impaired as of December 31, 2016.

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

Under our the 2004 Stock Option Plan, or the Option Plan, we granted options to purchase a total of 355,000 and 10,110,000 ordinary shares of our company to our employees and directors in 2013 and 2015, respectively. We did not grant any options under the Option Plan in 2014. We granted options to purchase a total of 6,000,000 ordinary shares of our company to a director and a consultant in 2016.

We measure the cost of employee services received in exchange for stock-based compensation measured at the grant date fair value of the award. For the awards that are modified, we determine the incremental cost as the excess of the fair value of the modified award over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. We recognize the compensation costs, net of the estimated forfeiture, on a straight-line basis over the vesting period of the award, which generally ranges from one to four years. Forfeiture rates are estimated based on historical forfeiture patterns and adjusted to reflect future changes in circumstances and facts, if any. If actual forfeitures differ from those estimates, the estimates may be revised in subsequent periods. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

Determining the fair value of stock options requires significant judgment. We measure the fair value of the stock options using the Black-Scholes option-pricing model with assumptions made regarding expected term, volatility, risk-free interest rate, and dividend yield. The expected term represents the period of time that the awards granted are expected to be outstanding. The expected term is determined based on historical data on employee exercise and post-vesting employment termination behavior, or the “simplified” method for stock option awards with the characteristics of “plain vanilla” options for 2010 and 2011. Expected volatilities are based on historical volatilities of our ordinary shares. Risk-free interest rate is based on U.S. government bonds issued with maturity terms similar to the expected term of the stock-based awards. While we paid a discretionary cash dividend in January 2009, we do not anticipate paying any recurring cash dividends in the foreseeable future.

In addition, on December 8, 2010, we granted 1,500,000 ordinary shares to Jun Zhu, our chairman and chief executive officer, which will only be vested if our company achieves certain income targets and the shares are not entitled to receive dividends until they become vested. Of such shares, 500,000 ordinary shares were vested and issued to IncSight Limited, a company wholly-owned by Jun Zhu, on November 17, 2015. We considered the grant of ordinary shares as an incentive to retain Mr. Jun Zhu’s services with our company. The awarded non-vested shares would be valid for five years from December 8, 2010. The fair value of the granted non-vested shares is US\$6.48 per share, the market price on the date of grant. We record share-based compensation expenses for these performance-based awards based upon our estimate of the probable outcome at the end of the performance period (i.e., the estimated performance against the performance targets). We periodically adjust the cumulative share-based compensation recorded when the probable outcome for these performance-based awards is updated based upon changes in actual and forecasted operating results. Our actual performance against the performance targets could differ materially from our estimates.

In May 2011, we granted 30,000 ordinary shares to each of our four non-executive directors, of which 10,000 ordinary shares vest for each director on July 1 of each year from 2011 to 2013 so long as such director continues his service as of such date. An aggregate of 40,000 ordinary shares vested in each of July 2011, July 2012 and July 2013, respectively. The fair value of the shares granted was US\$6.03 per share, being the market price on the date of the grant.

In February 2006, Red 5 adopted a Stock Incentive Plan, or Red 5 Stock Incentive Plan, under which Red 5 may grant to its employees, director and consultants stock options to purchase common stocks or restricted stocks of Red 5. Red 5 granted options to purchase an aggregate of 28,963,258 shares of common stock under the Red 5 Stock Incentive Plan from April 6, 2010 to December 31, 2013. In September 2012, Red 5 granted an aggregate of 6,122,435 restricted common stocks to two directors of Red 5 including Mr. Zhu for their services to Red 5. We measure the share-based compensation based on the fair value of the award as of the grant date. We measure the fair value of the stock options using the Black-Scholes option-pricing model with assumptions made regarding the fair value of the common stock, expected term, volatility, risk-free interest rate, and dividend yield.

Share-based compensation expenses of RMB3.7 million, RMB34.0 million and RMB28.1 million (US\$4.1 million) were recognized for the years ended December 31, 2014, 2015 and 2016, respectively, for options and warrants granted to our company’s and its subsidiaries’ employees and directors, including incremental compensation cost due to the modification of option exercise price in April 2013 and November 2015.

### ***Impairment Loss of Equity Investment***

We assess our equity investments for impairment on a periodic basis by considering factors 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. If it has been determined that the carrying amount of equity investment are higher than related fair value and that this decline is other-than-temporary, the carrying value of the equity investment is adjusted downward to reflect these declines in value. Impairment loss relating to investment in an equity investee of nil, nil and RMB2.8 million (US\$0.4 million) was recognized in 2014, 2015 and 2016, respectively.

### ***Impairment on Long-lived Assets and Allowance on Long-term Receivable***

We review long-lived assets and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. We assess the recoverability of long-lived assets and intangible assets (other than goodwill) by comparing the carrying amount to the estimated future undiscounted cash flow associated with the related assets. We recognize impairment of long-lived assets and intangible assets in the event that the net book value of such assets exceeds the estimated future undiscounted cash flow attributable to such assets. We use estimates and judgment in our impairment tests, and if different estimates or judgments had been utilized, the timing or the amount of the impairment charges could be different. Impairment charges relating to intangible assets and other assets amounting to RMB3.6 million, RMB8.4 million and RMB 68.0million (US\$9.8 million) were recognized in 2014, 2015 and 2016, respectively. We determine the allowances on long-term receivables when facts and circumstances indicate that the long-term receivable is unlikely to be collected. When the collectability of the long-term receivable became likely subsequently, we reverse the allowance. We provided allowance on long-term receivables amounting to RMB17.9 million in 2013 while in 2014 we reversed the allowance on long-term receivables amounting to RMB17.9 million.

### ***Refund of WoW Game Points***

As a result of non-renewal of WoW license on June 7, 2009, we announced a refund plan in connection with unactivated WoW game point cards. According to the plan, unactivated WoW game point card holders are eligible to receive a cash refund from us. We recorded a liability in connection with both unactivated points cards and activated but unconsumed point cards of approximately RMB200.4 million, of which RMB4.0 million was refunded in 2009. Upon the loss of the WoW license, we concluded that the nature of the obligation substantively changed from deferred revenue, for which we had the ability to satisfy the underlying performance obligation, to an obligation to refund players for their unconsumed points. Thus, we have accounted for this refund liability by applying the relevant derecognition guidance when determining the proper accounting treatment. In accordance with this guidance, the refund liability associated with these WoW game points, to the extent not refunded, will be recorded as other operating income after we are legally released from the obligation to refund amounts under the applicable laws. As we announced the refund plan on September 7, 2009, the statute of limitations of the creditors (in this case the game players with claims for refund of unactivated WoW game point cards) to assert their claims for refund is two years from such date under applicable laws and thus our legal liability relating to the unactivated WoW game point cards was extinguished on September 7, 2011 and the associated liability amounting to RMB26.0 million was recognized as other operating income for the year ended December 31, 2011. With respect to the remaining refund liability, based on current PRC laws, to the extent not refunded, we, in consultation with legal counsel, have determined that we will be legally released from this liability in 2029, which represents 20 years from the date of discontinuation of WoW in 2009. However, if management were to publicly announce a refund policy, we would be legally released from any remaining liability for these activated, but unconsumed points, sooner than 20 years. To date, we have determined not to publicly announce any refund policy with respect to this remaining liability, and no refunds have been claimed. The remaining refund liability relating to the activated, but unconsumed WoW game points was RMB170.0 million (US\$24.5 million) as of December 31, 2016.

### ***Convertible Notes and Beneficial Conversion Feature (“BCF”)***

We have issued convertible notes and warrants in December 2015. We have evaluated whether the conversion feature of the notes is considered an embedded derivative instrument subject to bifurcation in accordance with ASC 815, *Accounting for Derivative Instruments and Hedging Activities*. Based on our evaluation, the conversion feature is not considered an embedded derivative instrument subject to bifurcation as conversion option does not provide the holder of the notes with means to net settle the contracts. Convertible notes, for which the embedded conversion feature does not qualify for derivative treatment, are evaluated to determine if the effective rate of conversion pursuant to the terms of the convertible note agreement is below market value. In these instances, the value of the BCF is determined as the intrinsic value of the conversion feature, which is recorded as deduction to the carrying amount of the notes and credited to additional paid-in-capital. For convertible notes issued with detachable warrants, a portion of the note’s proceeds is allocated to the warrant based on the fair value of the warrants as of the date of issuance. The allocated fair values for the warrants and BCF are both recorded in the financial statements as debt discounts from the face amount of the notes, which are then accreted to interest expense over the life of the related debt using the effective interest method.

## Warrants

We account for the detachable warrants issued in connection with convertible notes under the authoritative guidance on accounting for derivative financial instruments indexed to, and potentially settled in, a company's own stock. We classify warrants in our consolidated balance sheet as a liability which is revalued at each balance sheet date subsequent to the initial issuance. We use the Black-Scholes pricing model to value the warrants. Determining the appropriate fair-value model and calculating the fair value of warrants requires considerable judgment. A small change in the estimates used may cause a relatively large change in the estimated valuation. The estimated volatility of our common stock at the date of issuance, and at each subsequent reporting period, is based on historic fluctuations in our stock price. The risk-free interest rate is based on U.S. government bonds with a maturity similar to the expected remaining life of the warrants at the valuation date. The expected life of the warrants is based on the historical pattern of exercises of warrants.

## Redeemable Non-controlling Interests

Redeemable non-controlling interests are equity interests of our consolidated subsidiary not attribute to us that have redemption features that are not solely within our control. These interests are classified as temporary equity because their redemption is considered probable. These interests are measured at the greater of estimated redemption value at the end of each reporting period or the initial carrying amount of the redeemable non-controlling interests adjusted for cumulative earning allocations.

## Recent Accounting Pronouncements

A list of recent accounting pronouncements that are relevant to us is included in note 2 to our consolidated financial statements, which are included in this annual report.

## Results of Operations

The following table sets forth a summary of our consolidated statements of operations for the periods indicated.

	For the Year Ended December 31,			
	2014	2015	2016	
	RMB	RMB	RMB	US\$( <sup>1</sup> )
<b>Consolidated Statement of Operation Data</b>				
Revenues:				
Online game services	55,417,700	40,504,363	48,565,620	6,994,904
Other revenues	9,421,865	6,105,523	7,719,902	1,111,897
Sales taxes	(562,674)	(198,555)	(86,236)	(12,421)
Net revenues	64,276,891	46,411,331	56,199,286	8,094,380
Cost of revenue	(85,782,569)	(67,743,995)	(48,518,779)	(6,988,158)
Gross profit (loss)	(21,505,678)	(21,332,664)	7,680,507	1,106,222
Operating expenses:				
Product development	(156,253,036)	(135,042,829)	(77,991,408)	(11,233,099)
Sales and marketing	(51,758,100)	(31,692,522)	(21,286,647)	(3,065,915)
General and administrative	(111,157,250)	(131,768,503)	(129,047,846)	(18,586,756)
Provision (reversal of provision) for allowance for long-term receivable and prepayment	14,371,918	(8,439,580)	—	—
Impairment of intangible assets	—	—	(68,003,805)	(9,794,585)
Impairment loss on goodwill	—	—	(10,561,857)	(1,521,224)
Gain on disposal of subsidiaries	165,392,382	3,339,394	—	—

	For the Year Ended December 31,			
	2014	2015	2016	
	RMB	RMB	RMB	US\$ <sup>(1)</sup>
Total operating expenses	(139,404,086)	(303,604,040)	(306,891,563)	(44,201,579)
Other operating income (expenses)	75,000	(1,563,518)	3,604,749	519,192
Loss from operations	(160,834,764)	(326,500,222)	(295,606,307)	(42,576,165)
Impairment on available-for-sale investment	—	—	(244,798,058)	(35,258,254)
Impairment on other investment	—	—	(2,806,439)	(404,211)
Interest income	3,414,559	775,152	161,144	23,210
Interest expenses	—	(6,397,192)	(56,471,609)	(8,133,603)
Fair value change on convertible bonds and warrants	—	(7,129,161)	48,057,204	6,921,677
Gain(loss) on disposal of equity investee and available-for-sale investment	33,153,452	—	(1,217,405)	(175,343)
Other income (expenses), net	(963,125)	(1,916,755)	(9,952,271)	(1,433,426)
Loss before income tax expense and share of loss in equity method investments	(125,229,878)	(341,168,178)	(562,633,741)	(81,036,115)
Income tax benefit (expense)	—	—	6,079,282	875,599
Share of loss in equity investments	(3,712,530)	(13,013,791)	(110,535,486)	(15,920,421)
Net loss	(128,942,408)	(354,181,969)	(667,089,945)	(96,080,937)
Net loss attributable to noncontrolling interest	(21,443,321)	(16,655,902)	(58,584,204)	(8,437,880)
Net loss attributable to redeemable noncontrolling interest	(20,876,617)	(32,697,713)	(14,724,152)	(2,120,719)
Net loss attributable to The9 Limited	(86,622,470)	(304,828,354)	(593,781,589)	(85,522,338)
Accretion on redeemable noncontrolling interest	21,076,744	79,805,706	82,890,188	11,938,670
Net loss attributable to holders of ordinary shares	(107,699,214)	(384,634,060)	(676,671,777)	(97,461,008)

(1) Translation from RMB amounts into U.S. dollars was made at a rate of RMB6.9430 to US\$1.00 for the convenience of the reader only. See “Item 3. Key Information—A. Selected Financial Information—Exchange Rate Information.”

## Year 2016 Compared to Year 2015

**Revenues.** Our revenues increased by 20.8%, from RMB46.6 million in 2015 to RMB56.3 million (US\$8.1 million) in 2016, primarily due to an increase in revenues from our online game services.

**Online Game Services.** Our revenues from our online game services increased by 20.0%, from RMB40.5 million in 2015 to RMB48.6 million (US\$7.0 million) in 2016. The increase was primarily due to an increase in revenues from Firefall amounting to RMB5.7 million (US\$0.8 million) and an increase in revenues from Song of Knights amounting to RMB5.0 million (US\$0.7 million). Such increase was primarily due to the increase of our average quarterly paying user from 10,364 in 2015 to 11,049 in 2016.

Quarterly paying user refers to the number of users who purchase virtual currency at least once for our online games during a quarter. Average quarterly paying user is the average of quarterly paying users for each of the four quarters during a year. Quarterly revenue per paying user refers to our revenues from online games during a given quarter divided by the number of the quarterly paying users. Average quarterly revenue per paying user is the average of quarterly revenues per paying users for each of the four quarters during a year.

Our revenues from TV games increased from RMB22.8 million in 2015 to RMB24.0 million (US\$3.5 million) in 2016. Unlike PC online games, our TV games are operated through telecommunication carriers and we do not maintain information relating to active users pursuant to our cooperation agreements with the telecom carriers.

**Other Revenues.** Revenues generated from other products and services increased by 26.4% from RMB6.1 million in 2015 to RMB7.7 million (US\$1.1 million) in 2016, primarily due to revenues from the provision of game development and technical services to third-parties in 2016, which amounted to RMB1.2 million (US\$0.2 million) in 2016.

**Cost of Revenue.** Cost of revenue decreased by 28.4% from RMB67.7 million in 2015 to RMB48.5 million (US\$7.0 million) in 2016, primarily due to a decrease in amortization of intangible assets following an impairment of intangible assets in 2016.

**Operating Expenses.** Operating expenses increased slightly by 1.1% from RMB303.6 million in 2015 to RMB306.9 million (US\$44.2 million) in 2016.

**Product Development Expenses.** Product development expenses decreased by 42.3% from RMB135.0 million in 2015 to RMB78.0 million (US\$11.2 million) in 2016. The decrease was primarily due to a decrease in staff cost relating to research and development personnel and a decrease in the development outsourcing expenses relating to Firefall due to a reduced volume of outsourced development works.

**Sales and Marketing Expenses.** Sales and marketing expenses decreased by 32.8% from RMB31.7 million in 2015 to RMB21.3 million (US\$3.1 million) in 2016. The decrease in sales and marketing expenses was primarily due to decreased expenses incurred for Firefall in North America and Europe in 2016.

**General and Administrative Expenses.** General and administrative expenses decreased slightly by 2.1% from RMB131.8 million in 2015 to RMB129.0 million (US\$18.6 million) in 2016.

**Provision(Reversal of Provision) for Allowance for Long-term Receivables and Prepayments.** We had an allowance of other receivable of RMB8.4 million in 2015. We did not have such allowance in 2016.

**Impairment on Intangible Assets.** We had impairment charges on certain intangible assets of RMB68.0 million (US\$9.8 million) for the year ended December 31, 2016. We did not have such impairment charges in 2015.

**Impairment Loss on Goodwill.** We recorded impairment of goodwill of RMB10.6 million (US\$1.5 million) in 2016, compared to nil in 2015.

**Gain/loss on Disposal of Subsidiaries.** We recorded a gain on disposal of a subsidiary of RMB3.3 million in October 2015 in connection with the disposal of 58% equity interest in Shanghai Jiucheng Advertisement, which operates a mobile advertising platform. We did not have any gain or loss on disposal of subsidiaries in 2016.

**Other Operating Income(Expenses).** We had an operating income of RMB3.6 million (US\$0.5 million) in 2016, including primarily IDC rental fee and office rental fee of RMB4.2 million (US\$0.6 million), which were partially offset by the disposal of property, equipment and software of RMB0.6 million (US\$0.09 million). We had operating expenses of RMB1.6 million in 2015, which represented a loss on disposal of property, equipment and software.

**Impairment on Available-for-sale Investment.** We recorded an impairment on available-for-sale investment of RMB244.8 million (US\$35.3 million) in 2016, primarily due to a decrease in the share price of L&A, which we classify as available-for-sale investment. There was no such impairment in 2015.

**Impairment on Other Investment.** We recorded an impairment of other investment amounting of RMB2.8 million (US\$0.4 million) in 2016, primarily due to a decrease in the market value of our investment in Tandem Fund II, L.P., or the Tandem Fund. There was no such impairment in 2015.

**Interest Income.** Interest income decreased to RMB0.2 million (US\$0.02 million) in 2016 from RMB0.8 million in 2015, primarily due to a decrease in our bank cash deposits during the year of 2016.

**Interest Expenses.** Interest expenses increased to RMB56.5 million (US\$8.1 million) in 2016 from RMB6.4 million in 2015, primarily due to accrued interest expenses of RMB50.4 million (US\$7.3 million) on the Convertible Notes and loan interest expenses of RMB5.3 million (US\$0.8 million).

**Fair Value of Change on Convertible Bonds and Warrants.** We had a fair value of change on convertible bonds and warrants of RMB48.1 million (US\$6.9 million) in 2016, primarily due to a decrease in our share price as of December 31, 2016 compared to December 31, 2015.

**Other Income (Expenses), Net.** Other expenses increased from RMB1.9 million in 2015 to RMB10.0 million (US\$1.4 million) in 2016, which mainly reflected an increase in exchange loss.

**Loss on Disposal of Equity Investee and Available-for-Sale Investment.** We recorded a loss on disposal of equity investee and available-for-sale investment of RMB1.2 million (US\$0.2 million) in November 2016 in connection with the disposal of all of our equity interest in Crowdstar Inc., our equity investee, to a third-party investor.

**Net Loss Attributable to Holders of Ordinary Shares.** Primarily as a result of the cumulative effect of the above factors, net loss attributable to our holders of ordinary shares increased to RMB676.7 million (US\$97.5 million) in 2016 from RMB384.6 million in 2015.

## **Year 2015 Compared to Year 2014**

**Revenues.** Our revenues decreased by 28.1%, from RMB64.8 million in 2014 to RMB46.6 million in 2015, primarily due to a decrease in revenue from our online game services.

**Online Game Services.** Our revenues from our online game services decreased by 26.9%, from RMB55.4 million in 2014 to RMB40.5 million in 2015. The decrease was primarily due to a decrease in revenues from PC online games which decreased from RMB33.4 million in 2014 to RMB16.1 million in 2015. Such decrease was primarily due to the net effect of (i) the decrease of our average quarterly paying user from 42,620 in 2014 to 10,364 in 2015, and (ii) the increase of our average quarterly revenue per paying user from RMB254 in 2014 to RMB369 in 2015.

Our revenues from TV games increased from RMB19.2 million in 2014 to RMB22.8 million in 2015. This increase was primarily due to an increase in our average quarterly revenue per paying user from RMB37 in 2014 to RMB49 in 2015.

**Other Revenues.** Revenues generated from other products and services decreased by 35.2% from RMB9.4 million in 2014 to RMB6.1 million in 2015, primarily due to a decrease in revenue from our then mobile advertising platform. We disposed of 58% equity interest in Shanghai Jiucheng Advertising, which operates a mobile advertising platform, in October 2015. We account for Shanghai Jiucheng Advertisement as an equity investment after such disposal.

**Cost of Revenue.** Cost of revenue decreased by 21.0% from RMB85.8 million in 2014 to RMB67.7 million in 2015. The decrease was primarily driven by a decrease of the rental cost in connection with the Internet data centers, which is in line with revenue decrease, and a decrease in employee salary and welfares as we continued to reduce the headcounts in our customer service department in 2015 as part of our cost saving efforts.

**Operating Expenses.** Operating expenses increased by 117.8% from RMB139.4 million in 2014 to RMB303.6 million in 2015.

**Product Development Expenses.** Product development expenses decreased by 13.6% from RMB156.3 million in 2014 to RMB135.0 million in 2015. The decrease was primarily due to the decrease of research and development staff cost and development outsourcing expenses due to less volume of outsourced development works.

**Sales and Marketing Expenses.** Sales and marketing expenses decreased by 38.8% from RMB51.8 million in 2014 to RMB31.7 million in 2015. The decrease in sales and marketing expenses was primarily due to decreased expenses incurred for Firefall in North America and Europe in 2015.



*General and Administrative Expenses.* General and administrative expenses increased by 18.5% from RMB111.2 million in 2014 to RMB131.8 million in 2015.

*Provision (Reversal of Provision) for Allowance for Long-term Receivables and Prepayments.* We recorded allowance of other receivable of RMB8.4 million in 2015. In 2014, we had allowance for long-term receivables and prepayments charges of RMB3.6 million, and we reversed an allowance on long-term receivables of RMB17.9 million in 2014 as we reevaluated the collectability of the receivables and determined that the payments can be collected. We collected the amount in full in 2015.

*Gain/loss on Disposal of Subsidiaries.* We recorded a gain on disposal of a subsidiary of RMB3.3 million in October 2015 in connection with the disposal of 58% equity interest in Shanghai Jiucheng Advertisement, which operates a mobile advertising platform. We recorded a gain on disposal of subsidiaries of RMB165.4 million in 2014 in connection with disposal of our equity interests in Huopu Cloud and Kai Yue.

*Other Operating Income(Expenses).* We recorded rental income of RMB75,000 and loss on disposal of property, equipment and software of RMB1.6 million in 2014 and 2015, respectively.

*Interest Income.* We had interest income of RMB0.8 million in 2015, compared to net interest income of RMB3.4 million in 2014, primarily due to the decrease in cash balance during the year of 2015.

*Interest Expenses.* We had interest expenses of RMB6.4 million in 2015, compared to nil in 2014, primarily due to the accrual of interest expenses of RMB5.9 million in connection with the Convertible Notes issued in December 2015 and RMB0.5 million in connection with loans in 2015.

*Fair Value of Change on Convertible Bonds and Warrants.* We had fair value of change on convertible bonds and warrants of RMB7.1 million in 2015 primarily due to a decrease in our share price as of December 31, 2015 compared to the issuance date of the Convertible Notes and the Warrants.

*Other Income (Expenses), Net.* Other expenses were RMB1.9 million in 2015, which mainly reflected exchange loss. Other expenses were RMB1.0 million in 2014, which mainly reflected exchange loss, partially offset by the government subsidy we received.

*Gain on Disposal of Equity Investee and Available-for-Sale Investment.* We recorded a gain on disposal of equity investee and available-for-sale investment of RMB33.2 million in 2014 in connection with the disposal of Beijing Linkage Technology Co., Ltd., or Beijing Linkage, the Tandem Fund, and Youjia Group Limited, or Youjia. We did not have any such gain or loss in 2015.

*Net Loss Attributable to Holders of Ordinary Shares.* As a result of the cumulative effect of the above factors, net loss attributable to our holders of ordinary shares was RMB384.6 million in 2015, compared to the net loss of RMB107.7 million in 2014.

## **B. Liquidity and Capital Resources**

We are a holding company and conduct our operations primarily through our subsidiaries and affiliated PRC entities in China. As a result, our cash requirements and our ability to pay dividends principally depend upon dividends and other distributions from our subsidiaries, which in turn are derived principally from earnings generated by our affiliated PRC entities. Specifically, The9 Computer, one of our subsidiaries in China, obtains funds from the PRC entities in the form of payments under the exclusive technical service agreements, pursuant to which The9 Computer is entitled to determine the amount of payment.

We acknowledge that 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. However, under existing PRC foreign exchange regulations, payments of current account items, including profit distributions and trade and service-related foreign exchange transactions, can be made in foreign currencies without prior approval from SAFE, by complying with certain procedural requirements. Therefore, we are able to pay dividends in foreign currencies without prior approval from SAFE. Approval from or registration with 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.

Furthermore, if our subsidiaries or any newly formed subsidiaries incur debt on their own behalf, the agreements governing their debt may restrict their ability to pay dividends to us. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China— Restrictions on currency exchange in China limit our ability to utilize our revenues effectively, make dividend payments and meet our foreign currency denominated obligations.”

Current PRC regulations restrict our affiliated entities and subsidiaries from paying dividends in the following two principal aspects: (i) our affiliated entities and subsidiaries in China are only permitted to pay dividends out of their respective accumulated profits, if any, determined in accordance with PRC accounting standards and regulations; and (ii) these entities are required to allocate at least 10% of their respective accumulated profits each year, if any, to fund certain capital reserves until the cumulative total of the allocated reserves reaches 50% of registered capital, and a portion of their respective after-tax profits to their staff welfare and bonus reserve funds as determined by their respective boards of directors. Although the statutory reserves can be used, among other ways, to increase the registered capital and eliminate future losses in excess of retained earnings of the respective companies, companies may not distribute the reserve funds as cash dividends except upon a liquidation of these subsidiaries. In addition, dividend payments from our PRC subsidiaries could be delayed as we may only distribute such dividends upon completion of annual statutory audits of the subsidiaries. As of December 31, 2016, such restricted portion was RMB16.4 million (US\$2.4 million). We have not directed our PRC subsidiaries or affiliated entities to distribute any dividends to-date.

The aggregate net assets as of December 31, 2014, 2015 and 2016, as reflected on our statutory accounts, including registered capital and statutory reserves, was approximately RMB75.6 million and RMB97.9 million and RMB76.1 million (US\$11.0 million) lower than the amount determined under U.S. GAAP, respectively.

### **Cash Flows and Working Capital**

We financed our operations primarily through our available cash in hand as well as cash generated from our operating, financing and investing activities. As of December 31, 2014, 2015 and 2016, we had RMB181.5 million, RMB49.0 million and RMB38.9 million (US\$5.6 million), respectively, in cash and cash equivalents. The decrease in cash and cash equivalents from 2015 to 2016 was primarily due to cash outflows to operating activities for product development and sales and marketing, offset by net proceeds from the a loan provided by a financial services company, a bank loan provided by Bank of Shanghai, loans from related parties and fund-raising on Inner Mongolia Culture Assets and Equity Exchange. The decrease in cash and cash equivalents from 2014 to 2015 was primarily due to cash outflows to finance capital investment in a joint venture and operating activities for product development and sales and marketing, offset by net proceeds from the issuance and sale of the Convertible Notes to Splendid Days and the entrusted loan provided by a third party in December 2015.

We have an accumulated deficit of approximately RMB2,897.8 million (US\$417.4 million) and total current liabilities exceeded total assets by approximately RMB222.9 million (US\$32.1 million) as of December 31, 2016. We also had a net loss of approximately RMB667.1 million (US\$96.1 million) for the year ended December 31, 2016, and have not generated significant revenues or positive cash flows from operations since 2009. We expect to continue to incur product development and sales and marketing expenses for licensed and proprietary new games in order to achieve revenue growth. To meet our capital needs, we have engaged and are considering multiple alternatives, including but not limited to debt financings, other financing transactions, launch new games and cost control, as discussed below. We may continue to incur losses, negative cash flows from operating activities and net current liabilities in the future. If we are not able to return to profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—We may continue to incur losses, negative cash flows from operating activities and net current liabilities in the future. If we are not able to return to profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern.”

### *Additional External Debt Financing*

In March 2016, we obtained a credit facility for a principal amount of US\$50 million (US\$7.2 million) from Bank of Shanghai, or BOS for working capital purpose. In March 2017, the credit facility was extended for one year until March 2018. As of December 31, 2016, we had drawn down RMB25.0 million (US\$3.6 million) under this facility, which bears interest at a rate of 6.525% per annum and are guaranteed by Mr. Jun Zhu and The9 Computer.

In June 2016, our subsidiary Asian Development borrowed a total of HK\$92.3 million from a financial services company at an annual interest rate of 2% for a term of 24 months, which is secured by a pledge of 417,440,000 shares of L&A. As Asian Development is currently in default of the loan due to a sharp decline in the stock price of L&A, the lender is entitled to foreclose the pledged L&A shares. If the market value of the pledged shares cannot cover the total outstanding amount owed by Asian Development to the lender, the lender may also make a claim against Asian Development for any outstanding amounts of the loan.

In December 2015, we borrowed an entrusted loan of approximately RMB31.6 million (US\$4.6 million) from a third party, at an interest rate of 12% per year, for an initial term of three years, subject to an extension for two years. The loan is secured by a mortgage over our office building in Shanghai which we currently use as our principal executive offices. As of December 31, 2016, all of the entrusted loan remained outstanding.

### *Other External Financing*

We are financing the development of the CrossFire New Mobile Game through fund-raising on Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2016, we had raised RMB57.5 million (US\$8.3 million), and we aim at raising an additional RMB100 million (US\$14.4 million) until the game is launched. Under this fund-raising arrangement, we are required to share certain percentages of the revenues generated from the CrossFire New Mobile Game with the investors that provided funding to us.

### *Launch of New Games*

We plan to launch our proprietary online games on different platforms, including the CrossFire New Mobile Game, which is mobile game, and a web game called Soul Awake. In addition, Asian Way Development Limited is developing and plans to launch a game called Audition AR.

### *Cost Control*

Currently a significant portion of our cash requirements is attributable to payroll-related costs. We have the ability to control the level of discretionary spending on payroll by reducing our headcount within a short period of time when necessary. However, there can be no assurance that we will be able to successfully conduct the cost control measures with results favorable to us, or at all.

If we are unable to obtain the necessary capital, we will need to license or sell our assets, seek to be acquired by another entity and/or cease operations. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—We may not be able to obtain additional financing to support our business and operations, and our equity or debt financings may have an adverse effect on our business operations and share price.”

We believe that, with the foregoing potential sources of cash flow and potential cost control measures, we have sufficient financial resources to meet our anticipated operating cash flow requirements, to meet our obligations and to pay off liabilities as and when they fall due for the 12 months following the date of this annual report.

In addition to the above financing measures, pursuant to the Convertible Note and Warrant Purchase Agreement dated November 24, 2015, on December 11, 2015, we issued and sold the Convertible Notes in the aggregate principal amount of US\$40,050,000 to Splendid Days Limited, or Splendid Days. We received net proceeds of US\$36,850,000 from the sale of the Convertible Notes. The Convertible Notes are divided into three tranches in principal amounts of US\$22,250,000, US\$13,350,000 and US\$4,450,000, respectively, which will be convertible at the option of the holder at any time into our ADSs at initial conversion prices of US\$2.6, US\$5.2 and US\$7.8 per ADS, respectively, provided that at no time shall the holder convert any portion of the Convertible Notes if subsequent to such conversion such holder will hold more than 20% of the total outstanding and issued shares of our company. The Convertible Notes bear interest at a rate of 12% per year, payable when the principal amount of the Convertible Notes becomes due, and have initial terms of three years, subject to an extension for two years at the discretion of the holder. The initial conversion prices are subject to adjustments for share splits, reverse splits, share dividends and distributions, and certain issuances (or deemed issuances) of ordinary shares or ADSs for consideration less than the conversion price then in effect. In addition, the holder of the Convertible Notes is entitled to any extraordinary cash dividend (to the extent that it exceeds the accrued interest amount per share) and dividend in kind that we distribute based on the number of shares into which the Convertible Notes are then convertible. Following a “change of control,” as such term is defined in the Convertible Notes, the holder of the Convertible Notes will be entitled to require us to redeem all or part of the Convertible Notes, at a price payable in cash equal to 100% of the outstanding principal amount of the Convertible Notes, plus all accrued and unpaid interests thereon, if any. In addition, pursuant to the terms of the Convertible Notes, if there is a continuing event of default, the holder will be entitled to declare any of the Convertible Notes immediately due and payable, and request redemption by us at a price equal to the outstanding principal amount plus all accrued and unpaid interests thereon, if any. “Events of default” as defined in the Convertible Notes include, among other things, an event of default under any indebtedness in the amount exceeding US\$500,000.

Pursuant to the same agreement, on December 11, 2015, we issued to Splendid Days four tranches of warrants in an aggregate principal amount of US\$9,950,000. The Warrants are divided into four tranches in principal amounts of US\$5,000,000, US\$2,750,000, US\$1,650,000 and US\$550,000, respectively, which will be exercisable for our ADSs at the option of the holder at any time at initial exercise prices of US\$1.5, US\$2.6, US\$5.2 and US\$7.8 per ADS, respectively. The initial exercise prices are subject to adjustments for share splits, reverse splits, share dividends and distributions, distribution of assets, certain issuances (or deemed issuances) of ordinary shares or ADSs for consideration less than the exercise price then in effect, as applicable for each warrant. In addition, the holder of the Warrants with initial exercise prices of US\$2.6, US\$5.2 and US\$7.8 per ADS is entitled to any cash dividend (to the extent that it exceeds the notional interest amount attributable to such Warrants) and dividend in kind that we distribute based on the number of shares into which the Warrants are then exercisable. The tranche of Warrants with an exercise price of US\$1.5 per ADS has a term of five years, while the remaining three tranches have initial terms of three years, subject to an extension for two years if the holder exercises its discretion to extend the term of the Convertible Notes. The Convertible Notes are secured by a pledge of our 100% equity interests in two of our wholly-owned subsidiaries in China, including The9 Computer and C9I Shanghai, and a mortgage over our office building in Shanghai which we currently use as our principal executive offices. Pursuant to the agreement, we have registered the ordinary shares into which the Convertible Notes are convertible and the Warrants are exercisable on a registration statement on F-3, which was declared effective by the SEC on June 17, 2016.

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

	For the Year Ended December 31,			
	2014	2015	2016	
	RMB	RMB	RMB	US\$
	(in thousands)			
Net cash used in operating activities	(269,098)	(175,587)	(180,986)	(26,067)
Net cash (used in)/provided by investing activities	197,752	(208,996)	(10,395)	(1,497)
Net cash (used in)/provided by financing activities	100,222	257,937	190,092	27,379
Effect of foreign exchange rate changes on cash	(4,381)	(5,826)	(8,844)	(1,274)
Net (decrease)/increase in cash and cash equivalents	24,495	(132,472)	(10,133)	(1,459)
Cash and cash equivalents at beginning of year	156,987	181,482	49,011	7,059
Cash and cash equivalents at end of year	181,482	49,011	38,878	5,600

### *Operating Activities*

Net cash used in operating activities was RMB181.0 million (US\$26.1 million) in 2016, compared to RMB175.6 million in 2015 and RMB269.1 million in 2014. The yearly decrease of net cash used in operating activities from 2014 to 2016 was mainly due to a decrease in cash outflow associated with product development and sales and marketing expenses.

The net cash used in operating activities in 2016 primarily reflected a net loss of RMB667.1 million (US\$96.1 million), partially offset by the impairment of available-for-sales investment of RMB244.8 million (US\$35.3 million), adjustments for share-based compensation expense of RMB28.1 million (US\$4.0 million), impairment of intangible assets of RMB68.0 million (US\$9.8 million), amortization of intangible assets of RMB10.2 million (US\$1.5 million), and depreciation and amortization of property, equipment and software of RMB7.3 million (US\$1.1 million).

The net cash used in operating activities in 2015 primarily reflected a net loss of RMB354.2 million in 2015, partially offset by the adjustments for share-based compensation expense of RMB34.0, changes in amounts due to related party of RMB61.5 million primarily due to the receipt of the initial license fee of Firefall in China, amortization of intangible assets of RMB19.1 million, depreciation and amortization of property, equipment and software of RMB11.6 million and allowance of receivables of RMB8.4 million. The net cash used in operating activities in 2014 primarily reflected a net loss of RMB128.9 million in 2014 and the gain on disposal of subsidiary of RMB165.4 million, partially offset by the adjustments for amortization of intangible assets of RMB28.9 million and depreciation and amortization of property, equipment and software of RMB15.7 million.

### ***Investing Activities***

Net cash used in investing activities was RMB10.4 million (US\$1.5 million) in 2016, which primarily included (i) loan receivable due from ZTE9 of RMB2.8 million (US\$0.4 million), (ii) capital expenditures including purchase of property, equipment, software and license of RMB8.3 million (US\$1.2 million), partially offset by a dividend of RMB0.7 million, (US\$1.1 million) from Tandem Fund.

Net cash used in investing activities was RMB209.0 million in 2015, which primarily included (i) cash used for investment in System Link of RMB223.4 million, (ii) loan receivable due from ZTE9 of RMB9.9 million, and (iii) capital expenditures including purchase of property, equipment and software of RMB10.6 million, partially offset by collection of long-term receivable from WoW game points refund agent which amounted to RMB17.9 million and receipt of proceeds of RMB12.2 million in connection with the disposal of our equity interest in Kai Yue.

Net cash provided by investing activities was RMB197.8 million in 2014, which primarily included (i) proceeds from disposal of subsidiaries of RMB163.7 million relating to Huopu Cloud and Kai Yue, (ii) proceeds from disposal of equity investees of RMB25.0 million and proceeds from disposal of available-for-sale investment of RMB6.3 million, relating to Beijing Linkage, Tandem Fund and Youjia, (iii) proceeds from refund of upfront license fees and upfront property, equipment and software purchase payment of RMB4.0 million, partially offset by the cash used for capital expenditures including purchase of property, equipment and software of RMB3.1 million.

### ***Financing Activities***

Net cash provided by financing activities in 2016 was RMB190.1 million (US\$27.4 million), primarily attributable to a loan of RMB79.2 million (US\$11.4 million) borrowed from a financial services company and secured by a pledge of shares of L&A, a bank loan of RMB25.0 million (US\$3.6 million) provided by Bank of Shanghai and loans of RMB60.0 million (US\$8.6 million) borrowed from related parties, partially offset by loans of RMB34.8 million (US\$5.0 million) repaid to related parties. We also obtained funding for the development of CrossFire New Mobile Game through fund-raising on Inner Mongolia Culture Assets and Equity Exchange of RMB57.5 million (US\$8.3 million) in 2016. Net cash provided by financing activities in 2015 was RMB258.0 million, primarily attributable to the issuance and sale of the Convertible Notes in the aggregate principal amount of US\$40,050,000 to Splendid Days in December 2015 and an entrusted loan of RMB31.6 million provided by a third party. Net cash provided by financing activities in 2014 was RMB100.2 million, primarily attributable to issuance of redeemable noncontrolling interest relating to the investment made by Shanghai Oriental Pearl Culture Development Co., Ltd. in Red 5 of RMB118.3 million.

As a result of non-renewal of WoW license on June 7, 2009, we announced a refund plan in connection with unactivated WoW game point cards. According to the plan, unactivated WoW game point card holders are eligible to receive a cash refund from us. We recorded a liability in connection with both unactivated points cards and activated but unconsumed point cards of approximately RMB200.4 million, of which RMB4.0 million was refunded in 2009. Upon the loss of the WoW license, we concluded that the nature of the obligation substantively changed from deferred revenue, for which we had the ability to satisfy the underlying performance obligation, to an obligation to refund players for their unconsumed points. Thus, we have accounted for this refund liability by applying the relevant derecognition guidance when determining the proper accounting treatment. In accordance with this guidance, the refund liability associated with these WoW game points, to the extent not refunded, will be recorded as other operating income after we are legally released from the obligation to refund amounts under the applicable laws. As we announced the refund plan on September 7, 2009, the statute of limitations of the creditors (in this case the game players with claims for refund of unactivated WoW game point cards) to assert their claims for refund is two years from such date under applicable laws and thus our legal liability relating to the unactivated WoW game point cards was extinguished on September 7, 2011 and the associated liability amounting to RMB26.0 million was recognized as other operating income for the year ended December 31, 2011. With respect to the remaining refund liability, based on current PRC laws, to the extent not refunded, we, in consultation with legal counsel, have determined that we will be legally released from this liability in 2029, which represents 20 years from the date of discontinuation of WoW in 2009. However, if management were to publicly announce a refund policy, we would be legally released from any remaining liability for these activated, but unconsumed points, sooner than 20 years. To date, we have determined not to publicly announce any refund policy with respect to this remaining liability, and no refunds have been claimed. The remaining refund liability relating to the activated, but unconsumed WoW game points was RMB170.0 million (US\$24.5 million) as of December 31, 2016.

### **Capital Expenditures**

We incurred capital expenditures of RMB22.6 million, RMB30.1 million and RMB8.3 million (US\$1.2 million) in 2014, 2015 and 2016, respectively. The capital expenditures principally consisted of purchases of servers, computers and other items related to our network infrastructure. If we license new games or enter into strategic joint ventures or acquisitions, we may require additional funds for necessary capital expenditures.

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

Our research and development efforts are primarily focused on the development of our proprietary online games, the localization of licensed games from foreign developers, and the maintenance of our websites. Our research and development expenses were RMB156.3 million, RMB135.0 million and RMB78.0 million (US\$11.2 million) in 2014, 2015 and 2016, respectively.

### **D. Trend Information**

Except as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from January 1, 2016 to December 31, 2016 that are reasonably likely to have a material adverse effect on our net sales or revenues, results of operations, profitability, liquidity or capital resources, or that would cause the reported financial information not necessarily to be 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. We have not entered into any off-balance sheet derivative instruments. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

## F. Contractual Obligations

The following table sets forth our contractual obligations and other commitments under as of December 31, 2016:

	Payments Due by Period				
	Total	Less than 1 year	1-2 years	3-5 years	More than 5 years
	(in thousands of RMB)				
Short-term borrowings <sup>(1)</sup>	107,517.4	107,517.4	—	—	—
Long-term borrowings <sup>(2)</sup>	31,624.6	—	31,624.6	—	—
Convertible notes payable <sup>(3)</sup>	278,067.2	—	278,067.2	—	—
Interest expense on short-term borrowings, long-term borrowings and notes payable	111,973.3	484.3	111,489.0	—	—
Purchase obligation <sup>(4)</sup>	6,800.0	6,800.0	—	—	—
Operating lease obligations <sup>(5)</sup>	3,549.6	3,276.2	273.4	—	—
<b>Total</b>	<b>539,532.1</b>	<b>118,077.9</b>	<b>421,454.2</b>	<b>—</b>	<b>—</b>

- (1) Short-term borrowings include (i) a bank loan of RMB25.0 million (US\$3.6 million) and (ii) a pledged loan of RMB82.5 million (US\$11.9 million) from a financial services company.
- (2) Long-term borrowings include an entrusted loan of approximately RMB31.6 million (US\$4.6 million) obtained from a third party, all of which remained outstanding as of December 31, 2016.
- (3) Represents the Convertible Notes in an aggregate principal amount of US\$40,050,000 which bear interest at a rate of 12% per year, payable when the principal amount of the Convertible Notes becomes due. The Convertible Notes have initial terms of three years, subject to an extension to five years at the discretion of the holder.
- (4) We have entered into a game development agreement with a third-party game developer for a total consideration of RMB8.6 million (US\$1.2 million) and we had paid RMB1.8 million (US\$0.3 million) as of December 31, 2016.
- (5) We have entered into leasing arrangements related to the use of certain office premises and Internet data centers.

## G. Safe Harbor

This annual report on Form 20-F contains statements of a forward-looking nature. These statements are made under the “safe harbor” provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as “may,” “will,” “expects,” “anticipates,” “future,” “intend,” “plan,” “believe,” “estimate,” “is/are likely to,” “considers” or other and similar expressions. The accuracy of these statements may be impacted by a number of risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, the following:

- our ability to return to profitability or raise sufficient capital to cover our capital needs;
- our ability to successfully launch and operate additional games in China and overseas;
- our ability to develop, license or acquire additional online games that are attractive to users;
- the maintenance and expansion of our relationships with game distributors and online game developers, including our existing licensors;
- our ability to maintain and expand our relationships with joint venture partners and other business partners;
- uncertainties in and the timeliness of obtaining necessary governmental approvals and licenses for operating any new online game;
- risks inherent in the online game business;
- risks associated with our future acquisitions and investments;
- our ability to compete effectively against our competitors;
- risks associated with our corporate structure and the regulatory environment in China; and
- other risks outlined in our filings with the SEC including this annual report on Form 20-F.

These risks are not exhaustive. We operate in an emerging and evolving environment. New risk factors emerge from time to time and it is impossible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any specific factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

We would like to caution you not to place undue reliance on forward-looking statements and you should read these statements in conjunction with the risk factors disclosed in “Item 3. Key Information—D. Risk Factors.” We do not undertake any obligation to update forward-looking statements except as required under applicable law.

## 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.

<u>Directors and Executive Officers</u>	<u>Age</u>	<u>Position/Title</u>
Jun Zhu	50	Chairman of the Board and Chief Executive Officer
Davin Alexander Mackenzie <sup>(1)(2)</sup>	56	Independent Director
Kwok Keung Chau <sup>(1)(2)</sup>	40	Independent Director
Ka Keung Yeung <sup>(1)(2)</sup>	57	Independent Director
George Lai	40	Chief Finance Officer and Director
Chris Shen	48	Vice President

(1) Member of Audit Committee.

(2) Member of Compensation Committee.

### **Biographical Information**

**Jun Zhu** is one of our co-founders. He has served as the chairman of our board of directors and chief executive officer since our inception. Prior to founding our company, Mr. Zhu co-founded Flagholder New Technology Co. Ltd., an information technology company based in China, in 1997, and served as its director from 1997 to 1999. From 1993 to 1997, Mr. Zhu worked at QJ (U.S.A.) Investment, Ltd., a trading company in the United States. Mr. Zhu attended an undergraduate program at Shanghai Jiaotong University.

**Davin Alexander Mackenzie** has served as our independent director since July 2005. Mr. Mackenzie was a consultant of Spencer Stuart Beijing Office, a renowned global executive search company, from 2012 to 2014. Mr. Mackenzie is also a director of MicroCred Group, a France-based investment company, Sports Beijing, a non-profit recreational youth sports organization, and a director of Mountain Hazelnut Ventures, a private agricultural company. From 2009 to 2011, Mr. Mackenzie was the Beijing representative of Brocade Capital Limited, a private equity advisory firm that he founded in 2009. From 2008 to 2009, Mr. Mackenzie was the managing director and Beijing representative of Arctic Capital Limited, a pan-Asia private equity advisory firm. Between 2000 and 2008, Mr. Mackenzie held the same positions in Peak Capital LLC, another private equity investment and advisory firm that focuses on the China market. Prior to Peak Capital, Mr. Mackenzie worked with the International Finance Corporation, a private sector arm of The World Bank Group, for seven years, including four years as the resident representative for China and Mongolia. Mr. Mackenzie has also worked at Mercer Management Consultants in Washington, D.C., and at First National Bank of Boston in Taiwan. Mr. Mackenzie received a bachelor’s degree in Government from Dartmouth College. He received a master’s degree in international studies and an MBA degree from the Wharton School of Business at the University of Pennsylvania. Mr. Mackenzie has also completed the World Bank Executive Development Program at Harvard Business School.



**Kwok Keung Chau** has served as our independent director since October 2015. Mr. Chau is an executive director, the chief financial officer and the company secretary of Comtec Solar Systems Group Limited, a Hong Kong listed company (Stock Code: 712), responsible for corporate financial and general management. He currently also serves as an independent non-executive director and the chairman of the audit committee of Qingdao Port International Co., Ltd., a Hong Kong listed company (Stock Code: 6198). He acted as a member of supervisory board of RIB Software AG, a software company in Germany, which was listed in Frankfurt Stock Exchange, from May 2010 to June 2013. Prior to joining Comtec Solar in November 2007, Mr. Chau served in various positions at China.com Inc., a Hong Kong listed company (Stock Code: 8006) from October 2005 to October 2007, including vice president of the finance department, chief financial officer, company secretary and authorized representative. Prior to joining China.com Inc., Mr. Chau had several years of experience in finance at different companies and a professional firm. Mr. Chau has been a fellow member of the Association of Chartered Certified Accountants since June 2002, a member of the Hong Kong Institute of Certified Public Accountants since July 2005 and a Chartered Financial Analyst of the CFA Institute since September 2003. Mr. Chau received his bachelor's degree in business administration from the Chinese University of Hong Kong in May 1998.

**Ka Keung Yeung** has served as our independent director since July 2005. Mr. Yeung is the executive vice president and chief financial officer of Phoenix Satellite Television Holdings Limited, or Phoenix, a listed company in Hong Kong, and is in charge of corporate finance and administration. He is also the company secretary and qualified accountant. Mr. Yeung joined Phoenix in March 1996 and is in charge of all of Phoenix's internal and external financial management and arrangements and also supervises administration and personnel matters. Mr. Yeung also serves as a director of Phoenix New Media, a subsidiary of Phoenix and a company listed on the NYSE. Mr. Yeung graduated from the University of Birmingham and is qualified as a chartered accountant. Upon returning to Hong Kong, he worked at Hutchison Telecommunications and STAR in the fields of finance and business development.

**George Lai** has served as our chief financial officer since July 2008 and our director since January 2016. Prior to joining us, Mr. Lai worked for Deloitte Touche Tohmatsu since 2000. Mr. Lai worked in several different Deloitte offices, including Hong Kong, New York and Beijing. During his eight years at Deloitte, Mr. Lai played key roles in the audit function in a number of IPO projects in the United States and China. He also assisted public companies in the United States, Hong Kong and China with a wide range of accounting matters. Mr. Lai received his bachelor of business administration, with a focus in professional accountancy, from the Chinese University of Hong Kong. Mr. Lai holds various accounting professional qualifications, including from AICPA, FCCA and HKICPA.

**Chris Shen** has served as our vice president since January 2006. Mr. Shen joined us in August 2005 as our senior director of marketing and is in charge of our mobile social gaming platform and marketing and public relations activities. Prior to joining us, Mr. Shen served as the group account director and account director for several renowned advertising agencies in Shanghai and Taipei, mainly serving multinational companies in various industries, such as consumer goods, financial services and retail. During the past twelve years, Mr. Shen helped numerous local and international brands plan and execute various marketing initiatives. Mr. Shen received his bachelor's degree in management science from the National Chiao Tung University in Taiwan.

## **B. Compensation**

### **Compensation of Directors and Executive Officers**

In 2016, the aggregate cash compensation paid to our executive officers was approximately RMB6.2 million (US\$0.9 million). We paid a total of RMB1.3 million (US\$0.2 million) in cash to our non-executive directors for their services in 2016. No director or executive officer is entitled to any severance benefits upon termination of his or her employment with or appointment by our company. On December 8, 2010, we granted 1,500,000 ordinary shares to Jun Zhu, our chairman and chief executive officer, which will only be vested if our company achieves certain income targets and the shares are not entitled to receive dividends until they become vested. Of such shares, 500,000 ordinary shares were vested and issued to Incisight Limited, a company wholly owned by Jun Zhu, on November 17, 2015. In May 2011, our board of directors granted 30,000 ordinary shares to each of our four non-executive directors then in office, of which 10,000 ordinary shares vest for each director on July 1 of each year from 2011 to 2013 so long as such director continues his services as of such date. An aggregate of 40,000 ordinary shares, 40,000 ordinary shares and 40,000 ordinary shares were vested in July 2011, 2012 and 2013, respectively. The fair value of the shares granted was US\$6.03 per share, being the market price on the date of the grant.

## Share Incentive Plan

### *Sixth Amended and Restated 2004 Stock Option Plan*

Our board of directors and our shareholders have adopted and approved the 2004 Stock Option Plan, or the Option Plan, in 2004 in order to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentives to employees, directors and consultants and to promote the success of our business. The Option Plan was amended and restated in December 2006, November 2008, August 2010, November 2010, November 2015 and August 2016. By the last amendment and restatement in August 2016, we increased the total number of ordinary shares reserved under the Option Plan from 14,449,614 to 34,449,614. As of February 28, 2017, options to purchase 18,135,200 ordinary shares under the Option Plan were outstanding. In April 2013, our board of directors approved an adjustment to the exercise price of options to purchase 2,829,941 shares previously granted from 2008 to 2011 under our Option Plan to establish a new exercise price for such share options at US\$2.41 per ADS, which was the closing price of our ADSs as of April 22, 2013. In November 2015, our board of directors approved an adjustment to the exercise price of options to purchase 4,629,100 shares previously granted from 2010 to 2015 under our Option Plan to establish a new exercise price for such share options at US\$1.53 per ADS, which was the closing price of our ADSs on November 9, 2015.

The following table provides a summary of the options granted to our directors, executive officers and other individuals as a group under the Option Plan as of February 28, 2017 and that remained outstanding.

	Total Number of Ordinary Shares Underlying Options Outstanding†	Exercise Price (in US\$)	Expiration Date
Jun Zhu	8,000,000	1.53	June 13, 2020 – November 17, 2020
Jun Zhu	5,000,000	1.86	August 6, 2021
Davin Alexander Mackenzie	610,000	1.53	April 22, 2018 – November 17, 2020
Kwok Keung Chau	*	1.53	November 17, 2020
Ka Keung Yeung	610,000	1.53	April 22, 2018 – November 17, 2020
George Lai	895,400	1.53	April 22, 2018 – November 17, 2020
Chris Shen	*	1.53	August 27, 2020 – November 17, 2020
All Directors and Senior Executive Officers as a Group†	15,935,400	1.53/ 1.86	April 22, 2018 – August 6, 2021
Other Individuals as a Group (other than those listed above)	1,199,800 1,000,000	1.53 1.86	June 13, 2020 – November 17, 2020 August 6, 2021

† Excluding 3,466,502 options forfeited and 1,664,871 options exercised as of February 28, 2017 pursuant to the terms of our Option Plan.

\* The options held by this executive officer represent less than 1% of our total outstanding shares.

*Termination of Options.* Where the option agreement permits the exercise or purchase of the options granted for a certain period of time following the recipient's termination of service with us, or the recipient's disability or death, the options will terminate to the extent not exercised or purchased on the last day of the specified period or the last day of the original term of the options, whichever occurs first.

*Administration.* Our stock option plan is administered by our board of directors or an option administrative committee designated by our board of directors and constituted to comply with applicable laws. In each case, our board of directors or the committee it designates will determine the provisions, terms and conditions of each option grant, including, but not limited to, the option vesting schedule, repurchase provisions, forfeiture provisions, form of payment upon settlement of the award, payment contingencies and satisfaction of any performance criteria.

*Vesting Schedule.* Options granted under our stock option plan vest over a two to four year period following a specified vesting commencement date. In general, the options granted will vest over the vesting period on a monthly basis, subject to the recipient of the options continuing to be employed by us on each vesting date.

*Option Agreement.* Options granted under our stock option plan are evidenced by an option agreement that contains, among other things, provisions concerning exercisability and forfeiture upon termination of employment or consulting arrangements, as determined by our board. In addition, the option agreement also provides that options granted under our stock option plan are subject to a 180-day lock-up period following the effective date of a registration statement filed by us under the Securities Act, if so requested by us or any representative of the underwriters in connection with any registration of the offering of any of our securities.

*Option Exercise.* The term of options granted under our stock option plan may not exceed five years from the date of grant. The consideration to be paid for our shares upon exercise of an option or purchase of shares underlying the option will be determined by the plan administrator and may include cash, check, ordinary shares, a promissory note, consideration received by us under a cashless exercise program implemented by us in connection with our stock option plan, or any combination of the foregoing methods of payment.

*Third-Party Acquisition.* If a third party acquires us through the purchase of all or substantially all of our assets, a merger or other business combination, all outstanding options or share purchase rights will be assumed or equivalent options or rights substituted by the successor corporation or parent or subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the options or share purchase rights, all options or share purchase rights will become fully vested and exercisable immediately prior to such transaction and all unexercised awards will terminate unless, in either case, the awards are assumed by the successor corporation or its parent.

*Changes in Capitalization and Other Adjustments.* If we shall at any time increase or decrease the number of outstanding shares, or change in any way the rights and privileges of our outstanding shares, by means of a payment or a stock dividend or any other distribution upon such ordinary shares, or through a stock split, subdivision, consolidation, combination, reclassification or recapitalization involving such ordinary shares, then in relation to the ordinary shares that are covered by the options granted or available under the plan and are affected by one or more of the above events, the number, rights and privileges shall be increased, decreased or changed in like manner as if such ordinary shares had been issued and outstanding, fully paid and non-assessable at the time of such occurrence.

*Termination of Plan.* Unless terminated earlier, our stock option plan will expire in 2024. Our board of directors has the authority to amend, alter, suspend or terminate our stock option plan. However, no such action may (i) impair the rights of any optionee unless agreed by the optionee and the stock option plan administrator, or (ii) affect the stock option plan administrator's ability to exercise the powers granted to it under our stock option plan.

## **C. Board Practices**

### **Board of Directors**

Our board of directors consists of the following five directors: Jun Zhu, Kwok Keung Chau, Davin Mackenzie, Ka Keung Yeung and George Lai. A director is not required to hold any shares in our company by way of qualification. A director may vote with respect to any contract, proposed contract or arrangement in which he is materially interested so long as he has disclosed the nature of the interest at a meeting of the directors. A director may exercise all the powers of our company to borrow money, mortgage its undertaking, property and uncalled capital, and issue debentures or other securities whenever money is borrowed or as security for any obligation of our company or of any third party.

### **Committees of the Board of Directors**

*Audit Committee.* Our audit committee consists of Messrs. Kwok Keung Chau, Davin A. Mackenzie and Ka Keung Yeung, all of whom satisfy the "independence" definition under Rule 5605 of the Nasdaq Stock Market, Inc. Marketplace Rules, or the Nasdaq Rules, and the audit committee independence standard under Rule 10A-3 under the Exchange Act. All the members of our audit committee meet the "financial expert" definition of the Nasdaq Rules.

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

- selecting the independent auditors and pre-approving all auditing and non-auditing services permitted to be performed by the independent auditors;
- reviewing and approving all proposed related-party transactions;
- discussing the annual audited financial statements with management and the independent auditors;
- annually reviewing and reassessing the adequacy of our audit committee charter;
- meeting separately and periodically with management and the independent auditors;
- 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 Messrs. Kwok Keung Chau, Davin A. Mackenzie and Ka Keung Yeung, all of whom meet the “independence” standards for compensation committee members under the Nasdaq Rules. The compensation committee assists the board in reviewing and approving the compensation structure of our executive officers, including all forms of compensation to be provided to our executive officers. The compensation committee will be responsible for, among other things:

- reviewing and determining the compensation for our five most senior executives;
- reviewing the compensation of our other employees and recommending any proposed changes to the management;
- reviewing and approving director and officer indemnification and insurance matters;
- reviewing and approving any employee loans in an amount equal to or greater than US\$60,000 (or such amount as from time to time announced by the relevant regulatory bodies as requiring the approval of the Committee); and
- reviewing periodically and approving any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pensions and welfare benefits plans.

## **Duties of Directors**

Under Cayman Islands law, our directors have fiduciary duties to act honestly, in good faith and with a view to 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 amended and restated from time to time. We have the right to seek damages if a duty owed by our directors is breached.

## **Terms of Directors**

Our board of directors is currently divided into three classes with different terms. This provision would delay the replacement of a majority of our directors and would make changes to the board of directors more difficult than if such provision were not in place. Our independent directors, namely Kwok Keung Chau, Davin A. Mackenzie and Ka Keung Yeung, were re-elected (elected in the case of Kwok Keung Chau) at our 2015 annual general meeting and each of them is serving a three-year term until the 2018 annual general meeting or until his successor is duly elected and qualified, whichever is earlier. Jun Zhu, our chairman and chief executive officer, was re-elected as a director at our 2016 annual general meeting and is serving a three-year term until the 2019 annual general meeting or until his successor is duly elected and qualified, whichever is earlier. George Lai, our chief financial officer and director, was re-elected as a director at our 2016 annual general meeting and is serving a three-year term until the 2019 annual general meeting or until his successor is duly elected and qualified, whichever is earlier. Upon expiration of the term of office of each class, succeeding directors in each class will be elected for a term of three years. Directors may be removed from office by ordinary resolution of shareholders at any time before the expiration of his/her term. Pursuant to the natural expiration of the directorial terms, elections for directors would be held on the date of the annual general meeting of shareholders.

## Voting Agreement

On November 26, 2004, Incisight and Bosma, our two largest shareholders, entered into a voting agreement with respect to the election of our board of directors. Both parties have agreed to vote their respective shares to ensure that our board of directors consists of: (i) one director designated by Incisight, so long as it holds 5% or more of our total outstanding shares, which is currently Jun Zhu; (ii) one director designated by Bosma, so long as it holds 5% more of our total outstanding shares; (iii) two individuals mutually acceptable to Incisight and Bosma, but who are not otherwise affiliated with either of them, our company or any of our shareholders; and (iv) an additional individual who is not affiliated with either Incisight, Bosma, our company or any of our shareholders. Both parties agreed to vote to ensure that none of the directors elected pursuant to the voting agreement shall be removed from office, except for cause or unless by the affirmative vote of both parties. In addition, each of Incisight and Bosma agrees to elect one or two individuals designated by the other party as directors so long as each of them holds not less than 20% of the total issued shares of our company. The voting agreement shall continue until both parties mutually agree in writing to terminate it.

## D. Employees

As of December 31, 2016, we had 354 employees, of which 340 were based in China, including 69 in management and administration, 30 in our customer service centers, 41 in game operations, sales and marketing, and 200 in product development, including supplier management personnel and technical support personnel, 13 were based in the United States and one was based in another region. We had 498 and 565 employees as of December 31, 2014 and 2015, respectively. The decrease in the number of employees as of December 31, 2016 as compared to that of December 31, 2015 was primarily due to our business restructuring. We consider our relations with our employees to be good.

## E. Share Ownership

As of February 28, 2017, there were 57,283,929 ordinary shares outstanding, including 33,368,428 ordinary shares issued to The Bank of New York Mellon, our ADS depository, for our future issuance of ADSs upon the exercise of options under our share incentive plan and for our treasury ADSs.

The following table sets forth information with respect to the beneficial ownership of our ordinary shares as of February 28, 2017 by:

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

	Ordinary Shares Beneficially Owned	
	Number <sup>(1)</sup>	% <sup>(2)</sup>
<b>Directors and Executive Officers:</b>		
Jun Zhu <sup>(3)</sup>	14,026,950	21.8%
Davin Alexander Mackenzie	*	*
Kwok Keung Chau	*	*
Ka Keung Yeung	*	*
George Lai	*	*
Chris Shen	*	*
All Directors and Senior Executive Officers as a Group <sup>(4)</sup>	15,794,518	23.9%
<b>Principal Shareholders:</b>		
Incisight Limited <sup>(5)</sup>	7,019,428	12.3%
Splendid Days Limited <sup>(6)</sup>	11,974,826	17.3%
Bosma Limited <sup>(7)</sup>	4,612,522	8.1%
Quality Event Limited <sup>(8)</sup>	4,393,159	7.1%

\* Less than 1% of our total outstanding shares.

- (1) Beneficial ownership is determined in accordance with the rules of the SEC, and includes voting or investment power with respect to the securities. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, we have included shares that the person has the right to acquire within 60 days of February 28, 2017, including through the exercise of any option, warrant or other right or the conversion of any other security.
- (2) Percentage of beneficial ownership is based on 57,283,929 ordinary shares outstanding as of February 28, 2017, as well as the shares underlying share options and warrants exercisable by such person or group within 60 days from February 28, 2017.
- (3) Includes (i) 6,107,334 ordinary shares and 912,094 ordinary shares represented by ADSs held by Incisight Limited, a British Virgin Islands company wholly-owned and controlled by Jun Zhu, and (ii) 7,007,522 ordinary shares that Jun Zhu has the right to acquire upon exercise of options within 60 days after February 28, 2017.
- (4) Includes ordinary shares, ordinary shares represented by ADSs and ordinary shares issuable upon exercise of options held by all of our directors and executive officers as a group.
- (5) Includes 6,107,334 ordinary shares and 912,094 ordinary shares represented by ADSs held by Incisight Limited, a British Virgin Islands company wholly-owned and controlled by Jun Zhu. The business address for Incisight Limited is Building No. 3, 690 Bibo Road, Zhangjiang Hi-Tech Park, Pudong New Area, Shanghai 201203, People's Republic of China.
- (6) Includes an aggregate 7,195,982 ADSs issuable upon conversion of the Convertible Notes and an aggregate 4,778,844 ADSs issuable upon exercise of the Warrants within 60 days of December 21, 2015 that are beneficially owned by Splendid Days Limited, or Splendid Days, as reported by Splendid Days on the Schedule 13D filed with the SEC on December 21, 2015. Splendid Days currently holds all of the Convertible Notes and the Warrants that we issued in December 2015, and it may not convert any portion of the Convertible Notes if subsequent to such conversion it will hold more than 20% of our total outstanding and issued ordinary shares. According to the Schedule 13D, Splendid Days, a British Virgin Islands company, Ark Pacific Investment Management Limited, a company organized under the laws of Cayman Islands, Ark Pacific Special Opportunities Fund I, L.P., an exempted limited partnership organized under the laws of Cayman Islands, and Ng Chi Keung Kenneth, a PRC citizen, share the voting and dispositive powers with respect to the aggregate 11,974,826 ADSs. The percentage of beneficial ownership reported herein was calculated based on the total number of outstanding shares of our company as of February 28, 2017. The address for Splendid Days Limited is Sea Meadow House, Blackburne Highway, (P.O. Box 116), Road Town, Tortola, British Virgin Islands.
- (7) Consists of 4,145,065 ordinary shares and 467,457 ADSs held by Bosma Limited, as reported by Bosma Limited on the Schedule 13G/A filed with the SEC on February 13, 2009. Bosma Limited, a British Virgin Islands corporation, is wholly-owned by Morningside VC Limited, a British Virgin Islands corporation, which is in turn wholly-owned by The HCB Trust, an Isle of Man trust, the trustee of which is Dunn Investments Limited, an Isle of Man corporation. Dunn Investments Limited controls indirectly, through The HCB Trust, a 100% interest in Bosma Limited, and as a result has the sole power to vote and dispose of the shares of our company held by Bosma Limited. Dunn Investments Limited is controlled by its board of directors, consisting of Lorna Irene Cameron and Philip Alvaro Salazar, both of whom expressly disclaim beneficial ownership of the shares held by Bosma Limited. The address for Bosma Limited is Pasea Estate, Road Town, Tortola, British Virgin Islands.
- (8) Includes 2,058,760 ADSs issuable upon conversion of the Convertible Notes and 2,334,399 ADSs issuable upon exercise of the Warrants within 60 days of December 21, 2015 that are beneficially owned by Quality Event Limited, as reported by Quality Event Limited on the Schedule 13G filed with the SEC on December 21, 2015. According to the Schedule 13D filed by Splendid Days with the SEC on December 21, 2015, Quality Event Limited has acquired beneficial ownership over such ADSs through a participation agreement entered into with Splendid Days and other parties effective on December 4, 2015. According to the Schedule 13G that it filed, Quality Event Limited, a British Virgin Islands company, is a wholly-owned subsidiary of Verdant Private Portfolios, a Cayman Islands company, which is a wholly-owned subsidiary of Verdant Investment Holdings Ltd., a British Virgin Islands company. Verdant Investment Holdings Ltd. is a wholly-owned subsidiary of Verdant Holdings Limited, a Hong Kong company, which is a wholly-owned subsidiary of Jing An Equity Investment Company Limited, a PRC company. Jing An Equity Investment Company Limited is a wholly-owned subsidiary of National Property Company Limited, a PRC company, of which the controlling shareholder is Jin Xi, a PRC citizen. The percentage of beneficial ownership was calculated based on the total number of outstanding shares of our company as of February 28, 2017. The address for Quality Event Limited is 21/F, York House, The Landmark, 15 Queen's Road Central, Hong Kong.

To our knowledge, as of February 28, 2017, 46,971,530 ordinary shares, or approximately 82.0% of the issued and outstanding shares, were held by one record shareholder in the United States, namely, The Bank of New York Mellon, our ADS depository. 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 shareholders has different voting rights from other shareholders as of the date of this annual report. We are currently not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

## **Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

### **A. Major Shareholders**

Please refer to “Item 6. Directors, Senior Management and Employees—E. Share Ownership.”

### **B. Related Party Transactions**

#### **Arrangements with Affiliated PRC Entities**

Current PRC laws and regulations impose substantial restrictions on foreign ownership of entities involved in ICP, Internet culture operation and Internet publishing businesses, including online game operations, in China. Therefore, we conduct part of our activities through a series of agreements with Shanghai IT, our key affiliated PRC entity. Shanghai IT holds the requisite licenses and approvals for conducting ICP, Internet culture operation and Internet publishing businesses in China. Shanghai IT is owned by our employee Wei Ji, who acquired his equity interests in Shanghai IT from Jun Zhu in November 2011, and our employee Zhimin Lin, who acquired his equity interests in Shanghai IT from Yong Wang in April 2014.

We have obtained the exclusive right to benefit from Shanghai IT’s licenses and approvals. In addition, through a series of contractual arrangements with Shanghai IT and its shareholders, we are able to direct and control the operation and management of Shanghai IT. We believe that the individual shareholders of Shanghai IT will not receive material personal benefits from these agreements except as shareholders or employees of The9 Limited.

We do not believe we could have obtained these agreements, taken as a whole, from unrelated third parties. Because of the uncertainty relating to the legal and regulatory environment in China, the terms of most of the agreements were not defined unless terminated by the parties thereto. According to our PRC counsel, Zhong Lun Law Firm, subject to the interpretation and implementation of the GAPP Circular and the Network Publication Measures, these agreements, except those that have already been terminated, are valid, binding and enforceable under the current laws and regulations of China. The principal provisions of these agreements are described below.

***Exclusive Technical Service Agreement.*** We provide Shanghai IT with technical services for the operation of computer software and related businesses, including the provision of systematic solutions for the operation of Internet websites, the rental of computer and Internet facilities, daily maintenance of Internet servers and databases, the development and update of relevant computer software, and all other related technical and consulting services. Shanghai IT pays service fees to us based on their actual operating results at a service fee equal to 90% of all operating profit generated by Shanghai IT. We are the exclusive provider of these services to Shanghai IT. According to the relevant PRC rules and regulations, related party transactions should be negotiated at the arm’s length basis and apply reasonable transfer pricing methods. However, the determination of service fees is under the sole discretion of us. This agreement does not have specific clauses on renewal but does have an initial term of 20 years (with the earliest expiration date being December 31, 2029). By virtue of the governance rights we maintain over Shanghai IT, through the terms of the other agreement noted above, we are able to unilaterally renew, extend or amend the service agreement at our discretion.

**Shareholder Voting Proxy Agreement.** Each of the shareholders of Shanghai IT has entered into a shareholder voting proxy agreement with us, under which each shareholder of Shanghai IT irrevocably grants any third parties designate by us the power to exercise all voting rights to which he/she is entitled as a shareholder of Shanghai IT, including the right to attend shareholders meetings, to exercise voting rights and to appoint directors, a general manager, and other senior management of Shanghai IT. The power of proxy is irrevocable and may only be terminated at our discretion.

**Call Option Agreement.** We entered into a call option agreement with each of the shareholders of Shanghai IT, under which the parties irrevocably agreed that, at our sole discretion, we and/or any third parties designated by us will be entitled to acquire all or part of the equity interests in Shanghai IT, to the extent permitted by the then-effective PRC laws and regulations. The consideration for such acquisition will be the price equal to the lower of the amount of the registered capital of Shanghai IT and the minimum amount permissible by the then-applicable PRC law. The shareholders of Shanghai IT have also agreed not to enter into any transaction, or fail to take any action, that would substantially affect the assets, liabilities, equity, operations or other legal rights of Shanghai IT without our prior written consent, including, without limitation, declaration and distribution of dividends and profits; sale, assignment, mortgage or disposition of, or encumbrances on, Shanghai IT's equity; merger or consolidation; creation, assumption, guarantee or incurrence of any indebtedness; entering into other materials contracts. This agreement shall not expire until such time as we acquire all equity interests of Shanghai IT subject to applicable PRC laws.

**Loan Agreement.** From 2002 to May 2005, we provided an aggregate of RMB23.0 million in loan to the then shareholders of Shanghai IT, namely Jun Zhu and Yong Wong, for the purposes of capitalizing and increasing the registered capital of Shanghai IT. Such loan agreement was assumed by the current shareholders of Shanghai IT when Jun Zhu transferred the equity interest in Shanghai IT to Wei Ji in 2011 and Yong Wang transferred the equity interests in Shanghai IT to Zhimin Lin in 2014. Pursuant to the terms of this loan agreement, we granted an interest-free loan to each shareholder of Shanghai IT for the explicit purpose of making a capital contribution to Shanghai IT. The loans have an unspecified term and will remain outstanding for the shorter of the duration of The9 Computer or that of the Shanghai IT, or until such time that we elect to terminate the agreement (which is at our sole discretion) at which point the loans are payable on demand. Such loan shall only become immediately due and payable when we send a written notice to the borrowers requesting repayment. Currently, Zhimin Lin and Wei Ji have pledged all of their equity interests in Shanghai IT in favor of us under the equity pledge agreements. In the event of a breach of any term in the loan agreement or any other agreements by either Shanghai IT or its shareholders, we will be entitled to enforce our rights as a pledgee under the agreement.

**Equity Pledge Agreements.** To secure the full performance by Shanghai IT or its shareholders of their respective obligations under the Shareholder Voting Proxy Agreement, the Call Option Agreement and the Loan Agreement, the shareholders of Shanghai IT have pledged all of their equity interests in Shanghai IT in favor of us under two equity pledge agreements. In addition, the dividend distributions to the shareholders of Shanghai IT, if any, will be deposited in an escrow account over which we have exclusive control. The pledge shall remain effective until all obligations under such agreements have been fully performed. The shareholder has the obligation to maintain ownership and effective control over the pledged equity. Under no circumstances, without our prior written consent, may the shareholder transfer or otherwise encumber any equity interests in Shanghai IT. If any event of default as provided for therein occurs, The9 Computer, as the pledgee, will be entitled to dispose of the pledged equity interests through transfer or assignment and use the proceeds to repay the loans or make other payments due under the above loan agreement up to the loan amounts. Each of the shareholders of Shanghai IT has registered the pledge of its equity interests with the relevant local administration for industry and commerce pursuant to the new PRC Property Rights Law. In the event of a breach of any term in the above agreements by either Shanghai IT or its shareholders, we will be entitled to enforce our pledge rights over such pledged equity interests to compensate for any and all losses suffered from such breach.

#### **Investments or Agreements entered into with Affiliated Entities or Associates**

In February 2013, we established a new joint venture, namely ZTE9, in cooperation with Shanghai Zhongxing Communication Technology Enterprise Co., Ltd. and Shanghai Ruigao Information Technology Co., Ltd., in Wuxi, Jiangsu province of China, to develop and operate home entertainment set top box business. In February 2014, Guangdong Hongtu Guangdian Investment Limited Company made a capital investment of RMB12.5 million to acquire 10% equity interests in ZTE9. As of December 31, 2016, we held 28.8% equity interest in ZTE9. For the years ended December 31, 2014, 2015 and 2016, net royalty charged by ZTE9 for providing game contents on IPTV to us was RMB6.8 million, RMB6.3 million and RMB5.2 million (US\$0.7 million), respectively. In 2016, we provided IPTV-related advertisement service to ZTE9 amounting to RMB0.5 million (US\$0.07 million). As of December 31, 2016, the outstanding balance due to ZTE9 for the IPTV business was RMB16.8 million (US\$2.4 million). We extended a loan of RMB9.9 million and RMB2.8 million (US\$0.4 million) to ZTE9 to fund its operations for the years ended December 31, 2015 and 2016, respectively. The loan was interest-free and will be due in December 2017. As of December 31, 2015 and 2016, RMB9.9 million and RMB12.7 million (US\$1.8 million) of the loan remained outstanding, respectively.



In 2014, we entered a license agreement with System Link, a 50%-owned joint venture of our company, for publishing and operating Firefall for a five-year term in China. Under this license agreement, System Link shall pay no less than US\$160 million (including license fee and royalties) to Red 5 Singapore, our subsidiary, during the term of the agreement. In 2015, System Link paid US\$10 million to us as license fee. We recorded the amount as amount due to related party and amortizes the amount over the five-year period. As of December 31, 2016, the balance of amount due to System Link was RMB 54.1 million (US\$7.8 million) and we had recognized a revenue of RMB13.6 million (US\$2.0 million).

In 2016, we charged Shanghai Jiucheng Advertisement, an equity investee of our company, a service fee including, among others, an IDC rental fee and an office rental fee, which amounted to RMB4.5 million (US\$0.7 million). The service fee was fully paid to us in 2016.

In 2016, we entered into a license agreement with T3 Entertainment, an equity investee of our company, for developing a game using augmented reality (AR) technologies based on the intellectual property relating to the game Audition. Upon commercial launch of the game, we will share certain percentages of revenues of the game with T3 Entertainment. The game was still under development as of December 31, 2016.

#### **Loan from Related Parties**

In 2016, Mr. Jun Zhu, our chairman and chief executive officer, extended an aggregate of RMB60.0 million in loan to us. The loan was interest-free. As of December 2016, RMB25.2 million (US\$3.6 million) of such loan remained outstanding.

#### **Stock Option Grants**

See “Item 6. Directors, Senior Management and Employees—B. Compensation—Share Incentive Plan—Sixth Amended and Restated 2004 Stock Option 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**

Red 5 is currently in dispute with Qihoo 360 and its affiliates regarding System Link and Firefall. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—Our equity investments or establishment of joint ventures and any material disputes with our investment or joint venture partners may have an adverse effect on our financial results, business prospects and our ability to manage our business.” In addition, on September 30, 2015, a former employee who served as a human resources generalist of Red 5 filed a complaint before the Superior Court of California, County of Orange, against Red 5 and our company for wrongful termination of employment, and claimed general damages in excess of US\$1.0 million and special damages in excess of US\$0.5 million. On February 22, 2016, we submitted an answer to complaint and demand to the court to defend the action. This case was subsequently settled on December 13, 2016 and we do not believe that it had a material impact on our financial position or profitability.

Other than the 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, financial condition and results of operations.

## **Dividend Policy**

We currently intend to retain most, if not all, of our available funds and any future earnings for use in the operation of our business. Our board of directors has discretion as to whether we will distribute dividends in the future, subject to applicable laws. Even if our board of directors determines to distribute dividends, the form, frequency and amount of our dividends will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions, legal restrictions and other factors as the board of directors may deem relevant. Any dividend we declare will be paid to the holders of ADSs, subject to the terms of the deposit agreement, to the same extent as holders of our ordinary shares, less the fees and expenses payable under the deposit agreement. Any dividend we declare will be distributed by the depositary bank to the holders of our ADSs. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

## **B. Significant Changes**

Except as otherwise disclosed 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**

Our ADSs, each representing one ordinary share, have been listed on the Nasdaq Global Market since December 15, 2004. Our ADSs are traded under the symbol “NCTY.” The following table provides the high and low trading prices for our ADSs on the Nasdaq Global Market for the periods specified.

	<b>Sales Price</b>	
	<b>High</b>	<b>Low</b>
<b>Annual High and Low</b>		
2012	7.98	2.71
2013	4.50	2.08
2014	4.22	1.52
2015	4.49	0.90
2016	3.28	1.20
<b>Quarterly High and Low</b>		
First Quarter 2015	1.71	1.09
Second Quarter 2015	2.14	1.21
Third Quarter 2015	1.66	1.09
Fourth Quarter 2015	4.49	0.90
First Quarter 2016	3.28	1.81
Second Quarter 2016	2.55	1.67
Third Quarter 2016	2.20	1.43
Fourth Quarter 2016	1.84	1.20
First Quarter 2017	1.27	0.94
<b>Monthly High and Low</b>		
October 2016	1.84	1.52
November 2016	1.79	1.20
December 2016	1.45	1.23
January 2017	1.27	0.94
February 2017	1.23	0.97
March 2017	1.16	1.00
April 2017 (through April 5)	1.06	1.00

**B. Plan of Distribution**

Not applicable.

**C. Markets**

Our ADSs, each representing one ordinary share, have been listed on the Nasdaq Global Market since December 15, 2004 under the symbol “NCTY.”

**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 an exempted company incorporated in the Cayman Islands and our affairs are governed by our memorandum and articles of association and the Companies Law (2016 Revision) of the Cayman Islands, which is referred to as the Companies Law below.

As of the date of this annual report, our authorized share capital is US\$2,500,000, consisting of 250,000,000 ordinary shares, par value of US\$0.01 each. The following are summaries of material provisions of our currently effective amended and restated memorandum and articles of association and the Companies Law insofar as they relate to the material terms of our ordinary shares.

**Ordinary Shares**

**General.** All of our outstanding ordinary shares are fully paid and non-assessable. Certificates representing the ordinary shares are issued in registered form. Our shareholders may freely hold and vote their shares.

**Dividends.** The holders of our ordinary shares are entitled to such dividends as may be declared by our board of directors subject to the Companies Law.

**Voting Rights.** Each ordinary share is entitled to one vote on all matters upon which the ordinary shares are entitled to vote. Voting at any meeting of shareholders is by show of hands unless a poll is demanded. A poll may be demanded by any shareholder or shareholders together holding at least ten percent of the shares given a right to vote at the meeting, present in person or by proxy.

A quorum required for a meeting of shareholders consists of holders of not less than one-third of all outstanding shares entitled to vote. Shareholders' meetings shall, if required by the Companies Law, be held annually. Annual general meetings and extraordinary general meetings may be convened by our board of directors on its own initiative. Extraordinary general meetings shall be convened by our board of directors upon a request to the directors by shareholders holding in aggregate at least 33% of our voting share capital. Advance notice of at least seven business days is required for the convening of our annual general meeting and other shareholders meetings.

An ordinary resolution to be passed by the shareholders requires the affirmative vote of a simple majority of the votes attaching to the ordinary shares cast in a general meeting, while a special resolution requires the affirmative vote of no less than two-thirds of the votes attaching to the ordinary shares cast in a general meeting and includes a unanimous written resolution expressly passed as a special resolution. A special resolution is required for important matters such as a change of name, a decrease of our share capital, or amending the memorandum and articles of association. Holders of the ordinary shares may effect certain changes by ordinary resolution, including an increase of our share capital, the consolidation and division of all or any of our share capital into shares of a larger amount than our existing share capital, and the cancellation of any shares.

**Transfer of Shares.** Subject to the restrictions of our articles of association, as applicable, any of our shareholders may transfer all or any of his or her ordinary shares by an instrument of transfer in the usual or common form or any other form approved by our board. The transferor shall be deemed to remain the holder of the shares until the name of the transferee is entered in the register of members in respect thereof.

**Liquidation.** On a return of capital on winding up or otherwise (other than on conversion, redemption or purchase of shares), assets available for distribution among the holders of ordinary shares shall be distributed among the holders of the ordinary shares as the liquidator deems fair. If our assets available for distribution are insufficient to repay all of the paid-up capital, the assets will be distributed so that the losses are borne by our shareholders proportionately.

**Calls on Shares and Forfeiture of Shares.** Our board of directors may from time to time make calls upon shareholders for any amounts unpaid on their shares in a notice served to such shareholders at least 14 days prior to the specified time and place of payment. The shares that have been called upon and remain unpaid on the specified time are subject to forfeiture.

**Redemption and Repurchase of Shares.** Subject to the provisions of the Companies Law and our articles of association, we may issue shares on terms that are subject to redemption, at our option or at the option of the holders, on such terms and in such manner as may be determined by our board of directors. Our company may also repurchase any of our shares provided that the manner of such purchase has been approved by ordinary resolution of our shareholders or the manner of such purchase is in accordance with our articles of association. Under the Companies Law, the redemption or repurchase of any share may be paid out of our company's profits or out of the proceeds of a fresh issue of shares made for the purpose of such redemption or repurchase, or out of capital (including share premium account and capital redemption reserve) if the company can, immediately following such payment, pay its debts as they fall due in the ordinary course of business. In addition, under the Companies Law no such share may be redeemed or repurchased (a) unless it is fully paid up, (b) if such redemption or repurchase would result in there being no shares outstanding, or (c) if the company has commenced liquidation.

**Variation of Rights of Shares.** All or any of the special rights attached to any class of shares may, subject to the provisions of the Companies Law, be varied either with the written consent of a majority of the issued shares of that class or with the sanction of an ordinary resolution passed at a general meeting of the holders of the shares of that class.

**Inspection of Books and Records.** Holders of our ordinary shares will have no general right under Cayman Islands law to inspect or obtain copies of our list of shareholders or our corporate records. However, we will provide our shareholders with annual audited financial statements. See “—H. Documents on Display.”

## **Differences in Corporate Law**

The Companies Law is modeled after that of English law but does not follow recent English law statutory enactments. In addition, the Companies Law differs from laws applicable to Delaware corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of the Companies Law applicable to us and the laws applicable to Delaware corporations and their shareholders.

**Mergers and Similar Arrangements.** The Companies Law permits mergers and consolidations between Cayman Islands companies and between Cayman Islands companies and non-Cayman Islands companies. For these purposes:

- a “merger” means the merging of two or more constituent companies and the vesting of their undertaking, property and liabilities in one of such companies as the surviving company; and
- a “consolidation” means the combination of two or more constituent companies into a consolidated company and the vesting of the undertaking, property and liabilities of such companies to the consolidated company.

In order to effect such a merger or consolidation, the directors of each constituent company must approve a written plan of merger or consolidation, which must then be authorized by:

- a special resolution of the shareholders of each constituent company; and
- such other authorizations, if any, as may be specified in such constituent company's articles of association.

The plan of merger or consolidation must be filed with the Registrar of Companies together with a declaration as to the solvency of the consolidated or surviving company, a declaration as to the assets and liabilities of each constituent company and an undertaking that a copy of the certificate of merger or consolidation will be given to the members and creditors of each constituent company that notification of the merger or consolidation will be published in the Cayman Islands Gazette. Dissenting shareholders have the right to be paid the fair value of their shares if they follow the required procedures, subject to certain exceptions. The fair value of the shares will be determined by the Cayman Islands court if it cannot be agreed among the parties. Court approval is not required for a merger or consolidation which is effected in compliance with these statutory procedures.

In addition, there are statutory provisions that facilitate the reconstruction and amalgamation of companies, provided that the arrangement is approved by a majority in number of each class of shareholders or creditors with whom the arrangement is to be made, and who must in addition represent three-fourths in value of each such class of shareholders or creditors, as the case may be, that are present and voting either in person or by proxy at a meeting, or meetings, convened for that purpose. The convening of the meetings and subsequently the arrangement must be sanctioned by the Grand Court of the Cayman Islands. While a dissenting shareholder has the right to express to the court the view that the transaction ought not to be approved, the court can be expected to approve the arrangement if it determines that:

- the statutory provisions as to majority vote have been met;
- the shareholders have been fairly represented at the meeting in question and the statutory majority are acting bona fide without coercion of the minority to promote interests adverse to those of the class;
- the arrangement is such that may be reasonably approved by an intelligent and honest man of that class acting in respect of his interest; and
- the arrangement is not one that would more properly be sanctioned under some other provision of the Companies Law.

When a take-over offer is made and accepted by holders of 90% of the shares affected within four months, the offeror may, within a two month period commencing on the expiration of such four month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the Grand Court of the Cayman Islands but this is unlikely to succeed in the case of an offer which has been so approved unless there is evidence of fraud, bad faith or collusion.

If the arrangement and reconstruction is thus approved, the dissenting shareholder would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of Delaware corporations, providing rights to receive payment in cash for the judicially determined value of the shares.

***Shareholders' Suits.*** The Cayman Islands courts can be expected to follow English case law precedents. The Cayman Islands courts can be expected to apply and follow common law principles (namely the rule in *Foss v Harbottle* and the exceptions thereto) that permit a minority shareholder to commence a class action against the company or a derivative action in the name of the company to challenge (1) an act that is outside the company's corporate powers or that is illegal, (2) an act constituting a fraud against the minority shareholders where the wrongdoers are themselves in control of the company, and (3) an action requiring a resolution passed by a qualified or special majority that has not been obtained.

**Directors' Fiduciary Duties.** Under Delaware corporate law, a director of a Delaware corporation has a fiduciary duty to the corporation and its shareholders. This duty has two components: the duty of care and the duty of loyalty. The duty of care requires that a director act in good faith, with the care that an ordinarily prudent person would exercise under similar circumstances. Under this duty, a director must inform himself of, and disclose to shareholders, all material information reasonably available regarding a significant transaction. The duty of loyalty requires that a director act in a manner he reasonably believes to be in the best interests of the corporation, he must not use his corporate position for personal gain or advantage. This duty prohibits self-dealing by a director and mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally. In general, actions of a director are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation. However, this presumption may be rebutted by evidence of a breach of one of the fiduciary duties. Should such evidence be presented concerning a transaction by a director, a director must prove the procedural fairness of the transaction, and that the transaction was of fair value to the corporation.

As a matter of Cayman Islands law, a director of a Cayman Islands company is in the position of a fiduciary with respect to the company and therefore it is considered that he owes the following duties to the company — a duty to act in good faith in the best interests of the company, a duty not to make a personal profit out of his position as director (unless the company permits him to do so), a duty not to put himself in a position where the interests of the company conflict with his personal interest or his duty to a third party and a duty to exercise powers for the purpose for which such powers were intended. A director of a Cayman Islands company owes to the 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, there are indications that the English and Commonwealth courts are moving towards an objective standard with regard to the required skill and care and these authorities are likely to be followed in the Cayman Islands.

**Shareholder Action by Written Consent.** Under the Delaware General Corporation Law, a corporation may eliminate the right of shareholders to act by written consent by amendment to its certificate of incorporation. Cayman Islands law and our articles of association provide that shareholders may approve corporate matters by way of written resolution signed by or on behalf of each shareholder who would have been entitled to vote on such matter at a general meeting without a meeting being held.

**Shareholder Proposals.** Under the Delaware General Corporation Law, a shareholder has the right to put any proposal before the annual meeting of shareholders, provided it complies with the notice provisions in the governing documents. A special meeting may be called by the board of directors or any other person authorized to do so in the governing documents, but shareholders may be precluded from calling special meetings. Cayman Islands law and our articles of association allow our shareholders holding not less than 33 per cent of the paid up voting share capital of our company to requisition a shareholder's meeting.

**Cumulative Voting.** Under the Delaware General Corporation Law, cumulative voting for elections of directors is not permitted unless the corporation's certificate of incorporation specifically provides for it. Cumulative voting potentially facilitates the representation of minority shareholders on a board of directors since it permits the minority shareholder to cast all the votes to which the shareholder is entitled on a single director, which increases the shareholder's voting power with respect to electing such director. As permitted under Cayman Islands law, our articles of association do not provide for cumulative voting.

**Removal of Directors.** Under the Delaware General Corporation Law, a director of a corporation may be removed with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. Under our articles of association, directors can be removed with or without cause, but only by the vote of a majority of the holders of our shares voting at a general meeting or the unanimous written resolution of all shareholders.

**Transactions with Interested Shareholders.** The Delaware General Corporation Law contains a business combination statute applicable to Delaware public corporations whereby, unless the corporation has specifically elected not to be governed by such statute by amendment to its certificate of incorporation, it is prohibited from engaging in certain business combinations with an “interested shareholder” for three years following the date that such person becomes an interested shareholder. An interested shareholder generally is a person or group who or which owns or owned 15% or more of the target’s outstanding voting stock within the past three years. This has the effect of limiting the ability of a potential acquiror to make a two-tiered bid for the target in which all shareholders would not be treated equally. The statute does not apply if, among other things, prior to the date on which such shareholder becomes an interested shareholder, the board of directors approves either the business combination or the transaction which resulted in the person becoming an interested shareholder. This encourages any potential acquiror of a Delaware public corporation to negotiate the terms of any acquisition transaction with the target’s board of directors.

Cayman Islands law has no comparable statute. As a result, we cannot avail ourselves of the types of protections afforded by the Delaware business combination statute. However, although Cayman Islands law does not regulate transactions between a company and its significant shareholders, it does provide that such transactions must be entered into bona fide in the best interests of the company and for a proper purpose and not with the effect of constituting a fraud on the minority shareholders.

**Dissolution; Winding Up.** Under the Delaware General Corporation Law, unless the board of directors approves the proposal to dissolve, dissolution must be approved by shareholders holding 100% of the total voting power of the corporation. Only if the dissolution is initiated by the board of directors may it be approved by a simple majority of the corporation’s outstanding shares. Delaware law allows a Delaware corporation to include in its certificate of incorporation a supermajority voting requirement in connection with dissolutions initiated by the board. Under the Companies Law, our company may be dissolved, liquidated or wound up by either an order of the courts of the Cayman Islands or by a special resolution, or by an ordinary resolution on the basis that our company is unable to pay its debts as they fall due. The court has authority to order winding up in a number of specified circumstances including where it is, in the opinion of the court, just and equitable to do so.

**Variation of Rights of Shares.** Under the Delaware General Corporation Law, a corporation may vary the rights of a class of shares with the approval of a majority of the outstanding shares of such class, unless the certificate of incorporation provides otherwise. Under our articles of association, if our share capital is divided into more than one class of shares, we may vary the rights attached to any class only with the written consent of the holders of at least a majority of the shares of such class or with the sanction of a resolution passed by at least a majority of the holders of such class present in person or by proxy at a separate general meeting of the holders of the shares of that class.

**Amendment of Governing Documents.** Under the Delaware General Corporation Law, a corporation’s governing documents may be amended with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. As permitted by Cayman Islands law, our memorandum and articles of association may be amended with the vote of at least two-third holders of our shares at a general meeting or the unanimous written resolution of all shareholders.

**Anti-Takeover Provisions in Memorandum and Articles of Association.** Some provisions of our memorandum and articles of association may discourage, delay or prevent a change in control of our company or management that shareholders may consider favorable, including provisions that:

- authorize our board of directors to issue preference shares in one or more series and to designate the price, rights, preferences, privileges and restrictions of such preference shares without any further vote or action by our shareholders; and
- create a classified board of directors pursuant to which our directors are elected for staggered terms, which means that shareholders can only elect, or remove, a limited number of directors in any given year.

However, under Cayman Islands law, our directors may only exercise the rights and powers granted to them under our memorandum and articles of association for a proper purpose and for what they believe in good faith to be in the best interests of our company.

***Rights of Non-Resident or Foreign Shareholders.*** There are no limitations imposed by our memorandum and articles of association on the rights of non-resident or foreign shareholders to hold or exercise voting rights on our shares. In addition, there are no provisions in our memorandum and articles of association governing the ownership threshold above which shareholder ownership must be disclosed.

***Inspection of Books and Records.*** Under the Delaware General Corporation Law, any shareholder of a corporation may for any proper purpose inspect or make copies of the corporation's stock ledger, list of shareholders and other books and records. Holders of our shares will have no general right under Cayman Islands law to inspect or obtain copies of our list of shareholders or corporate records. However, we will provide our shareholders with annual audited financial statements.

## **Shareholder Rights Plan**

On January 8, 2009, our board of directors declared a dividend of one ordinary share purchase right, or a Right, for each of our ordinary shares outstanding at the close of business on January 22, 2009. See "Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds."

## **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.

## **D. Exchange Controls**

See "Item 4. Information on the Company—B. Business Overview—Government Regulations—Regulations on Foreign Currency Exchange and Dividend Distribution."

## **E. Taxation**

### **Cayman Islands Taxation**

In the opinion of our Cayman Islands counsel, Maples and Calder (Hong Kong) LLP, 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. No Cayman Islands stamp duty will be payable unless an instrument is executed in, or after execution, brought to, or produced before a court of the Cayman Islands. The Cayman Islands is not party to any double tax treaties which are applicable to payments made to or by our company. There are no exchange control regulations or currency restrictions in the Cayman Islands.

### **People's Republic of China Taxation**

If we are considered a PRC resident enterprise under the EIT Law, our shareholders and ADS holders who are deemed non-resident enterprises may be subject to the 10% EIT on the dividends payable by us or any gains realized from the transfer of our shares or ADSs, if such income is deemed derived from China, provided that (i) such foreign enterprise investor has no establishment or premises in China, or (ii) it has establishment or premises in China but its income derived from China has no real connection with such establishment or premises. Furthermore, if we are considered a PRC resident enterprise and relevant PRC tax authorities consider the dividends we pay with respect to our shares or ADSs and the gains realized from the transfer of our shares or ADSs to be income derived from sources within the PRC, it is also possible that such dividends and gains earned by non-resident individuals may be subject to the 20% PRC individual income tax. It is uncertain whether, if we are considered a PRC resident enterprise, holders of our shares or ADSs would be able to claim the benefit of tax treaties or arrangements entered into between China and other jurisdictions.

If we are required under the PRC tax law to withhold PRC income tax on our dividends payable to our non-PRC resident shareholders and ADS holders, or if any gains realized from the transfer of our shares or ADSs by our non-PRC resident shareholders and ADS holders are subject to the EIT or the individual income tax, your investment in our shares or ADSs could be materially and adversely affected.



## U. S. Federal Income Taxation

The following discussion is a summary of U.S. federal income tax considerations to U.S. Holders (as defined below) relating to the ownership and disposition of the ADSs or ordinary shares. This discussion applies only to U.S. Holders of the ADSs or ordinary shares as “capital assets” (generally, property held for investment). This discussion is based on the tax laws of the United States in effect 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.

The following discussion is for general information only and does not address all of the tax considerations that may be relevant to any particular investor or to persons in special tax situations such as:

- banks and other financial institutions;
- insurance companies;
- pension plans;
- cooperatives;
- regulated investment companies;
- real estate investment trusts;
- broker-dealers;
- traders that elect to use a mark-to-market method of accounting;
- U.S. expatriates or entities subject to the U.S. anti-inversion rules;
- tax-exempt entities (including private foundations);
- persons liable for alternative minimum tax;
- persons whose functional currency is not the U.S. dollar;
- persons holding ADSs or ordinary shares as part of a straddle, hedging, conversion or integrated transaction for U.S. federal income tax purposes;
- persons holding ADSs or ordinary shares through a bank, financial institution or other entity, or a branch thereof, located, organized or resident outside the United States;
- persons that directly, indirectly or constructively own 10% or more of the total combined voting power of all classes of our voting stock;
- partnerships or other pass-through entities, or persons holding ADSs or ordinary shares through such entities; or
- persons who acquired ADSs or ordinary shares pursuant to the exercise of any employee share option or otherwise as compensation.

In addition, the discussion below does not address any U.S. state, local or non-U.S. tax considerations, the Medicare tax, alternative minimum tax, or any non-income tax (such as U.S. federal estate or gift tax) considerations.

**U.S. HOLDERS 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.**

The discussion below of the U.S. federal income tax consequences to “U.S. Holders” will apply to you 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) organized 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 a partnership (or other entity taxable as a partnership for U.S. federal income tax purposes) is a beneficial owner of our ADSs or ordinary shares, the tax treatment of a partner in such partnership will depend on the status of such partner and the activities of such partnership. If you are a partner or a partnership holding our ADSs or ordinary shares, you are urged to consult your tax advisor as to the particular U.S. federal income tax considerations of an investment in the ADSs or ordinary shares that is applicable to you.

It is generally expected that a holder of ADSs should be treated, for U.S. federal income tax purposes, as the beneficial owner of the underlying shares represented by the ADSs. The remainder of this discussion assumes that a holder of ADSs will be treated in this manner. Predicated upon such treatment, deposits or withdrawals of our ordinary shares for our ADSs will not be subject to U.S. federal income tax. The U.S. Treasury has expressed concerns that intermediaries in the chain of ownership between the holder of an ADS and the issuer of the security underlying the ADS may be taking actions that are inconsistent with the beneficial ownership of the underlying security (for example, pre-releasing ADSs to persons that do not have beneficial ownership of the securities underlying the ADSs). Accordingly, the creditability of any foreign tax credits or the availability of the reduced tax rate for dividends received by certain non-corporate U.S. Holders, including individual U.S. Holders (as 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 value and composition of our assets and liabilities, we believe we were not a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for the taxable year ended December 31, 2016. However, as previously disclosed, although not free from doubt, we believed that we were a PFIC for U.S. federal income tax purposes for prior years.

A non-U.S. corporation will be a PFIC for any taxable year if either:

- at least 75% of its gross income for such year consists of certain types of passive income (the “income test”); or
- at least 50% of the average quarterly value of its assets (as generally determined on the basis of fair market value) produce or are held for the production of passive income (the “asset test”).

For this purpose, cash and assets readily convertible into cash are generally classified as passive assets and goodwill and other unbooked intangibles associated with active business activities may generally be classified as non-passive assets. Passive income generally includes dividends, interest, royalties and rents (other than certain royalties and rents derived in the active conduct of a trade or business and not derived from a related person), and gains from the disposition of passive assets. The classification of certain of our income as active or passive and certain of our assets as producing active or passive income, and hence whether we expect to be or will become a PFIC, depends on the interpretation of certain U.S. Treasury Regulations, including certain regulations relating to royalty income and income from intangible assets, as well as certain Internal Revenue Service (“IRS”) guidance relating to the classification of assets as producing active or passive income and certain IRS guidance relating to the distinction between services income and royalties for U.S. federal income tax purposes. Such regulations and guidance are potentially subject to different interpretations. If the percentage of our passive income or our assets treated as producing passive income increases, we may be more likely to be treated as a PFIC for such taxable year.

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. In applying this rule, however, it is not clear whether the contractual arrangements between us and our affiliated entities will be treated as ownership of stock. Moreover, it is not clear whether gain recognized from the sale of stock (or an arrangement treated as ownership of stock for U.S. federal income tax purposes) in a 25% (by value) or greater owned subsidiary (or VIE) is characterized as passive or as if we had held and sold directly our proportionate share of our subsidiary's (or VIE's) assets.

Although the law in this regard is not clear, we treat our VIEs as being owned by us for U.S. federal income tax purposes because we exercise effective control over them and are entitled to substantially all of their economic benefits. As a result, we consolidate the VIEs' results of operations in our consolidated U.S. GAAP financial statements. If it were determined that we are not the owner of our VIEs for U.S. federal income tax purposes, the composition of our income and assets would change and we may be more likely to be treated as a PFIC for any subsequent taxable year.

We must make a separate determination 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 asset test generally will be determined by reference to the market price of our ADSs or ordinary shares from time to time, our PFIC status will depend in part on the market price of our ADSs or ordinary shares, which may fluctuate significantly, and the composition of our assets and liabilities. Based on the market price of our ADSs and the value and composition of our assets and liabilities, we believe that we were not a PFIC for U.S. federal income tax purposes for the taxable year ended December 31, 2016. However, as previously disclosed, although not free from doubt, we believed that we were a PFIC for U.S. federal income tax purposes for prior years.

If we are a PFIC for any taxable year during which you hold ADSs or ordinary shares, 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. However, if we cease to be a PFIC, provided that you have not made a mark-to-market election, as described below, you may avoid some of the adverse effects of the PFIC regime by making a "deemed sale" election with respect to the ADSs or ordinary shares, as applicable. If such election is made, you will be deemed to have sold our ADSs or ordinary shares you hold at their fair market value and any gain from such deemed sale would be subject to the rules described in the following two paragraphs. After the deemed sale election, so long as we do not become a PFIC in a subsequent taxable year, your ADSs or ordinary shares with respect to which such election was made will not be treated as shares in a PFIC and you will not be subject to the rules described below with respect to any "excess distribution" you receive from us or any gain from an actual sale or other disposition of the ADSs or ordinary shares. The rules dealing with deemed sale elections are very complex. **You are strongly urged to consult your tax advisors as to the possibility and consequences of making a deemed sale election if we cease to be a PFIC and such election becomes available to you.**

For each taxable year that 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, if you receive any excess distribution or recognize any gain from a sale or other disposition of the ADSs or ordinary shares:

- 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 became a PFIC (a “pre-PFIC year”), will be treated as ordinary income;
- the amount allocated to each prior taxable year, other than a pre-PFIC 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 prior taxable year other than a pre-PFIC year.

The tax liability for amounts allocated to 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) from 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 a PFIC for any taxable year and any of non-U.S. subsidiaries is also a PFIC, a U.S. Holder would be treated as owning a proportionate amount (by value) of the shares of the lower-tier PFIC for purposes of the application of these rules, and could incur liability for the deferred tax and interest charge described below if either (1) we receive a distribution from, or dispose of all or part of our interest in, the lower-tier PFICs or (2) you dispose of all or part of your ADSs or ordinary shares. It is possible that one or more of our subsidiaries were PFICs for the taxable year ending December 31, 2016. You should consult your tax advisors regarding the application of the PFIC rules to any of our subsidiaries.

The tax liability for amounts allocated to years prior to the year of disposition of “excessive distribution” cannot be offset by any net operating losses for such years, and gains (but not losses) realized on the sale of the ADSs or ordinary shares cannot be treated as capital, even if you hold the ADSs or ordinary shares as capital assets.

Alternatively, a U.S. Holder of “marketable stock” (as defined below) of 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. If you make a valid mark-to-market election for the ADSs or ordinary shares, you will include in income for each year that we are a PFIC an amount equal to the excess, if any, of the fair market value of the ADSs or ordinary shares as of the close of your taxable year over your adjusted basis in such ADSs or ordinary shares. You will be allowed a deduction for the excess, if any, of the adjusted basis of the ADSs or ordinary shares 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 or ordinary shares 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 or ordinary shares, will be treated as ordinary income. Ordinary loss treatment will apply to the deductible portion of any mark-to-market loss on the ADSs or ordinary shares, as well as to any loss from the actual sale or other disposition of the ADSs or ordinary shares, to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included for such ADSs or ordinary shares. Your basis in the ADSs or ordinary shares will be adjusted to reflect any such income or loss amounts. If you make a mark-to-market election, any distributions that we make generally would be subject to the tax rules discussed below under “—Taxation of Dividends and Other Distributions on the ADSs or Ordinary Shares,” except that the lower tax rate applicable to qualified dividend income would not apply.

The mark-to-market election is available only for “marketable stock,” which is stock that is traded in greater than *de minimis* quantities on at least 15 days during each calendar quarter (“regularly traded”) on a qualified exchange or other market, as defined in applicable U.S. Treasury regulations. Although our ADSs are currently listed on, and historically regularly traded on, Nasdaq, which is a qualified exchange or other market for these purposes, no assurance can be given that the ADSs will be regularly traded on an established securities market in the United States for any taxable year. Moreover, if our ADSs are delisted (as described in “Item 3. Key Information—D. Risk Factors—Risks Related to Our Shares and ADSs—We currently fail to meet two of the continued listing requirements for the Nasdaq Global Market. If we fail to regain compliance with the listing requirement on a timely basis or fail to meet other listing requirements for the Nasdaq Global Market, our ADSs may be delisted from the Nasdaq Global Market or need to be transferred to other stock exchanges or trading venues, which may materially and adversely affect the market liquidity of our ADSs and our ability to obtain financing”), then the mark-to-market election generally would be unavailable to U.S. Holders. If any of our subsidiaries are or become PFICs, the mark-to-market election will likely not be available with respect to the shares of such subsidiaries that are treated as owned by you. Consequently, you could be subject to the PFIC rules with respect to income of the lower-tier PFICs the value of which already had been taken into account indirectly via mark-to-market adjustments. 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, a U.S. Holder of stock in a PFIC may make a “qualified electing fund” election with respect to such corporation to elect out of the PFIC rules described above regarding excess distributions and recognized gains. A U.S. Holder that makes a qualified electing fund election with respect to a PFIC generally will include in income such holder’s pro rata 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 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. shareholder of a PFIC is required to file an annual report containing such information as the U.S. Treasury may require. In addition, if you hold ADSs or ordinary shares in any year in which we are a PFIC, you will be required to file Internal Revenue Service Form 8621 regarding distributions received on the ADSs or ordinary shares and any gain realized on the disposition of the ADSs or ordinary shares. You should consult your tax advisors regarding any reporting requirements that may apply to you.

**YOU ARE STRONGLY URGED TO CONSULT YOUR TAX ADVISORS REGARDING THE IMPACT OF OUR BEING A PFIC FOR PRIOR YEARS ON YOUR INVESTMENT IN OUR ADSs AND ORDINARY SHARES AS WELL AS THE APPLICATION OF THE PFIC RULES AND THE POSSIBILITY OF MAKING A MARK-TO-MARKET OR DEEMED SALE ELECTION.**

#### *Taxation of Dividends and Other Distributions on the ADSs or Ordinary Shares*

Subject to the PFIC rules discussed above, the gross amount of any distribution we make to you with respect to the ADSs or ordinary shares 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 by you, in the case of ordinary shares, but only to the extent that the distribution is paid out of our current or accumulated earnings and profits (as computed under U.S. federal income tax principles). The dividends will not be eligible for the dividends-received deduction allowed to corporations in respect of dividends received from other U.S. corporations. To the extent the amount of the distribution exceeds our current and accumulated earnings and profits, (as computed 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, as a capital gain. Because we do not intend to determine our earnings and profits on the basis of U. S. federal income tax principles, any distribution paid will generally be reported as a “dividend” for U. S. federal income tax purposes.

With respect to certain non-corporate U.S. Holders, including individual U.S. Holders, dividends will be taxed at the lower capital gains rate applicable to “qualified dividend income,” provided that (1) the ADSs or ordinary shares, as applicable, are readily tradable on an established securities market in the United States, or 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 are 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, and (3) certain holding period requirements are met. Under Internal Revenue Service authority, common or ordinary shares, or ADSs representing such shares, are considered for the purpose of clause (1) above to be readily tradable on an established securities market in the United States if they are listed on Nasdaq, as are our ADSs (but not our ordinary shares). There can be no assurance that our ADSs will be considered readily tradable on an established securities market in the United States in later years. Moreover, if our ADSs are delisted and not readily tradable on an established securities market in the United States (as described in “Item 3. Key Information—D. Risk Factors—Risks Related to Our Shares and ADSs—We currently fail to meet two of the continued listing requirements for the Nasdaq Global Market. If we fail to regain compliance with the listing requirement on a timely basis or fail to meet other listing requirements for the Nasdaq Global Market, our ADSs may be delisted from the Nasdaq Global Market or need to be transferred to other stock exchanges or trading venues, which may materially and adversely affect the market liquidity of our ADSs and our ability to obtain financing”), clause (1) above would not be satisfied, and dividends would not qualify for the preferential rate applicable to qualified dividend income. Since we do not expect that our ordinary shares will be listed on an established securities market in the United States, it is unclear the dividends that we pay on our ordinary shares that are not backed by ADSs currently meet the conditions required for the reduced tax rate. Furthermore, as previously disclosed, although not free from doubt, we believed that we were a PFIC for U.S. federal income tax purposes for prior years. If we are treated as a “resident enterprise” for PRC tax purposes under the EIT Law (see “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to suffer”), 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 capital gains rate applicable to qualified dividend income for dividends paid with respect to our ADSs or ordinary shares.

Dividends will constitute foreign source income for foreign tax credit limitation purposes. If the 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 in general will 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, dividends distributed by us with respect to the ADSs or ordinary shares generally will constitute “passive category income” but could, in the case of certain U.S. Holders, constitute “general category income.”

If PRC withholding taxes apply to dividends paid to you with respect to our ADSs or ordinary shares (see “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to suffer”), subject to certain conditions and limitations, such PRC withholding taxes may 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, including the effects of any applicable income tax treaties.

### ***Taxation of Disposition of the 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 an ADS or ordinary share equal to the difference between the amount realized (in U.S. dollars) for the ADS or ordinary share and your tax basis (in U.S. dollars) in the ADS or ordinary share. If the consideration you receive for the ADS or ordinary share is not paid in U.S. dollars, the amount realized will be the U.S. dollar value of the payment received. In general, the U.S. dollar value of such a payment will be determined on the date of receipt of payment if you are a cash basis taxpayer and on the date of disposition if you are an accrual basis taxpayer. However, if the ADSs or ordinary shares, as applicable, are treated as traded on an established securities market and you are either a cash basis taxpayer or an accrual basis taxpayer who has made a special election, you will determine the U.S. dollar value of the amount realized in a foreign currency by translating the amount received at the spot rate of exchange on the settlement date of the sale. The gain or loss generally will be a capital gain or loss. If you are a non-corporate U.S. Holder, including an individual U.S. Holder, that has held the ADS or ordinary share for more than one year, you generally will be eligible for reduced tax rates. The deductibility of capital losses is subject to limitations.

Any gain or loss that you recognize on a disposition of ADSs or ordinary shares generally will be treated as U.S. source income or loss for foreign tax credit limitation purposes (in the case of loss, subject to certain limitations). However, if we are treated as a “resident enterprise” for PRC tax purposes and PRC tax were to be imposed on any gain from the disposition of the ADSs or ordinary shares (see “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to suffer”), 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. You should consult your tax advisors regarding the proper treatment of gain or loss in your particular circumstances, including the effect of any applicable income tax treaties.

## ***Information Reporting***

Dividend payments with respect to ADSs or ordinary shares and proceeds from the sale, exchange or redemption of ADSs or ordinary shares generally will be subject to information reporting to the Internal Revenue Service.

U.S. Holders who are individuals generally will be required to report our name, address and such information relating to an interest in the ADSs or ordinary shares as is necessary to identify the class or issue of which your ADSs or ordinary shares are a part. These requirements are subject to exceptions, including an exception for ADSs or ordinary shares held in accounts maintained by certain financial institutions and an exception applicable if the aggregate value of all “specified foreign financial assets” (as defined in the Code) does not exceed certain thresholds.

U.S. Holders should consult their tax advisors regarding the application of the information reporting rules.

### **F. Dividends and Paying Agents**

Not applicable.

### **G. Statement by Experts**

Not applicable.

### **H. Documents on Display**

We are subject to the periodic reporting and other informational requirements of the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the SEC. Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the SEC. The SEC also maintains a web site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding Registrants that make electronic filings with the SEC using its EDGAR system. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

Our financial statements have been prepared in accordance with U.S. GAAP.

We will furnish our shareholders with annual reports, which will include a review of operations and annual audited consolidated financial statements prepared in conformity with U.S. GAAP.

### **I. Subsidiary Information**

Not applicable.

## **Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **Interest Rate Risk**

Our exposure to interest rate risk for changes in interest rates relates primarily to the interest income generated by excess cash invested in bank deposits. We have not used any derivative financial instruments in our investment portfolio or for cash management purposes. Interest-earning instruments carry a degree of interest rate risk. We have not been exposed nor do we anticipate being exposed to material risks due to changes in interest rates. However, our future interest income may fall short of expectations due to changes in interest rates.

## Foreign Exchange Risk

We are exposed to foreign exchange risk arising from various currency exposures. Our payments to overseas developers, a portion of our financial assets and the Convertible Notes are denominated in U.S. dollars and other foreign currencies, while a significant portion of our revenues are denominated in RMB, the legal currency in China. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency risk. 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. Any significant revaluation of RMB against the U.S. dollar may materially affect our earnings and financial position, and the value of, and any dividends payable on, our ADS in U.S. dollars. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Future movements in exchange rates between the U.S. dollar and the RMB may adversely affect the value of our ADSs.”

A hypothetical 10% increase or decrease in the exchange rate of the U.S. dollar against the RMB would have resulted in an increase or decrease of RMB27.8 million (US\$4.0 million) in the aggregate principal amount of our U.S. dollar-denominated convertible notes outstanding as of December 31, 2016.

## Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

### A. Debt Securities

Not applicable.

### B. Warrants and Rights

Not applicable.

### C. Other Securities

Not applicable.

### D. American Depositary Shares

The Bank of New York Mellon, our ADS depository, collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depository 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 depository may collect its annual fee for depository services by deductions from cash distributions, or by directly billing investors, or by charging the book-entry system accounts of participants acting for them. The depository may generally refuse to provide fee-attracting services until its fees for those services are paid.

#### Persons depositing or withdrawing shares must pay:

US\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

US\$0.02 (or less) per ADS

A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs

US\$0.02 (or less) per ADS per calendar year

#### For:

- Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property
- Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
- Any cash distribution to ADS registered holders
- Distribution of securities distributed to holders of deposited securities that are distributed by the depository to ADS registered holders
- Depository services



**Persons depositing or withdrawing shares must pay:**

Registration or transfer fees

Expenses of the depositary

Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depositary or its agents for servicing the deposited securities

**For:**

- Transfer and registration of shares on our share register to or from the name of the depositary or its agent when you deposit or withdraw shares
- Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)
- Converting foreign currency to U.S. dollars
- As necessary
- As necessary

The depositary has agreed to reimburse us for expenses we incur that are related to the administration and maintenance of our ADS facility including, but not limited to, investor relations expenses, the annual Nasdaq Stock Market continued listing fees or any other program related expenses every year. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not related to the amounts of fees the depositary collects from investors. As of December 31, 2016, we had US\$0.1 million reimbursement receivable for the year 2016, after deducting withholding tax, from the depositary as reimbursement for legal fees and administrative expenses.

## PART II

### **Item 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

### **Item 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

#### **Shareholder Rights Plan**

On January 8, 2009, our board of directors declared a dividend of one ordinary share purchase right, or a Right, for each of our ordinary shares outstanding at the close of business on January 22, 2009. As long as the Rights are attached to the ordinary shares, we will issue one Right (subject to adjustment) with each new ordinary share so that all such ordinary shares will have attached Rights. When exercisable, each Right will entitle the registered holder to purchase from us one ordinary share at a price of US\$19.50 per ordinary share, subject to adjustment.

The Rights will expire on January 8, 2019, subject to our right to extend such date and are exercisable only if a person or group obtains ownership of or announces a tender offer for 15% or more of our voting securities (including ADSs representing our ordinary shares). Upon exercise, all Rights holders except the potential acquirer will be entitled to acquire our shares or the acquirer's shares at a discount. We are entitled to redeem the Rights in whole at any time on or before the acquisition by a person or group of 15% or more of our voting securities (which for these purposes include ADSs representing ordinary shares), or exchange the Rights, in whole or in part, at an exchange ratio of one ordinary share, and of other securities, cash or other assets deemed to have the same value as one ordinary share, per Right, subject to adjustment.

#### **Use of Proceeds**

Not Applicable.

## **Item 15. CONTROLS AND PROCEDURES**

### **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, 2016, 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 Annual Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such item is defined in Rules 13a-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 U.S. GAAP and includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (ii) 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 (iii) 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.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

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, 2016 using criteria established in "Internal Control—Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

### **Attestation Report of the Registered Public Accounting Firm**

This annual report on Form 20-F does not include an attestation report of our registered public accounting firm because our company is neither an accelerated filer nor a large accelerated filer, as such terms are defined in Rule 12b-2 under the Exchange Act.

### **Changes in Internal Control over Financial Reporting**

Our management has evaluated, with the participation of our chief executive officer and chief financial officer, whether any changes in our internal control over financial reporting that occurred during our last fiscal year have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, our management has concluded that no such changes occurred during the period covered by this annual report on Form 20-F.

**Item 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

See “Item 6. Directors, Senior Management and Employees—C. Board Practices.”

**Item 16B. CODE OF ETHICS**

Our board of directors has adopted a code of ethics that applies to our directors, officers, employees and agents, including certain provisions that specifically apply to our chief executive officer, chief financial officer, principal accounting officer, controller, vice presidents and any other persons who perform similar functions for us. We hereby undertake to provide to any person, without charge, a copy of our code of business conduct and ethics within ten working days after we receive such person’s written request.

**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 and Grant Thornton, our principal external auditors for the periods indicated below.

	2015	2016	
	RMB	RMB	US\$
Audit fees <sup>(1)</sup>	4,500,000	2,850,000	410,485
Tax fees <sup>(2)</sup>	152,003	132,472	19,080

(1) “Audit fees” means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for the audit of our annual financial statements.

(2) “Tax fees” means the fees billed for tax compliance services, including the preparation of tax returns and tax consultations.

The policy of our audit committee is to pre-approve all audit and non-audit services provided by our independent registered public accounting firm, including audit services, audit-related services, tax services and other services as described above, 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**

None.

**Item 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT**

On December 5, 2016, we dismissed Deloitte Touche Tohmatsu Certified Public Accountants LLP, or Deloitte, as our independent registered public accounting firm. On the same date, we engaged Grant Thornton as our independent registered public accounting firm in connection with the audit of our consolidated financial statements for the fiscal year ended December 31, 2016, effective immediately. During the fiscal years ended December 31, 2014 and 2015 and in the subsequent interim period through December 5, 2016, neither we nor anyone acting on our behalf consulted Grant Thornton regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered with respect to the consolidated financial statements of our company, and neither a written report nor oral advice was provided to us by Grant Thornton that Grant Thornton concluded was an important factor considered by us in reaching a decision as to any accounting, auditing or financial reporting issue; or (ii) any matter that was the subject of a “disagreement” (as that term is used in Item 304(a)(1)(iv) of Regulation S-K and the related instructions) or a “reportable event” (as that term is defined in Item 304(a)(1)(v) of Regulation S-K).

Deloitte's audit report on our company's consolidated financial statements as of and for the year ended December 31, 2014 did not contain any adverse opinion or disclaimer of opinion and was not qualified or modified as to uncertainty, audit scope or accounting principles. Deloitte's audit report on our company's consolidated financial statements as of and for the year ended December 31, 2015 expresses an unqualified opinion and includes an explanatory paragraph concerning substantial doubt about our company's ability to continue as a going concern. Deloitte did not audit any financial statements of our company as of any date or for any period subsequent to December 31, 2015.

Our decision to dismiss Deloitte and engage Grant Thornton was approved by our independent audit committee.

During the years ended December 31, 2014 and 2015 and the subsequent interim period through our dismissal of Deloitte on December 5, 2016, there were no disagreements between us and Deloitte on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Deloitte, would have caused Deloitte to make references thereto in their reports on the financial statements for such years. In addition, there were no "reportable events" requiring disclosure pursuant to Item 16F(a)(1)(v) of Form 20-F.

We provided Deloitte with a copy of the foregoing disclosure, and requested that Deloitte furnish us with a letter addressed to the SEC stating whether it agrees with the above statements, and if not, stating the respects in which it does not agree. We have received the requested letter from Deloitte, a copy of which is filed as Exhibit 15.8 to this Form 20-F.

#### **Item 16G. CORPORATE GOVERNANCE**

We are an exempted company incorporated in the Cayman Islands and our corporate governance practices are governed by applicable Cayman Islands law. In addition, because our ADSs are listed on the Nasdaq Global Market, we are subject to corporate governance requirements of the Nasdaq. However, Nasdaq Marketplace Rule 5615(a)(3) permits foreign private issuers like us to follow "home country practice" with respect to certain corporate governance matters, and we may decide to follow the "home country practice" on a case-by-case basis. In each of November 2015 and August 2016, our board of directors approved an increase in the total number of ordinary shares reserved for issuance under our Option Plan, for which we have followed "home country practice" in lieu of obtaining a shareholder approval pursuant to Nasdaq Marketing Rule 5635(c). We are committed to a high standard of corporate governance. As such, we endeavor to comply with most of the Nasdaq corporate governance practices and believe that we are currently in compliance with the Nasdaq corporate governance practices.

#### **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 consolidated financial statements for The9 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	Amended and Restated Memorandum and Articles of Association of the Registrant as currently in effect (incorporated by reference to Exhibit 1.1 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 7, 2011)
2.1	Specimen American Depositary Receipt (incorporated by reference to Exhibit A (Form of American Depositary Receipt) of Exhibit 1 (Form of Deposit Agreement) of our Post-Effective Amendment No. 2 to the Registration Statement on Form F-6 (file no. 333-156635) filed with the Securities and Exchange Commission on December 3, 2010)
2.2	Specimen Certificate for Ordinary Shares of The Registrant (incorporated by reference to Exhibit 4.2 from our Registration Statement on Form F-1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 26, 2004)
2.3	Form of Deposit Agreement dated as of December 20, 2004, as amended and restated as of January 16, 2009, as further amended and restated as of March 20, 2009, and as further amended and restated as of December 3, 2010 among The Registrant, The Bank of New York Mellon, as Depositary, and all Owners and Beneficial Owners from time to time of American Depositary Shares issued thereunder (incorporated by reference to Exhibit 1 of our Post-Effective Amendment No. 2 to the Registration Statement on Form F-6 (file no. 333-156635) filed with the Securities and Exchange Commission on November 19, 2010)
2.4	Rights Agreement dated as of January 8, 2009 between the Registrant and The Bank of New York Mellon, as Rights Agent (incorporated by reference to Exhibit 4.1 from our Report of Foreign Private Issuer on Form 6-K furnished to the Securities and Exchange Commission on January 8, 2009)
2.5	Amendment No. 1 to the Rights Agreement dated as of March 9, 2009 between the Registrant and The Bank of New York Mellon, as Rights Agent (incorporated by reference to Exhibit 4.1 of the Report of Foreign Private Issuer on Form 6-K furnished to the Securities and Exchange Commission on March 10, 2009)
4.1*	Sixth Amended and Restated 2004 Stock Option Plan
4.2	Form of Indemnification Agreement with the Registrant's directors and executive officers (incorporated by reference to Exhibit 10.2 from our Registration Statement on Form F-1 Amendment No. 1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 30, 2004)
4.3	Form of Employment Agreement between the Registrant and a Senior Executive Officer of the Registrant (incorporated by reference to Exhibit 10.3 from our Registration Statement on Form F-1 Amendment No. 1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 30, 2004)
4.4	Translation of Exclusive Technical Support Service Agreement, dated January 14, 2004, between Shanghai IT and The9 Computer (incorporated by reference to Exhibit 10.4 from our Registration Statement on Form F-1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 26, 2004)
4.5	Translation of Form of Call Option Agreement among The9 Computer, Shanghai IT and other parties therein (incorporated by reference to Exhibit 10.6 from our Registration Statement on Form F-1 Amendment No.1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 30, 2004)

<u>Exhibit Number</u>	<u>Description of Document</u>
4.6	Translation of Domain Name License Agreement, dated January 1, 2004, between GameNow.net (Hong Kong) Limited and Shanghai IT (incorporated by reference to Exhibit 10.9 from our Registration Statement on Form F-1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 26, 2004)
4.7	Translation of Form of Shareholder Voting Proxy Agreement among The9 Computer, Shanghai IT and its shareholders (incorporated by reference to Exhibit 4.31 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 7, 2011)
4.8	Translation of Equity Transfer Agreement dated October 25, 2011 between Jun Zhu and Wei Ji (incorporated by reference to Exhibit 4.37 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.9	Translation of Equity Pledge Agreement dated November 24, 2011 between Yong Wang and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.38 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.10	Translation of Equity Pledge Agreement dated November 24, 2011 between Wei Ji and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.39 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.11	Translation of Exclusive Call Option Agreement dated November 24, 2011 among Yong Wang, Wei Ji and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.40 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.12	Translation of Loan Agreement dated November 24, 2011 among Yong Wang, Wei Ji and The9 Computer(incorporated by reference to Exhibit 4.41 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.13	Translation of Shareholder Voting Proxy Agreement dated November 24, 2011 among Yong Wang, Wei Ji, The9 Computer and Shanghai IT(incorporated by reference to Exhibit 4.42 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.14	Translation of Novation Agreement dated November 25, 2011 among Jun Zhu, Wei Ji, Yong Wang, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.43 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)
4.15	Translation of Exclusive Technical Service Agreement, dated December 15, 2010, between Shanghai IT and The9 Computer (incorporated by reference to Exhibit 4.44 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 18, 2013)
4.16	Translation of Equity Transfer Agreement dated April 23, 2014 between Yong Wang and Zhimin Lin (incorporated by reference to Exhibit 4.21 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)
4.17	Translation of Equity Pledge Agreement dated April 22, 2014 between Zhimin Lin and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.22 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)
4.18	Translation of Exclusive Call Option Agreement dated April 22, 2014 among Zhimin Lin, Wei Ji and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.23 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)

<u>Exhibit Number</u>	<u>Description of Document</u>
4.19	Translation of Loan Agreement dated April 22, 2014 among Zhimin Lin, Wei Ji and The9 Computer (incorporated by reference to Exhibit 4.24 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)
4.20	Translation of Shareholder Voting Proxy Agreement dated April 22, 2014 among Zhimin Lin, Wei Ji, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.25 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)
4.21	Translation of Novation Agreement dated April 22, 2014 among Yong Wang, Zhimin Lin, Wei Ji, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.26 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)
4.22	Standstill Agreement dated January 8, 2009 among the Registrant, Jun Zhu and Incisight Limited (incorporated by reference to Exhibit 4.2 from our Report of Foreign Private Issuer on Form 6-K furnished to the Securities and Exchange Commission on January 8, 2009)
4.23	Convertible Note and Warrant Purchase Agreement dated November 24, 2015 among the Registrant, Splendid Days Limited and the security providers listed on Schedule 1 attached thereto (incorporated by reference to Exhibit 4.23 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 11, 2016)
8.1*	List of Significant and Other Principal Subsidiaries and Affiliated Entities of the Registrant
11.1	Amended Code of Business Conduct and Ethics of the Registrant (incorporated by reference to Exhibit 11.1 to our annual report on Form 20-F filed with the Securities and Exchange Commission on June 30, 2005)
12.1*	Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2*	Certification by Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1**	Certification by Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2**	Certification by Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1*	Consent of Maples and Calder (Hong Kong) LLP
15.2*	Consent of Zhong Lun Law Firm
15.3*	Consent of Grant Thornton, independent registered public accounting firm
15.4*	Consent of Deloitte Touche Tohmatsu Certified Public Accountants LLP, independent registered public accounting firm
15.5*	Consolidated financial statements of System Link Corporation Limited for the fiscal years ended December 31, 2014, 2015 and 2016
15.6*	Consent of Grant Thornton with respect to consolidated financial statements of System Link Corporation Limited
15.7*	Consent of Deloitte Touche Tohmatsu Certified Public Accountants LLP with respect to consolidated financial statements of System Link Corporation Limited

<u>Exhibit Number</u>	<u>Description of Document</u>
15.8*	Letter from Deloitte Touche Tohmatsu Certified Public Accountants LLP, regarding change in independent registered public accounting firm
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed with this Form 20-F.

\*\* Furnished with this Form 20-F.



## SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**The9 Limited**

By: /s/ Jun Zhu

Name: Jun Zhu

Title: Chairman and Chief Executive Officer

Date: April 7, 2017

**THE9 LIMITED**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of The9 Limited:

We have audited the accompanying consolidated balance sheet of The9 Limited, its subsidiaries and its variable interest entities (the “Group”) as of December 31, 2016, and the related consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for the year ended December 31, 2016. Our audit of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Schedule I. These consolidated financial statements and financial statement schedule are the responsibility of the Group’s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Group’s internal control over financial reporting. Our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements referred to above present fairly, in all material respects, the financial position of The9 Limited, its subsidiaries and its variable interest entities as of December 31, 2016, and the results of their operations and their cash flows for the year ended December 31, 2016, 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.

The accompanying consolidated financial statements have been prepared assuming that the Group will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Group has an accumulated deficit of approximately RMB2,897.8 million (US\$417.4 million) as of December 31, 2016, and incurred a net loss of approximately RMB667.1 million (US\$96.1 million) for the year ended December 31, 2016. These conditions, along with other matters set forth in Note 2 to the consolidated financial statements, raise substantial doubt about its ability to continue as a going concern. Management’s plans in regard to these matters are also discussed in Note 2 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Grant Thornton  
Shanghai, China  
April 7, 2017

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of The9 Limited:

We have audited the accompanying consolidated balance sheets of The9 Limited, its subsidiaries and its variable interest entities (the "Group") as of December 31, 2015, and the related consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for the two years in the period ended December 31, 2015 and related financial statement schedule included in Schedule 1. These consolidated financial statements and financial statement schedule are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group at December 31, 2015, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2015, 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.

Our audits also comprehended the translation of Renminbi amounts into United States dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 3. Such United States dollar amounts are presented solely for the convenience of readers in the United States of America.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP  
Shanghai, China  
April 11, 2016

THE9 LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS  
FOR THE YEARS ENDED DECEMBER 31, 2014, 2015 AND 2016

	2014 RMB	2015 RMB	2016 RMB	2016 US\$ (Note 3)
Revenues:				
Online game services	55,417,700	40,504,363	48,565,620	6,994,904
Other revenues	9,421,865	6,105,523	7,719,902	1,111,897
	64,839,565	46,609,886	56,285,522	8,106,801
Sales taxes	(562,674)	(198,555)	(86,236)	(12,421)
<b>Total net revenues</b>	<b>64,276,891</b>	<b>46,411,331</b>	<b>56,199,286</b>	<b>8,094,380</b>
Cost of revenues	(85,782,569)	(67,743,995)	(48,518,779)	(6,988,158)
<b>Gross (loss) profit</b>	<b>(21,505,678)</b>	<b>(21,332,664)</b>	<b>7,680,507</b>	<b>1,106,222</b>
Operating (expenses) income:				
Product development	(156,253,036)	(135,042,829)	(77,991,408)	(11,233,099)
Sales and marketing	(51,758,100)	(31,692,522)	(21,286,647)	(3,065,915)
General and administrative	(111,157,250)	(131,768,503)	(129,047,846)	(18,586,756)
Impairment loss on goodwill	—	—	(10,561,857)	(1,521,224)
(Provision)/reversal of provision for allowance for long-term receivables and prepayments	14,371,918	(8,439,580)	—	—
Impairment on intangible assets	—	—	(68,003,805)	(9,794,585)
Gain on disposal of subsidiaries	165,392,382	3,339,394	—	—
<b>Total operating expenses</b>	<b>(139,404,086)</b>	<b>(303,604,040)</b>	<b>(306,891,563)</b>	<b>(44,201,579)</b>
Other operating income (expenses)	75,000	(1,563,518)	3,604,749	519,192
<b>Loss from operations</b>	<b>(160,834,764)</b>	<b>(326,500,222)</b>	<b>(295,606,307)</b>	<b>(42,576,165)</b>
Impairment on available-for-sale investment	—	—	(244,798,058)	(35,258,254)
Impairment on other investment	—	—	(2,806,439)	(404,211)
Interest income	3,414,559	775,152	161,144	23,210
Interest expense	—	(6,397,192)	(56,471,609)	(8,133,603)
Fair value change on warrants liability	—	(7,129,161)	48,057,204	6,921,677
Gain (loss) on disposal of equity investee and available-for-sale investment	33,153,452	—	(1,217,405)	(175,343)
Other income (expenses), net	(963,125)	(1,916,755)	(9,952,271)	(1,433,426)
<b>Loss before income tax expense and share of loss in equity method investments</b>	<b>(125,229,878)</b>	<b>(341,168,178)</b>	<b>(562,633,741)</b>	<b>(81,036,115)</b>
Income tax benefit (expense)	—	—	6,079,282	875,599
Share of loss in equity method investments	(3,712,530)	(13,013,791)	(110,535,486)	(15,920,421)
<b>Net loss for the year</b>	<b>(128,942,408)</b>	<b>(354,181,969)</b>	<b>(667,089,945)</b>	<b>(96,080,937)</b>
Net loss attributable to noncontrolling interest	(21,443,321)	(16,655,902)	(58,584,204)	(8,437,880)
Net loss attributable to redeemable noncontrolling interest	(20,876,617)	(32,697,713)	(14,724,152)	(2,120,719)
Net loss attributable to The9 Limited	(86,622,470)	(304,828,354)	(593,781,589)	(85,522,338)
Change in redemption value of redeemable noncontrolling interest	(21,076,744)	(79,805,706)	(82,890,188)	(11,938,670)
<b>Net loss attributable to holders of ordinary shares</b>	<b>(107,699,214)</b>	<b>(384,634,060)</b>	<b>(676,671,777)</b>	<b>(97,461,008)</b>
Other comprehensive income (loss):				
Currency translation adjustments	(1,203,960)	5,009,430	(1,754,639)	(252,721)
<b>Total comprehensive loss</b>	<b>(130,146,368)</b>	<b>(349,172,539)</b>	<b>(668,844,584)</b>	<b>(96,333,658)</b>

**THE9 LIMITED**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS  
FOR THE YEARS ENDED DECEMBER 31, 2014, 2015 AND 2016**

	<u>2014</u> RMB	<u>2015</u> RMB	<u>2016</u> RMB	<u>2016</u> US\$
Comprehensive loss attributable to:				
Non-controlling interest	(22,995,718)	(16,912,488)	(66,293,454)	(9,548,244)
redeemable non-controlling interest	(20,876,617)	(32,697,713)	(14,724,152)	(2,120,719)
The9 Limited	(86,274,033)	(299,562,338)	(587,826,978)	(84,664,695)
Net loss attributable to holders of ordinary shares per share:				
- Basic and diluted	(4.65)	(16.55)	(28.34)	(4.08)
Weighted average number of shares outstanding:				
- Basic and diluted	23,164,695	23,235,848	23,874,102	23,874,102

The accompanying notes are an integral part of these consolidated financial statements.

**THE9 LIMITED**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 31, 2015 AND 2016**

	<b>December 31, 2015</b>	<b>December 31, 2016</b>	<b>December 31, 2016</b>
	<b>RMB</b>	<b>RMB</b>	<b>US\$ (Note 3)</b>
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	49,010,541	38,878,076	5,599,608
Accounts receivable, net of allowance for doubtful accounts of RMB991,743 and RMB992,010 as of December 31, 2015 and 2016, respectively	7,153,663	8,607,120	1,239,683
Advances to suppliers	898,126	9,085,165	1,308,536
Prepayments and other current assets	9,463,149	11,625,716	1,674,452
Amounts due from a related party	10,732,643	19,842,139	2,857,862
<b>Total current assets</b>	<b>77,258,122</b>	<b>88,038,216</b>	<b>12,680,141</b>
Investments in equity investees	267,539,694	163,037,501	23,482,284
Property, equipment and software, net	33,846,518	26,765,824	3,855,081
Goodwill	10,342,694	—	—
Intangible assets, net	78,876,486	—	—
Land use right, net	68,352,386	66,431,476	9,568,123
Other long-lived assets, net	1,879,021	6,618,977	953,331
<b>TOTAL ASSETS</b>	<b>538,094,921</b>	<b>350,891,994</b>	<b>50,538,960</b>
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS' EQUITY (DEFICIT)</b>			
Current liabilities:			
Short-term borrowing (including short-term borrowing of the consolidated VIEs without recourse to the Group of nil and RMB24,992,214 as of December 31, 2015 and December 31, 2016, respectively)	—	107,517,367	15,485,722
Accounts payable (including accounts payable of the consolidated VIEs without recourse to the Group of RMB7,292,389 and RMB5,883,617 as of December 31, 2015 and December 31, 2016, respectively)	41,248,455	37,038,856	5,334,704
Other taxes payable (including other taxes payable of the consolidated VIEs without recourse to the Group of RMB266,323 and RMB61,071 as of December 31, 2015 and December 31, 2016, respectively)	551,445	283,994	40,904
Advances from customers (including advances from customers of the consolidated VIEs without recourse to the Group of RMB8,913,065 and RMB15,396,355 as of December 31, 2015 and December 31, 2016, respectively)	19,605,593	26,711,967	3,847,323
Amounts due to related parties (including amounts due to related parties of the consolidated VIEs without recourse to the Group of RMB11,865,648 and RMB27,859,901 as of December 31, 2015 and December 31, 2016, respectively)	77,730,267	107,203,023	15,440,447
Deferred revenue (including deferred revenue of the consolidated VIEs without recourse to the Group of RMB4,732,678 and RMB3,121,950 as of December 31, 2015 and December 31, 2016, respectively)	18,552,217	15,921,873	2,293,227
Refund of game points (including refund of game points of the consolidated VIEs without recourse to the Group of RMB169,998,682 as of both December 31, 2015 and December 31, 2016)	169,998,682	169,998,682	24,484,903
Warrants (including warrants of consolidated VIEs without recourse to the Group of nil as of both December 31, 2015 and December 31, 2016)	64,414,941	16,357,737	2,356,004
Interest payables (including interest payables of consolidated VIEs without recourse to the Group of nil as of both December 31, 2015 and December 31, 2016)	—	412,626	59,431
Accrued expense and other current liabilities (including accrued expense and other current liabilities of the consolidated VIEs without recourse to the Group of RMB19,082,615 and RMB77,781,852 as of December 31, 2015 and December 31, 2016, respectively)	35,864,424	92,302,898	13,294,383
<b>Total current liabilities</b>	<b>427,966,024</b>	<b>573,749,023</b>	<b>82,637,048</b>
Long-term borrowing (including long-term borrowing of consolidated VIEs without recourse to the Group of nil as of both December 31, 2015 and December 31, 2016)	31,726,575	35,141,459	5,061,423
Convertible notes (including convertible notes of consolidated VIEs without recourse to the Group of nil as of both December 31, 2015 and December 31, 2016)	135,182,536	197,284,836	28,414,927
Deferred tax liabilities, non-current (including deferred tax liabilities, non-current of the consolidated VIEs without recourse to the Group of nil as of both December 31, 2015 and December 31, 2016)	5,690,705	—	—
<b>TOTAL LIABILITIES</b>	<b>600,565,840</b>	<b>806,175,318</b>	<b>116,113,398</b>
<b>Commitments and contingencies (Note 33)</b>			
<b>Redeemable noncontrolling interest (Note 31)</b>	<b>178,605,097</b>	<b>246,771,133</b>	<b>35,542,436</b>
<b>SHAREHOLDERS' EQUITY (DEFICITS):</b>			
Ordinary shares (US\$0.01 par value; 23,701,601 and 23,915,501 shares issued and outstanding as of December 31, 2015 and December 31, 2016, respectively)	1,917,620	1,931,642	278,214
Additional paid-in capital	2,080,041,288	2,525,599,832	363,762,038
Statutory reserves	28,071,982	28,071,982	4,043,206
Accumulated other comprehensive (loss) income	(3,372,588)	2,582,023	371,889
Accumulated deficit	(2,304,020,698)	(2,897,802,287)	(417,370,342)
The9 Limited shareholders' equity (deficit)	(197,362,396)	(339,616,808)	(48,914,995)
Non-controlling interest	(43,713,620)	(362,437,649)	(52,201,879)
<b>Total shareholders' equity (deficit)</b>	<b>(241,076,016)</b>	<b>(702,054,457)</b>	<b>(101,116,874)</b>
<b>TOTAL LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS' EQUITY (DEFICITS)</b>	<b>538,094,921</b>	<b>350,891,994</b>	<b>50,538,960</b>

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2014**

	Ordinary shares (US\$0.01 par value) Number of shares	Par value RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated other comprehensive loss RMB	Accumulated deficit RMB	Equity (deficit) attributable to The9 limited RMB	Noncontrolling interest RMB	Total Shareholder Equity (deficit) RMB
<b>Balance as of January 1, 2014</b>	23,146,859	1,881,784	2,152,320,786	28,071,982	(8,987,041)	(1,912,569,874)	260,717,637	(70,584,494)	190,133,143
<b>Net loss</b>	—	—	—	—	—	(86,622,470)	(86,622,470)	(21,443,321)	(108,065,791)
<b>Currency translation adjustments</b>	—	—	—	—	348,437	—	348,437	(1,552,397)	(1,203,960)
<b>Exercise of options</b>	54,742	3,369	809,266	—	—	—	812,635	—	812,635
<b>Minority interest change in redemption value</b>	—	—	(21,076,744)	—	—	—	(21,076,744)	—	(21,076,744)
<b>Share-based compensation</b>	—	—	2,703,685	—	—	—	2,703,685	968,615	(21,076,744)
<b>Change in equity interest attributable tononcontrolling interest</b>	—	—	(42,692,211)	—	—	—	(42,692,211)	42,692,211	—
<b>Change in equity interest attributable to non-controlling interest due to restructuring of Red 5 Singapore</b>	—	—	15,068,103	—	—	—	15,068,103	(15,068,103)	—
<b>Conversion of loans due from Red 5 to equity</b>	—	—	(31,784,850)	—	—	—	(31,784,850)	31,784,850	—
<b>Issuance of shares of Red 5 upon exercise of stock options</b>	—	—	552,426	—	—	—	552,426	64,262	616,688
<b>Balance as of December 31, 2014</b>	23,201,601	1,885,153	2,075,900,461	28,071,982	(8,638,604)	(1,999,192,344)	98,026,648	(33,138,377)	64,888,271



**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2015**

	Ordinary shares (US\$0.01 par value) Number of shares	Par value RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated other comprehensive loss RMB	Accumulated deficit RMB	Equity (deficit) attributable to The9 limited RMB	Noncontrolling interest RMB	Total Shareholder Equity (deficit) RMB
Balance as of January 1, 2015	23,201,601	1,885,153	2,075,900,461	28,071,982	(8,638,604)	(1,999,192,344)	98,026,648	(33,138,377)	64,888,271
Net loss	—	—	—	—	—	(304,828,354)	(304,828,354)	(16,655,902)	(321,484,256)
Currency translation adjustments	—	—	—	—	5,266,016	—	5,266,016	(256,586)	5,009,430
Minority interest change in redemption value	—	—	(79,805,706)	—	—	—	(79,805,706)	—	(79,805,706)
Noncontrolling interest on The9 Education Issuance of ordinary shares upon vesting of restricted shares	500,000	32,467	(32,467)	—	—	—	—	—	—
Change in noncontrolling interest due to disposal of Jincheng Advertisement Co., Ltd.	—	—	—	—	—	—	—	(298,336)	(298,336)
Purchase additional equity interest in a subsidiary	—	—	(2,408,096)	—	—	—	(2,408,096)	1,751,297	(656,799)
Beneficial conversion feature on convertible notes	—	—	52,679,692	—	—	—	52,679,692	—	52,679,692
Share-based compensation	—	—	33,184,307	—	—	—	33,184,307	823,322	34,007,629
Change in equity interest attributable to noncontrolling interest	—	—	80,903	—	—	—	80,903	(80,903)	—
Issuance of shares of Red 5 upon exercise of stock options	—	—	75,563	—	—	—	75,563	8,496	84,059
Balance as of December 31, 2015	23,701,601	1,917,620	2,080,041,288	28,071,982	(3,372,588)	(2,304,020,698)	(197,362,396)	(43,713,620)	(241,076,016)

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2016**

	Number of Ordinary shares (US\$0.01 par value)	Par value RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated other comprehensive loss RMB	Accumulated deficit RMB	Equity (deficit) attributable to The9 limited RMB	Noncontrolling interest RMB	Total Shareholder Equity (deficit) RMB
<b>Balance as of January 1, 2016</b>	23,701,601	1,917,620	2,080,041,288	28,071,982	(3,372,588)	(2,304,020,698)	(197,362,396)	(43,713,620)	(241,076,016)
Net loss	—	—	—	—	—	(593,781,589)	(593,781,589)	(58,584,204)	(652,365,793)
Currency translation adjustments	—	—	—	—	5,954,611	—	5,954,611	(7,709,250)	(1,754,639)
Minority interest change in redemption value	—	—	(82,890,188)	—	—	—	(82,890,188)	—	(82,890,188)
Exercise of options	213,900	14,022	2,128,532	—	—	—	2,142,554	—	2,142,554
Change in liquidation of branch office of Red 5	—	—	—	—	—	—	—	—	—
Partial disposal of Red 5	—	—	244,798,058	—	—	—	244,798,058	—	244,798,058
Share-based compensation	—	—	27,689,259	—	—	—	27,689,259	362,476	28,051,735
Change in equity interest attributable to noncontrolling interest	—	—	253,396,755	—	—	—	253,396,755	(253,396,755)	—
Issuance of shares of Red 5 upon exercise of stock options	—	—	436,128	—	—	—	436,128	603,704	1,039,832
<b>Balance as of December 31, 2016 (US\$ except share data, Note 3)</b>	23,915,501	1,931,642	2,525,599,832	28,071,982	2,582,023	(2,897,802,287)	(339,616,808)	(362,437,649)	(702,054,457)
	23,915,501	278,214	363,762,038	4,043,206	371,889	(417,370,342)	(48,914,995)	(52,201,879)	(101,116,874)

The accompanying notes are an integral part of these consolidated financial statements.

**THE9 LIMITED**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**FOR THE YEARS ENDED DECEMBER 31, 2014, 2015 AND 2016**

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2016</u>
	RMB	RMB	RMB	US\$ (Note 3)
<b>Cash flows from operating activities:</b>				
Net loss	(128,942,408)	(354,181,969)	(667,089,945)	(96,080,937)
Adjustments for:				
Loss on disposal of property, equipment and software	1,346,972	1,563,518	1,765,367	254,266
Gain on disposal of subsidiaries	(165,392,382)	(3,339,394)	—	—
Employee compensation relating to the issuance of redeemable noncontrolling interest	13,034,797	—	—	—
Share-based compensation expense	3,672,300	34,007,629	28,051,735	4,040,290
Impairment on equity investments	—	—	2,806,439	404,211
Impairment on available-for-sales investment	—	—	244,798,058	35,258,254
Provision/(reversal of provision) for allowance for long-term receivables and prepayments	(14,371,918)	8,439,580	—	—
Impairment of intangible assets	—	—	68,003,805	9,794,585
Allowance for doubtful accounts receivable	76,246	711,908	—	—
Impairment on goodwill	—	—	10,561,857	1,521,224
Depreciation and amortization of property, equipment and software	15,665,588	11,563,567	7,317,920	1,054,000
Amortization of land prepaid land use right	1,920,911	1,920,910	1,920,910	276,669
Amortization of intangible assets	28,854,483	19,136,842	10,151,356	1,462,099
Share of loss in equity method investments	3,712,530	13,013,791	110,535,486	15,920,421
Gain on disposal of investment in equity investee and available-for-sales investment	(33,153,452)	—	—	—
Exchange loss (gain)	3,086,602	7,313,303	13,131,779	1,891,370
Fair value change on warrant liability	—	7,129,161	(48,057,204)	(6,921,677)
Amortization of discount and interest on convertible note	—	2,609,771	50,409,270	7,260,445
Changes in operating assets and liabilities:				
Change in accounts receivable	7,257,096	3,630,201	(1,453,441)	(209,339)
Change in advance to suppliers	—	(164,787)	(8,187,039)	(1,179,179)
Change in prepayments and other current assets	(1,767,972)	11,928,473	(2,162,566)	(311,474)
Change in prepaid royalties	4,878,579	—	—	—
Change in deferred costs	58,472	9,745	—	—
Change in other long-lived assets	7,732,074	(1,970,192)	1,879,021	270,635
Change in accounts payable	(9,104,630)	565,870	(4,200,259)	(604,963)
Change in amounts due to related party	1,505,203	61,454,444	(2,063,553)	(297,213)
Change in deferred tax liability	—	—	(6,079,282)	(875,599)
Change in other taxes payable	(306,421)	(405,070)	(267,451)	(38,521)
Change in advances from customers	(2,062,884)	2,823,656	7,106,374	1,023,531
Change in deferred revenue	321,706	(1,882,745)	(2,630,344)	(378,848)
Change in interest payable	—	—	3,827,510	551,276
Change in other payables and accruals	(7,118,898)	(1,465,002)	(1,061,524)	(152,891)
Net cash used in operating activities	<u>(269,097,406)</u>	<u>(175,586,790)</u>	<u>(180,985,721)</u>	<u>(26,067,365)</u>

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2016</u>
	RMB	RMB	RMB	US\$
<b>Cash flows from investing activities</b>				
Decrease (Increase) in restricted cash	700,000	—	—	—
Proceeds from disposal of subsidiaries	163,715,759	12,178,328	—	—
Dividend from cost method investee	—	—	737,894	106,279
Proceeds from disposal of equity method investees	25,040,812	—	—	—
Proceeds from disposal of available-for-sale investment	6,274,326	—	—	—
Purchase of equity method and available-for-sale investments	—	(223,428,600)	—	—
Disbursement for loans receivable from a related party (including the former equity method investee before the disposal of its equity interest held by the Group in 2014)	(5,250,000)	(9,870,000)	(2,800,000)	(403,284)
Collection of loans receivable from related party (including the former equity method investee before the disposal of its equity interest held by the Group in 2014)	5,250,000	4,500,000	—	—
Proceeds from disposal of property, equipment and software	1,148,851	340,962	—	—
Refund of upfront license fees	2,000,000	—	—	—
Refund of long-term receivables	2,000,000	17,927,763	—	—
Purchase of property, equipment and software	(3,127,931)	(10,644,290)	(1,714,075)	(246,878)
Purchase of intangible assets	—	—	(6,618,977)	(953,331)
Net cash provided by (used in) investing activities	<u>197,751,817</u>	<u>(208,995,837)</u>	<u>(10,395,158)</u>	<u>(1,497,214)</u>
<b>Cash flows from financing activities:</b>				
Proceeds from stock option exercises	812,635	—	2,142,549	308,591
Proceeds from exercises of stock options of a subsidiary	616,688	84,059	1,039,832	149,767
Issuance of redeemable noncontrolling interest	118,262,180	—	—	—
Purchase of noncontrolling interest	—	(656,799)	—	—
Cash from pledged loan	—	—	79,190,933	11,405,867
Proceeds from bank borrowings	—	31,624,560	24,992,214	3,599,628
Proceeds from the issuance of convertible notes	—	260,068,680	—	—
Proceeds from Inner Mongolia Culture Assets and Equity Exchange	—	—	57,500,000	8,281,723
Payment for the issuance cost related to convertible notes	—	(20,779,520)	—	—
Amount due to related parties	—	2,597,440	—	—
Loan from a related party	—	30,000,000	60,009,400	8,643,151
Repayment of a loan from a related party	—	(30,000,000)	(34,782,586)	(5,009,734)
Contribution from noncontrolling interest	—	4,500,000	—	—
Payment for long-term payables	(19,469,853)	(19,501,485)	—	—
Net cash provided by financing activities	<u>100,221,650</u>	<u>257,936,935</u>	<u>190,092,342</u>	<u>27,378,993</u>
Effect of foreign exchange rate changes on cash and cash equivalents	<u>(4,380,962)</u>	<u>(5,826,067)</u>	<u>(8,843,928)</u>	<u>(1,273,791)</u>
Net change in cash and cash equivalents	24,495,099	(132,471,759)	(10,132,465)	(1,459,378)
Cash and cash equivalents, beginning of year	<u>156,987,201</u>	<u>181,482,300</u>	<u>49,010,541</u>	<u>7,058,986</u>
Cash and cash equivalents, end of year	<u>181,482,300</u>	<u>49,010,541</u>	<u>38,878,076</u>	<u>5,599,608</u>
<b>Supplemental disclosure of cash flow information:</b>				
Accrued purchases of property, equipment and software	1,747,081	1,841,541	1,832,201	263,892
Accrued purchases of intangible assets	36,775,866	20,010,351	—	—
Receivable related to the disposition of a subsidiary	12,750,000	—	—	—

The accompanying notes are an integral part of these consolidated financial statements.

**THE9 LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED DECEMBER 31, 2014, 2015 AND 2016**

**1. ORGANIZATION AND NATURE OF OPERATIONS**

The accompanying consolidated financial statements include the financial statements of The9 Limited (the “Company”), which was incorporated on December 22, 1999 in the Cayman Islands, its subsidiaries and variable interest entities (“VIE subsidiaries” or “VIEs”).

The Company, its subsidiaries and VIE subsidiaries are collectively referred to as the “Group”. The Group is principally engaged in the development and operation of online games and internet related businesses, including massively multiplayer online games (“MMOGs”), mobile games, web games and TV games.

The Company’s principal subsidiaries and VIE subsidiaries are as follows as of December 31, 2016:

<u>Name of entity</u>	<u>Date of incorporation</u>	<u>Place of incorporation</u>	<u>Legal Ownership</u>
<b>Subsidiaries:</b>			
GameNow.net (Hong Kong) Limited (“ <i>GameNow Hong Kong</i> ”)	January-00	Hong Kong	100%
The9 Computer Technology Consulting (Shanghai) Co., Ltd. (“ <i>The9 Computer</i> ”)	June-00	PRC	100%
China The9 Interactive Limited (“ <i>C9I</i> ”)	October-03	Hong Kong	100%
China The9 Interactive (Shanghai) Limited (“ <i>C9I Shanghai</i> ”)	February-05	PRC	100%
The9 Digital Entertainment Ltd. (“ <i>9 Dream</i> ”)	July-05	Hong Kong	<b>100%</b>
China The9 Interactive (Beijing) Limited (“ <i>C9I Beijing</i> ”)	March-07	PRC	100%
Jiu Jing Era Information Technology (Beijing) Limited (“ <i>Jiu Jing</i> ”)	April-07	PRC	100%
JiuTuo (Shanghai) Information Technology Limited (“ <i>JiuTuo</i> ”)	July-07	PRC	100%
China Crown Technology Limited (“ <i>China Crown Technology</i> ”)	November-07	Hong Kong	100%
Asian Development Limited (“ <i>Asian Development</i> ”)	January-07	Hong Kong	100%
Asian Way Development Limited (“ <i>Asian Way</i> ”)	November-07	Hong Kong	100%
New Star International Development Limited (“ <i>New Star</i> ”)	January-08	Hong Kong	100%
Red 5 Studios, Inc. (“ <i>Red 5</i> ”)	June-05	USA	34.71% (Note 2)
Red 5 Singapore Pte. Ltd. (“ <i>Red 5 Singapore</i> ”)	April-10	Singapore	34.71% (Note 2)
The9 Interactive, Inc. (“ <i>The9 Interactive</i> ”)	June-10	USA	100%
Shanghai Jiu Chang Investment Co., Ltd. (“ <i>Jiu Chang</i> ”)	December-14	PRC	100%
City Channel Ltd. (“ <i>City Channel</i> ”)	June-06	Hong Kong	100%
<b>Variable interest entity:</b>			
Shanghai The9 Information Technology Co., Ltd. (“ <i>Shanghai IT</i> ”)	September-00	PRC	N/A (Note 4)
Shanghai MengxiangHulian Digital Technology Co., Ltd. (“ <i>MengxiangHulian</i> ”)	December-11	PRC	20% (Note 4)
Shanghai Fire Wing Information Technology Co., Ltd. (“ <i>Shanghai Fire Wing</i> ”)	January-12	PRC	None

## Subsidiaries of Shanghai IT:

<u>Name of entity</u>	<u>Date of incorporation</u>	<u>Place of incorporation</u>	<u>Legal Ownership Held by Shanghai IT</u>
Shanghai Jiushi Interactive Network Technology Co., Ltd. (“ <i>Jiushi</i> ”)	July-11	PRC	80%
Shanghai The9 Education Software Technology Co., Ltd. (“ <i>The9 Education</i> ”)	May-12	PRC	70%
Beijing Chuan Yun Interactive Network Technology Co., Ltd. (“ <i>Chuan Yun</i> ”)	February-14	PRC	100%
Hangzhou Firerain Network Technology Co., Ltd. (“ <i>HZ Firerain</i> ”)	October-08	PRC	100%
Shanghai ShencaiChengjiu Information Technology Co., Ltd. (“ <i>SH Shencai</i> ”)	May-15	PRC	100%
Shanghai Wenhui Network Technology Co., Ltd. (“ <i>Shanghai Wenhui</i> ”)	November-15	PRC	80%
Wuxi Chuang You Technology Co., Ltd. (“ <i>Chuang You</i> ”)	July-15	PRC	100%
Wuxi Interest Dynamic Network Technology Co., Ltd. (“ <i>Wu Qudong</i> ”)	June-16	PRC	100%
Changsha Quxiang Network Technology Co., Ltd. (“ <i>Changsha Quxiang</i> ”)	June-16	PRC	100%
Shanghai Yuyou Network Technology Co., Ltd. (“ <i>Shanghai Yuyou</i> ”)	December-16	PRC	80%
Silver Express Investments Ltd. (“ <i>Silver Express</i> ”)	November-07	Hong Kong	100%

## **2. PRINCIPAL ACCOUNTING POLICIES**

### **<1>Basis of presentation**

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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.

The accompanying consolidated financial statements have been prepared on a going concern basis. The Group has accumulated deficit of approximately RMB2,897.8 million (US\$417.4 million) and total current liabilities exceeded total assets by approximately RMB222.9 million (US\$32.1 million) as of December 31, 2016. The Group also suffered a net loss of approximately RMB667.1 million (US\$96.1 million) for the year ended December 31, 2016. The Group expects to continue to incur product development, and sales and marketing expenses for licensed and proprietary new games in order to achieve overall revenue growth. These factors raise substantial doubt about the Group’s ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts of liabilities that might result from the outcome of this uncertainty.

To meet its capital needs, the Group is considering multiple alternatives, including, but not limited to, additional equity financings, launch of new games, other debt financings and cost control as outlined below. There can be no assurance that the Group will be able to complete any such transaction on acceptable terms or otherwise. If the Group is unable to obtain the necessary capital, it will need to pursue a plan to license or sell its assets, seek to be acquired by another entity and/or cease operations.

#### *Additional external debt financing*

In March 2016, Bank of Shanghai (BOS) issued a commitment letter whereby BOS agrees to grant the Group a credit facility of RMB50 million (US\$7.2 million). In March 2017, the credit facility was extended for one year. The Group can apply to withdraw the funding from BOS should they require liquidity for its operations. As of December 31, 2016, the Group had withdrawn RMB25.0 million (US\$3.6 million) under this credit facility with annual interest rate of 6.525% and the loans were guaranteed by Jun Zhu and The9 Computer.

#### *Launch of new games*

The Group plans to launch our proprietary online games on different platforms, including CrossFire New Mobile Game and a web game called Soul Awake in 2017. In addition, Asian Way is developing and plan to launch a game called Audition AR in 2017.

### *Other External Financing*

The Group is financing the development of CrossFire New Mobile Game through fund-raising on Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2016, the Group had raised RMB57.5 million (US\$8.3 million), and the group plans to raise an additional RMB100 million (US\$14.4 million) in 2017 until the game is launched. For details, please refer to Note 19.

### *Cost Control*

Currently a significant portion of our cash outflows is attributable to our payroll-related costs. We have the ability to control the level of discretionary spending on payroll costs by reducing our headcount within a short period of time when necessary.

### **<2> Consolidation**

The consolidated financial statements include the financial statements of the Company, its subsidiaries and VIEs in which it has a controlling financial interest. The results of the subsidiary are consolidated from the date on which the Company obtained control and continue to be consolidated until the date that such control ceases. A controlling financial interest is typically determined when a company holds a majority of the voting equity interest in an entity. However, if the company demonstrates its ability to control the VIEs through its rights to all the residual benefits of the VIEs and its obligation to fund losses of the VIEs then the entity is consolidated. All intercompany balances and transactions between the Company, its subsidiary and VIEs have been eliminated in consolidation.

In April 2010, the Group acquired a controlling interest in Red 5. In June 2016, the Group completed a share exchange transaction with L&A International Holding Limited, or L&A, with certain other shareholders of Red 5 (Note 8). After the transaction, the Group owned 34.71% shareholding in Red 5. As the Group owned majority of board members and continuously contributed funding to the operation of Red 5, the Group still retained effective control over Red 5 and Red 5 remained to be consolidated entity of the Group as of December 31, 2016.

PRC laws and regulations currently prohibit or restrict foreign ownership of internet-related business. In September 2009, the General Administration of Press and Publication Radio, Film and Television (“GAPPRFT”) further promulgated the Circular Regarding the Implementation of the Department Reorganization Regulation by State Council and Relevant Interpretation by State Commission Office for Public Sector Reform to Further Strengthen the Administration of Pre-approval on Online Games and Approval on Import Online Games, or the GAPP Circular. Pursuant to Administrative Measures on Network Publication, or the Network Publication Measures jointly issued by GRAPPRFT and the Ministry of Information Industry (which has subsequently been reorganized as the Ministry of Industry and Information Technology (“MIIT”) on February 4, 2016, effective from March 2016, wholly foreign-owned enterprises, Sino-foreign equity joint ventures and Sino-foreign cooperative enterprises shall not engage in the provision of web publishing services, including online game services. Prior examination and approval by GAPPRFT are required on project cooperation involving internet publishing services between an internet publishing services and a wholly foreign-owned enterprise, Sino-foreign equity joint venture, or Sino-foreign cooperative enterprise within China or an overseas organization or individual. It is unclear whether authorities will deem VIE structure of the Group as a kind of such “manners of cooperation” by foreign investors to gain control over or participate in domestic online game operators, and it is not clear whether GAPPRFT and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China. Therefore, the Group believes that its ability to direct the activities of VIEs that most significantly impact their economic performance is not affected by the GAPP Circular.



### **<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 contingent assets and liabilities at the date of the consolidated financial statements, and the reported revenues and expenses during the reported periods. Significant accounting estimates reflected in the Group's consolidated financial statements include the valuation of non-marketable equity investments and determination of other-than temporary impairment, allowance for doubtful accounts and prepayment, revenue recognition, assessment of recoverability of long-lived assets and goodwill impairment, assessment of impairment of available-for-sale investments, assessment of impairment of other long-lived assets, fair value of redeemable noncontrolling interest, the fair value of the warrants, share-based compensation expense, consolidation of VIEs, valuation allowances for deferred tax assets and contingencies. 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> Foreign currency translation**

The Group's reporting currency is Renminbi ("RMB"). The Group's functional currency with the exception of its subsidiaries, Red 5, The9 Interactive, Red 5 Singapore, Red5 Korea and The9 Korea, is the RMB. The functional currency of Red 5, The9 Interactive, Red 5 Singapore, Red5 Korea and The9 Korea is United States Dollar ("US\$", or "US dollars"), United States Dollar, Singapore Dollar, Korean Won and Korean Won, respectively. Assets and liabilities of Red 5, The9 Interactive, Red 5 Singapore, Red5 Korea and The9 Korea are translated at the current exchange rates quoted by the People's Bank of China (the "PBOC") in effect at the balance sheet dates. Equity accounts are translated at historical exchange rates and revenues and expenses are translated at the average exchange rates in effect during the reporting period to RMB. Gains and losses resulting from foreign currency translation to reporting currency are recorded in accumulated other comprehensive loss in the consolidated statements of changes in equity for the years presented.

Transactions denominated in currencies other than functional currencies, are translated into functional currencies at the exchange rates prevailing at the dates of the transactions. Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations and comprehensive loss. Monetary assets and liabilities denominated in foreign currencies are translated into functional currencies using the applicable exchange rates at the balance sheet dates. All such exchange gains and losses are included in other income (expense) in the consolidated statements of operations and comprehensive loss.

#### **<5> Cash and cash equivalents**

Cash and cash equivalents represent cash on hand and highly-liquid investments with an original maturity date of three months or less. At December 31, 2015 and 2016, cash equivalents were comprised primarily of bank deposits. Included in cash and cash equivalents as of December 31, 2015 and 2016 are amounts denominated in US Dollars totaling US\$0.1 million and US\$4.2 million, respectively.

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 the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in China's foreign exchange trading system market. The Company's aggregate amount of cash and cash equivalents denominated in RMB amounted to RMB48.1 million and RMB10.0 million (US\$1.4 million) as of December 31, 2015 and 2016, respectively.

#### **<6> Allowance for doubtful accounts**

Accounts receivable mainly consist of receivables from prepaid card distributors and third party game platforms, and are recorded net of allowance for doubtful accounts. The Group determines the allowances for doubtful accounts when facts and circumstances indicate that the receivable is unlikely to be collected. Allowances for doubtful accounts are charged to general and administrative expenses. If the financial condition of the Group's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company provided allowance for doubtful accounts of RMB0.08 million, RMB0.7 million and nil in 2014, 2015 and 2016, respectively.

#### **<7> Prepaid royalties and deferred costs**

Royalties paid to the licensors of games are initially recognized as prepaid royalties when paid and subsequently recognized as deferred costs upon the customers' online registration and activation of their cards or online points. Royalties payable to the licensors or receivable from collection agents upon customers' charging their accounts are initially recorded as deferred costs upon the customers' online registration and activation of their cards or online points. Deferred costs are then ultimately recognized as cost of services in the consolidated statements of operations and comprehensive loss based upon the actual consumption of game premium features or usage of the game playing time by the customers or when the likelihood that the Group would provide further services to those customers becomes remote.

### **<8>Investments in equity method investee and loan to equity method investee**

Equity investments comprised of investments in privately held companies. The Group uses the equity method to account for an equity investment over which it has the ability to exert significant influence but does not otherwise control. The Group records equity method investments at the cost of acquisition, plus the Group's share in undistributed earnings and losses since acquisition. For equity investments over which the Group does not have significant influence or control, the cost method of accounting is used.

The Group has historically provided loans to certain equity investees in order to provide to them financial support. If the Group's share of losses of the undistributed losses exceeds the carrying amount of an investment accounted for by the equity method, the Group continues to report losses up to the investment carrying amount, including any loans balance to the equity investees.

The Group assesses its equity investments and loans to equity investees for impairment on a periodic basis by considering factors 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. If it has been determined that the equity investment is less than its related fair value and that this decline is other-than-temporary, the carrying value of the investment and loan to equity investee is adjusted downward to reflect these declines in value.

### **<9> Available-for-sale investments**

Investments in debt and equity securities are, on initial recognition, classified into the three categories: held-to-maturity securities, trading securities and available-for-sale securities. Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses recognized in accumulated other comprehensive income.

When there is objective evidence that an available-for-sale investment is impaired, the cumulative losses from declines in fair value that had been recognized directly in other comprehensive income are removed from equity and recognized in earnings. When the available-for-sale investment is sold, the cumulative fair value adjustments previously recognized in accumulated other comprehensive income are recognized in the current period operating results. When the Group determines that the impairment of an available-for-sale equity security is other-than-temporary, the Group recognizes an impairment loss in earnings equal to the difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made. When other-than-temporary impairment has occurred for an available-for-sale debt security and the Group intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, an impairment loss is recognized in earnings equal to the difference between the investment's amortized cost basis and its fair value at the balance sheet date. The new cost basis will not be changed for subsequent recoveries in fair value. To determine whether a loss is other-than-temporary, the Group reviews the cause and duration of the impairment, the extent to which fair value is less than cost, the financial condition and near-term prospects of the issuer, and the Group's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery of its amortized cost.

**<10> Property, equipment and software**

Property, equipment and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

Leasehold improvements	the shorter of respective term of the leases or the estimated useful lives of the leasehold improvements
Computer and equipment	3 to 4 years
Software	5 years
Office furniture and fixtures	3 years
Motor vehicles	5 years
Office buildings	10 to 20 years

### **<11> Goodwill**

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Group's business acquisition. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. In September 2011, the Financial Accounting Standards Board ("FASB") issued an authoritative pronouncement related to testing goodwill for impairment. The guidance permits us to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Company adopted this pronouncement since 2012. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the Group completes a two-step goodwill impairment test in December of each year. The first step compares the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill.

### **<12> Intangible assets**

Intangible assets consist primarily of acquired game licenses and acquired game development costs from business combinations.

Acquired game licenses are amortized on a straight-line basis over the shorter of the useful economic life of the relevant online game or license period, which range from two to seven years. Amortization of acquired game licenses commences upon the monetization of the related online game.

The Group recognizes intangible assets acquired through business acquisitions as assets separate from goodwill. Acquired in-process research and development costs are initially considered an indefinite-lived asset. Subsequently, they are recorded as acquired game development cost upon completion of the research and development efforts and are amortized on a straight-line basis over the useful economic life of the relevant online game. Amortization of acquired game development cost commences upon the monetization of the related online game.

### **<13> Land use right**

Land use right represents operating lease prepayments to the PRC's land bureau for usage of the parcel of land where the Group's office building is located. Amortization is calculated using the straight-line method over the estimated land use right period of 44 years.

#### **<14> Impairment of long-lived assets and allowance on long-term receivables**

The Group evaluates its long-lived assets, including finite-lived intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable or that the useful life is shorter than the Group had originally estimated. The Group assesses the recoverability of the long-lived assets by comparing the carrying amount to the estimated future undiscounted cash flow expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets, the Group would recognize an impairment loss based on the fair value of the assets.

Indefinite-lived intangible assets are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the intangible asset to its carrying amount. If the carrying amount exceeds the fair value, an impairment loss is recognized in an amount equal to that excess.

The Group determines an allowance on doubtful long-term receivables when facts and circumstances indicate that the long-term receivable is unlikely to be collected. When the collectability of the long-term receivable became likely subsequently, the Group reverses the allowance.

#### **<15>Revenue recognition**

##### *Online game services*

The Group earns revenue from provision of online game operation services to players on the Group's game servers and third party platform and overseas licensing of the online game to other operators. The Group recognizes revenues when persuasive evidence of an arrangement exists, services are delivered or performed, our price is fixed or determinable and collectability is reasonably assured.

##### Online game services to players on the Group's game server

The Group sells its prepaid online points for its online game products directly to players via certain online payment platforms. The Group adopts virtual item / service consumption model for the online game services.

Players can access certain games free of charge, but may purchase game points to acquire in-game premium features. The distribution of points to players is typically made by sales of prepaid game cards and prepaid online points. Fees for prepaid game cards and prepaid online points are deferred when received. Revenue is recognized over the estimated life of the premium features or as the premium features are consumed.

For in-game premium features that are immediately consumed, revenue is recognized upon consumption. For premium features with a stated expiration time, which range from one to 180 days, revenue is recognized ratably over the period starting from when the feature is first used to the expiration time. For perpetual features with no predetermined expiration, revenue is recognized ratably over the estimated average lives of the perpetual features, which are typically less than one year. When estimating the average lives of the in-game perpetual features, the Group considers the average period that players typically play the game, other player behavior patterns, and factors including the acceptance and popularity of expansion packs, promotional events launched, and market conditions. Future usage patterns of players may differ from the historical usage patterns on which the virtual item / service consumption revenue recognition model is based. The Group continually monitors the operational statistics and usage patterns.

#### Online game operation services over third party platform

Certain social games, TV games, certain web games and certain MMOGS, have adopted the virtual item / service consumption model, and are launched on the third party game platforms and telecom carriers. Revenue from social and web games operated through third party game platforms are recognized upon consumption of the in-game premium features with the amount net of remittance to the third party game platforms as the Group does not set the pricing of the in-game currency of the third party game platforms.

Revenue from TV games operated through telecom carriers and certain MMOGS operated on the third party game platforms are recognized upon consumption of the in-game premium features based on the gross amount paid, as the Group is the primary obligor of the games operation. The remittance to the telecom carrier and third party game platforms is recognized as costs of revenue when incurred.

#### Licensing revenue

The Group licenses certain proprietary online games to other game operators and receives license fees and royalty income in connection with their operation of the games. License fee revenue is recognized over the license period upon the commercialization of the game in the licensees' market. Royalty income is recognized when earned, provided that collectability is reasonably assured.

#### *Other revenues*

Other revenues mainly include those generated from training. Training revenue include revenues generated from providing technical training to college students on mobile application programming. These revenues are recognized when delivery of the service has occurred or when services have been rendered and the collection of the related fees is reasonably assured.

#### **<16>Advances from customers and deferred revenue**

Online points that have been sold but not activated are recognized as advances from customers. Online points that have been activated but for which online game services will be rendered in the future are recognized as deferred revenue. Deferred revenue is recognized as income based upon the actual consumption of in-game premium features by players or when the likelihood that the Group would provide further online game service to those customers is remote.

The Group licenses proprietary games to operators in other countries and receives license fees and royalty income. License fee received in advance of the monetization of the game is recorded in advances from operators.

#### <17>Convertible note and warrants

##### **Convertible Notes and Beneficial Conversion Feature (“BCF”)**

The Group issued convertible notes and warrants in December 2015. The Group has evaluated whether the conversion feature of the notes is considered an embedded derivative instrument subject to bifurcation in accordance with ASC 815, *Accounting for Derivative Instruments and Hedging Activities*. Based on the Group’s evaluation, the conversion feature is not considered an embedded derivative instrument subject to bifurcation as conversion option does not provide the holder of the notes with means to net settle the contracts. Convertible notes, for which the embedded conversion feature does not qualify for derivative treatment, are evaluated to determine if the effective rate of conversion per the terms of the convertible note agreement is below market value. In these instances, the value of the BCF is determined as the intrinsic value of the conversion feature is recorded as deduction to the carrying amount of the notes and credited to additional paid-in-capital. For convertible notes issued with detachable warrants, a portion of the note’s proceed is allocated to the warrant based on the fair value of the warrants at the date of issuance. The allocated fair value for the warrants and the value of the BCF are both recorded in the financial statements as a debt discount from the face amount of the notes, which is then accreted to interest expense over the life of the related debt using the effective interest method.

The Group has early adopted ASU 2015-3, simplifying the presentation of debt issuance costs to present the occurred debt issuance costs as a direct deduction from the convertible note rather than as an asset. Amortization of the costs is reported as interest expense.

##### **Warrants**

The Group accounts for the detachable warrants issued in connection with convertible notes under the authoritative guidance on accounting for derivative financial instruments indexed to, and potentially settled in, a company’s own stock. The Group classifies warrants in its consolidated balance sheet as a liability which is revalued at each balance sheet date subsequent to the initial issuance. The Group uses the Black-Scholes pricing model to value the warrants. Determining the appropriate fair-value model and calculating the fair value of warrants requires considerable judgment. A small change in the estimates used may cause a relatively large change in the estimated valuation. The estimated volatility of the Group’s common stock at the date of issuance, and at each subsequent reporting period, is based on historic fluctuations in the Company’s stock price. The risk-free interest rate is based on United States Treasury zero-coupon issues with a maturity similar to the expected remaining life of the warrants at the valuation date. The expected life of the warrants is based on the historical pattern of exercises of warrants.



#### **<18>Cost of sales**

Cost of sales consists primarily of online game royalties, payroll, sharing to third party game platform, telecom carries and other suppliers, depreciation, maintenance and rental of Internet data center sites, depreciation and amortization of computer equipment and software, production costs for prepaid game cards, intangible assets amortization and other overhead expenses directly attributable to the services provided.

#### **<19>Product development costs**

For software development costs, including online games, to be sold or marketed to customers, 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 an online game is released, the capitalized product development costs are amortized over the estimated product life. To date, the Group has essentially completed its software development concurrently with the establishment of technological feasibility, and, accordingly, no costs have been capitalized.

For website and internally used software development costs, the Group expenses all costs that are incurred in connection with the planning and implementation phases of development and costs that are associated with repair or maintenance of the existing websites and software. Costs incurred in the application and infrastructure development phase are capitalized and amortized over the estimated product life. Since the inception of the Group, the amount of internally generated costs qualifying for capitalization has been immaterial and, as a result, all website and internally used software development costs have been expensed as incurred.

Product development costs consist primarily of outsourced research and development expenses, payroll, depreciation charge and other overhead expenses for the development of the Group's proprietary games. Other overhead product development costs include costs incurred by the Group to develop, maintain, monitor, and manage its websites.

#### **<20>Sales and marketing expenses**

Sales and marketing expenses consist primarily of advertising and promotional expenses, payroll and other overhead expenses incurred by the Group's sales and marketing personnel. Advertising expenses in the amount of RMB22.5million, RMB3.2 million and RMB2.5 million (US\$0.4 million) for the years ended December 31, 2014, 2015 and 2016, respectively, were expensed as incurred.

#### **<21>Government grants**

Unrestricted government subsidies from local government agencies allowing the Group full discretion to utilize the funds were RMB1.2 million, RMB0.3 million and RMB1.1 million (US\$0.2 million) for the years ended December 31, 2014, 2015 and 2016, respectively, which were recorded in other income (expense) in the consolidated statements of operations and comprehensive loss.

## <22>Share-based compensation

The Group has granted share-based compensation awards to certain employees under several equity plans. The Group measures the cost of employee services received in exchange for an equity award, based on the fair value of the award at the date of grant. Share-based compensation expense is recognized net of estimated forfeitures, determined based on historical experience. The Group recognizes share-based compensation expense over the requisite service period. For performance and market-based awards which also require a service period, the Group uses graded vesting over the longer of the derived service period or when the performance condition is considered probable. The Company determines the grant date fair value of stock options using a Black-Scholes-Merton option pricing model (the “Black-Scholes Model”) with assumptions made regarding expected term, volatility, risk-free interest rate, and dividend yield. The fair value of the stock options containing a market condition are estimated using a Monte Carlo simulation model. For options awarded by private subsidiaries of the Group, the fair value of shares is estimated based on the equity value of the subsidiary. The Group evaluates the fair value of the subsidiary by making judgments and assumptions about the projected financial and operating results of the subsidiary. Once the equity value of the subsidiary is determined, it is allocated (as applicable) into the various classes of shares and options using the option-pricing method, which is one of the generally accepted valuation methodologies.

The expected term represents the period of time that stock-based awards granted are expected to be outstanding. The expected term of stock-based awards granted is determined based on historical data on employee exercise and post-vesting employment termination behavior. Expected volatilities are based on historical volatilities of the Company’s ordinary shares. Risk-free interest rate is based on United States (“US”) government bonds issued with maturity terms similar to the expected term of the stock-based awards.

The Group recognizes compensation expense, net of estimated forfeitures, on all share-based awards on a straight-line basis over the requisite service period, which is generally a one-to-four year vesting period or in the case of market-based awards, over the greater of the vesting period or derived service period. Forfeiture rate is estimated based on historical forfeiture patterns and adjusted to reflect future changes in circumstances and facts, if any. If actual forfeitures differ from those estimates, the estimates may need to be revised in subsequent periods. The Group uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

For stock option modifications, the Group compares the fair value of the original award immediately before and after the modification. For modifications, or probable-to-probable vesting conditions, the incremental fair value of fully vested awards is recognized as expense on the date of the modification, with the incremental fair value of unvested awards recognized ratably over the new service period.

**<23>Leases**

Leases for which substantially all of the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases net of any incentives received by the Group from the leasing company are charged to the consolidated statements of operations and comprehensive loss on a straight-line basis over the lease periods.

**<24>Income taxes**

Current income taxes are provided for in accordance with the laws and regulations applicable to the Group as enacted by the relevant tax authorities. Income taxes are accounted for under the asset and liability method. Deferred taxes are determined based upon differences between the financial reporting and tax bases of assets and liabilities at currently enacted statutory tax rates for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized as income in the period of change. A valuation allowance is provided on deferred tax assets to the extent that it is more likely than not that such deferred tax assets will not be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred tax assets and liabilities.

The Group recognizes the impact of an uncertain income tax position at the largest amount that is more-likely-than not to be sustained upon audit by the relevant tax authority. Income tax related interest is classified as interest expenses and penalties as income tax expense.

**<25> Redeemable non-controlling interests**

Redeemable non-controlling interests are equity interests of our consolidated subsidiary not attributable to the Group that has redemption features that are not solely within the Group's control. These interests are classified as temporary equity because their redemption is considered probable. These interests are measured at the greater of estimated redemption value at the end of each reporting period or the initial carrying amount of the redeemable non-controlling interests adjusted for cumulative earnings (loss) allocations.

**<26>Noncontrolling interest**

A noncontrolling interest in a subsidiary or VIE of the Group represents the portion of the equity (net assets) in the subsidiary or VIE not directly or indirectly attributable to the Group. Noncontrolling interests is presented as a separate component of equity in the consolidated balance sheet and modifies the presentation of net income by requiring earnings and other comprehensive income loss to be attributed to controlling and noncontrolling interest.

### **<27>Loss per share**

Basic loss per share is computed by dividing net loss attributable to the holders of ordinary shares by the weighted average number of ordinary shares outstanding during the year. Diluted loss 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.

### **<28>Segment reporting**

The Group has one operating segment whose business is developing and operating online games and related services. The Group's chief operating decision maker is the chief executive officer, who reviews consolidated results when making decisions about allocating resources and assessing performance of the Group. The Group generates its revenues from customers in the PRC, North America and other areas.

### **<29>Certain risks and concentration**

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash and cash equivalents, accounts receivable and prepayments and other current assets. As of December 31, 2015 and 2016, substantially all of the Group's cash and cash equivalents were held by major financial institutions, which management believes are of high credit worthiness.

### **<30>Fair value measurements**

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability. The fair value measurement guidance provides a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement as follows:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets that the management has the ability to access at the measurement date.

Level 2 inputs include quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable for the asset (i.e., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 inputs include unobservable inputs to the valuation methodology that reflect management's assumptions about the assumptions that market participants would use in pricing the asset. The management develops these inputs based on the best information available, including their own data.

### **<31>Financial instruments**

Financial instruments primarily consist of cash and cash equivalents, restricted cash, short-term investment, accounts receivable, accounts payable, warrants, convertible notes, long-term accounts payable and long-term debt. The carrying value of the Group's cash and cash equivalents, restricted cash, short-term investment, accounts receivable and accounts payable approximate their market values due to the short-term nature of these instruments. Warrants are recorded in the consolidated balance sheets based on fair value. The carrying value of long-term accounts payable approximates its fair value as the impact to discount the long-term payable with interest rate is insignificant. The carrying value of long-term debt approximates its fair value as its interest rates is at the same level of the current market yield for comparable loans. The carrying value of convertible notes as of December 31, 2016 was RMB197.3 million (US\$28.4 million) and the fair value of the convertible notes was approximately RMB300.8 million (US\$43.3 million) as of December 31, 2016.

### **<32> Recent accounting pronouncements**

In May 2014, the Financial Accounting Standards Board (FASB) issued an accounting standard update on revenue recognition that will be applied to all contracts with customers. The update requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, deferring the effective date for ASU 2014-09 by one year, and thus, the new standard will be effective for fiscal years beginning after December 15, 2017, with early application permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The guidance allows for either a full retrospective or a modified retrospective transition method. The Group continues to evaluate the effect of these accounting pronouncements on its financial statements and will adopt this new guidance on January 1, 2018 using the modified retrospective application method.

In February 2015, the FASB issued ASU 2015-02 to respond to shareholder's concerns about the current accounting for consolidation of certain legal entities. Stakeholders expressed concerns that current generally accepted accounting principles (GAAP) might require a reporting entity to consolidate another legal entity in situations in which the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. Financial statement users asserted that in certain of those situations in which consolidation is ultimately required, deconsolidated financial statements are necessary to better analyze the reporting entity's economic and operational results. Previously, the FASB issued an indefinite deferral for certain entities to partially address those concerns. However, the amendments in this Update rescind that deferral and address those concerns by making changes to the consolidation guidance. The ASU is effective for fiscal years beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted.

In April 2015, the FASB issued ASU 2015-03 to simplify presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments. The ASU is effective for fiscal years beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The Group early adopted this guidance as of December 31, 2015. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In May 2015, the FASB issued ASU 2015-07, Topic 820, and Fair Value Measurement, which permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. Currently, investments valued using the practical expedient are categorized within the fair value hierarchy on the basis of whether the investment is redeemable with the investee at net asset value on the measurement date, never redeemable with the investee at net asset value, or redeemable with the investee at net asset value at a future date. For investments that are redeemable with the investee at a future date, a reporting entity must take into account the length of time until those investments become redeemable to determine the classification within the fair value hierarchy. The ASU is effective for fiscal years beginning after December 15, 2015, and interim periods thereafter. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In November 2015, the FASB issued ASU 2015-17, to simplify the presentation of deferred income taxes, which requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Update. The Group has adopted this guidance during the year ended December 31, 2015 with a retroactive application. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In January 2016, the FASB issued ASU 2016-01, to improve and to achieve convergence of their respective standards on the accounting for financial instruments and enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments in this Update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The Board also is addressing measurement of credit losses on financial assets in a separate project. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Group is in the process of evaluating the impact of the standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, which replaces existing lease guidance. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. The new guidance will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of income. The standard is effective for the Group beginning January 1, 2019, with early application permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented with various optional practical expedients. The Group is currently evaluating the potential effects of this pronouncement.

In March 2016, the FASB issued ASU 2016-06, which clarifies the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. An entity performing the assessment under the amendments in this Update is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. An entity should apply the amendments in this Update on a modified retrospective basis to existing debt instruments as of the beginning of the fiscal year for which the amendments are effective. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In March 2016, the FASB issued ASU 2016-07, which eliminates the requirement to retroactively adopt the equity method of accounting. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. The amendments in this Update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Earlier application is permitted. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In March 2016, the FASB issued ASU 2016-09, which simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. For public entities, the ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods. Early adoption will be permitted in any interim or annual period for which financial statements have not yet been issued or have not been made available for issuance. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." ASU 2016-16 modifies the current prohibition to recognize deferred income taxes from differences between the tax basis of assets in the buyer's tax jurisdiction and their cost resulting from an intra-entity transfer from one tax-paying component to another tax-paying component of the same consolidated group. Under current GAAP, deferred income taxes for intra-entity asset transfers are not recognized until the asset is sold to an outside party. ASU 2016-16 allows entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 is effective for fiscal years and interim periods beginning after December 15, 2017. For entities that issue interim financial statements and whose current fiscal year end date is December 31, 2016, early adoption can be made during the three month period ending March 31, 2017. The amendments in ASU 2016-16 should be applied on a modified retrospective basis through a cumulate-effect adjustment directly to retained earnings as of the beginning of the period of adoption. We are currently evaluating the amendments in ASU 2016-16 to determine the effect it will have on the Group's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This standard is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairments tests performed on testing dates after January 1, 2017. The Group is currently assessing the impact that the guidance will have on the Group's financial condition and results of operations.



### **3. CONVENIENCE TRANSLATION**

The Group, with the exception of its subsidiary, Red 5, The9 Interactive, Red 5 Singapore, Red5 Korea and The9 Korea, maintains its accounting records and prepares its financial statements in RMB. The United States dollar (“US dollar” or “US\$”) amounts disclosed in the accompanying financial statements are presented solely for the convenience of the readers at the rate of US\$1.00 = RMB6.943, representing the noon buying rate in the City of New York for cable transfers of RMB, as certified for customs purposes by the Federal Reserve Bank of New York, on December 31, 2016. Such translations should not be construed as representations that the RMB amounts represent, or have been or could be converted into, United States dollars at that or any other rate.

### **4. VARIABLE INTEREST ENTITIES**

The Group is the primary beneficiary of the certain VIEs, including 1) Shanghai IT which was designed by the Group to comply with PRC regulations that prohibit direct foreign ownership of businesses that operate online games in the PRC and ii) Mengxiang Hulian, which is a start-up research and development company (“R&D VIE”) developing games and software funded by the Group. Due to the weaker than expected performance of the game developed by Mengxiang Hulian, the Group has stopped funding Mengxiang Hulian and it had become an inactive company as of December 31, 2016.

Shanghai Huopu Cloud Computing Terminal Technology Co., Ltd. (“Huopu Cloud”) was considered as a VIE of the Group since its establishment in 2010. In 2014, the Group sold Houpu Cloud to a third party (Note 32).

#### Shanghai IT

Shanghai IT was designed by the Group to comply with PRC regulations that prohibit direct foreign ownership of businesses that operate online and TV games in the PRC.

There are a few key contractual arrangements between the Group’s subsidiary, The9 Computer (the “WOFE”) and respective VIEs that provide the Group with a controlling financial interest over the VIEs and upon which the Group concluded that it is required to consolidate these entities pursuant to the guidance in ASC 810.

A summary of the contractual agreements referenced above is as follows:

- 1) **Loan Agreement.** The WOFE entered into loan agreements with each shareholder of the relevant VIEs. Pursuant to the terms of these loan agreements, the WOFE granted an interest-free loan to each shareholder of the VIEs for the explicit purpose of making a capital contribution to the VIEs. The loans have an unspecified term and will remain outstanding for the duration of WOFE or until such time that the WOFE elects to terminate the agreement (which is at the WOFE’s sole discretion) at which point the loans are payable on demand. The shareholders of the VIEs may not prepay all or any portion of the loans without the WOFE’s prior written request.

- 2) **Equity Pledge Agreement.** The shareholders of the VIEs entered into equity pledge agreements with the WOFE. Under the equity pledge agreements, the shareholders of the VIEs pledged all of their equity interests in the VIEs to the WOFE as collateral for all of their payments due to the WOFE and to secure performance of all obligations of the VIEs and their shareholders under the above loan agreements. In addition, the dividend distributions to the shareholders of VIEs, if any, will be deposited in an escrow account over which the WOFE has exclusive control. The pledge shall remain effective until all obligations under such agreements have been fully performed. The shareholder has the obligation to maintain ownership and effective control over the pledged equity. Under no circumstances, without the prior written consent of the WOFE, may the shareholder transfer or otherwise encumber any equity interests in the VIEs. If any event of default as provided for therein occurs, the WOFE, as the pledgee, will be entitled to dispose of the pledged equity interests through transfer or assignment and use the proceeds to repay the loans or make other payments due under the above loan agreements up to the loan amounts.
- 3) **Call Option Agreement.** The VIEs and their shareholders entered into equity call option agreements with the WOFE. Pursuant to such agreements, the shareholders of the VIEs grant the WOFE an irrevocable and exclusive option to purchase the shares of VIEs at a purchase price equal to the amount of the registered capital of the VIE or the loan provided by the WOFE, permissible by the then-applicable PRC laws and regulations. WOFE may exercise such right at any time during the term of the agreement. Moreover, under the call option agreements, neither the VIEs nor their shareholders may take actions that could materially affect the VIEs' assets, liabilities, operations, equity or other legal rights without the prior written approval of the WOFE, including, without limitation, declaration and distribution of dividends and profits; sale, assignment, mortgage or disposition of, or encumbrances on, the VIE's equity; merger or consolidation; acquisition of and investment in any third-party entities; creation, assumption, guarantee or incurrence of any indebtedness; entering into other materials contracts. The agreements shall not expire until such time as the WOFE acquires all equity interests of the relevant VIEs subject to applicable PRC laws.
- 4) **Shareholder Voting Proxy Agreement.** Each of the VIE's shareholders executed an irrevocable power of proxy to appoint the WOFE as the attorney-in-fact to act on his or her behalf on all matters pertaining to the VIEs and to exercise all of his or her rights as a shareholder of the VIEs, including the right to attend shareholders meetings, to exercise voting rights and to appoint directors, a general manager, and other senior management of the VIEs. The power of proxy is irrevocable and may only be terminated at the discretion of the WOFE.
- 5) **Exclusive Technical Service Agreement.** Under the exclusive technical service agreement, the VIEs agreed to engage the WOFE as their exclusive provider of technology consulting and other services for a service fee equal to 90% of all operating profit generated by the VIEs. According to the relevant PRC rules and regulations, related party transactions should be negotiated at the arm's length basis and apply reasonable transfer pricing methods. However, the determination of service fees is under the sole discretion of the WOFE. These agreements do not have specific clauses on renewal but do have an initial term of 20 years (with the earliest expiration date being December 31, 2029). By virtue of the governance rights the WOFE maintains over the VIEs, through the terms of the other agreements noted above, the Group is able to unilaterally renew, extend or amend the service agreements at its discretion.

The Group shall be deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

- a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance; and
- b. The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In determining the Group has "the power to direct the activities of the VIE that most significantly impact the VIEs' economic performance," the Group looked to the specific provisions of the Call Option Agreement and Shareholder Voting Proxy Agreement. These agreements, as summarized above, provide the WOFE effective control over all of the corporate and operating decisions of the VIEs, and as such, the Group's management concluded that the WOFE has the requisite power to direct the activities of the VIEs that most significantly impact the VIEs' economic performance. In assessing the Group's obligation to absorb losses, the Group notes that it has funded through the loan agreements all of the entities' share capital and also provides financial support as necessary to the entities through intercompany transactions. The Group's rights to receive economic benefits that are significant to the VIEs are embodied firstly in the Equity Pledge Agreements that secure the equity owners' obligations under the relevant agreements, and ascribes to the WOFE all of the economic benefits of the equity interests including rights to any dividends declared. Secondly, the Exclusive Technical Service Agreement further secures the ability of WOFE to receive substantially all of the economic benefits from each of the VIEs on behalf of the Group.

In conclusion, because the Group, through its wholly owned subsidiary The9 Computer, has (1) the power to direct the activities of the VIEs that most significantly affect the VIE's economic performance and (2) the right to receive benefits from the VIEs that could potentially be significant to the VIEs, it has been deemed to be the primary beneficiary of the VIEs and has consolidated the respective VIEs since the date of execution of such agreements.

Shareholders of the VIEs may potentially have conflicts of interest with the Company, and they may breach their contracts with the PRC subsidiaries or cause such contracts to be amended in a manner contrary to the interests of the Company. As a result, the Company may have to initiate legal proceedings, which involve significant uncertainty. Such disputes and proceedings may significantly disrupt the Company's business operations and adversely affect the Company's ability to control the VIEs. In light of the fact that most of the shareholders of the VIEs are directors, officers, shareholders or employees of the Company or the PRC subsidiaries, management is of the view that the risk that misaligned interests may lead to deconsolidation in the foreseeable future is remote and insignificant.

PRC laws and regulations currently limit foreign ownership of companies that provide Internet content services, which include operating online games. In addition, foreign invested enterprises are currently not eligible to apply for the required licenses for operating online games in the PRC. The Company is incorporated in the Cayman Islands and is considered a foreign entity under the PRC laws. Due to restrictions on foreign ownership of the provision of online games, the Company is dependent on the licenses held by Shanghai IT to conduct its online games business through its subsidiary in the PRC. Shanghai IT holds the necessary licenses and approvals that are essential for the online game business. The9 Computer has entered into contractual arrangements with Shanghai IT for use of its relevant licenses and websites. Shanghai IT is principally owned by certain shareholder and employee of the Company. Pursuant to certain other agreements and undertakings, the Company in substance controls Shanghai IT. In the opinion of the Company's directors, the Company's current ownership structures and its contractual arrangements with Shanghai IT, and its equity owners as well as its operations, are in compliance with all existing PRC laws and regulations. However, there may be changes and other developments in the PRC laws and regulations or their interpretation. Specifically following the recent promulgation of the GAPP Circular, it is unclear whether the authorities will deem our VIE structure and contractual arrangements with Shanghai IT as an "indirect or disguised" way by foreign investors to gain control over or participate in domestic online game operators, and challenge our VIE structure accordingly. If the Company, its PRC subsidiaries and VIEs are found to be in violation of any existing or future PRC laws or regulations, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including requiring the Company to undergo a costly and disruptive restructuring such as forcing the Company to transfer its equity interest in the PRC subsidiaries to a domestic entity or invalidating the VIE agreements. If the PRC government authorities impose penalties which cause the Company to lose its rights to direct the activities of and receive economic benefits from the VIEs, the Company may lose the ability to consolidate and reflect in its financial statements the financial condition, and results of operation of the VIEs.

The Group has concluded that the aforementioned contractual arrangements are legally enforceable and provide the Group with full control of the VIEs. However, the aforementioned contractual arrangements with the VIEs and their respective shareholders are subject to risks and uncertainties:

- The VIEs or their shareholders could fail to obtain the proper operating licenses or fail to comply with other regulatory requirements. As a result, the PRC government could impose fines, new requirements or other penalties on the VIEs or the Group, mandate a change in ownership structure or operations for the VIEs or the Group, restrict the VIEs or the Group's use of financing sources or otherwise restrict the VIEs or the Group's ability to conduct business.
- The aforementioned contractual agreements may be unenforceable or difficult to enforce. The equity pledge agreements may be deemed improperly registered or the VIEs or the Group may fail to meet other requirements. Even if the agreements are enforceable, they may be difficult to enforce given the uncertainties in the PRC legal system.
- The PRC government may declare the aforementioned contractual agreements invalid. They may modify the relevant regulation, have a different interpretation of such regulations, or otherwise determine that the Group or the VIEs have failed to comply with the legal obligations required to effectuate such contractual arrangements.
- It may be difficult to finance the VIEs by means of loans or capital contributions. Loans from our offshore parent company to the VIEs must be approved by the relevant PRC government body and such approval may be difficult or impossible to obtain. Because the VIEs are domestic PRC enterprises owned by nominee shareholders, the Group is not likely to finance their activities by means of direct capital contributions either.

If the Company, its PRC subsidiaries and VIEs are found to be in violation of any existing or future PRC laws or regulations, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including requiring the Company to undergo a costly and disruptive restructuring such as forcing the Company to transfer its equity interest in the PRC subsidiaries to a domestic entity or invalidating the VIE agreements. If the PRC government authorities impose penalties which cause the Company to lose its rights to direct the activities of and receive economic benefits from the VIEs, the Company may lose the ability to consolidate and reflect in its financial statements the results of operation of the VIEs. The Company, however, does not believe such actions would result in the liquidation or dissolution of the Company, the WOFEs or VIEs.

#### R&D VIE

Mengxiang Hulian is a primarily start-up research and development company developing games and software funded by the Group starting from 2011. The Group had arrangements with Mengxiang Hulian (the "R&D" company) pursuant to which the Group provided substantial financial support and obtained equity interests in these entities. The Group has acquired or has an option to acquire the exclusive licenses in Mainland China or worldwide for the games and software under development by these entities. As of December 31, 2015 and 2016, the Group held equity interest of 20% of Mengxiang Hulian.

Under the above arrangements with the R&D company, the Group has the power to make decisions that most significantly affect the entities' operations and effectively assumed a majority of economic risks associated with these entities, and has the obligation to absorb losses and the right to receive returns that are significant to these entities. As such, prior to the reconsideration events discussed below, it was determined that the Group is the primary beneficiary of these entities and has included them in its consolidated financial statements since their respective dates of incorporation.

Summary financial information of the VIE subsidiaries included in the accompanying consolidated financial statements with intercompany balances and transactions eliminated are as follows:

	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$ (Note 3)
Total assets	141,614,244	111,978,182	16,128,213
Total liabilities	222,151,400	328,689,556	47,341,143

	<u>December 31, 2014</u> RMB	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$ (Note 3)
Net Revenue	42,697,861	34,390,944	38,445,435	5,537,295
Net profit (loss)	101,628,848	(95,285,846)	(80,050,853)	(11,529,721)

The VIEs contributed an aggregate of 66.4%, 74.1% and 68.4% of the consolidated net revenues for the years ended December 31, 2014, 2015 and 2016, respectively. The Company's operations not conducted through contractual arrangements with the VIE primarily consist of its product development on Firefall in the United States. As of the fiscal years ended December 31, 2015 and 2016, the VIEs accounted for an aggregate of 26.3% and 31.9%, respectively, of the consolidated total assets, and 37.0% and 40.8%, respectively, of the consolidated total liabilities.

There are no consolidated VIE's assets that are collateral for the VIE's obligations and can only be used to settle the VIE's obligations.

Relevant PRC laws and regulations restrict the VIE 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 29 for disclosure of restricted net assets.

## 5. ADVANCES TO SUPPLIERS

Advances to suppliers are as follows:

	December 31, 2015 RMB	December 31, 2016 RMB	December 31, 2016 US\$ (Note 3)
Financing fee	—	7,497,988	1,079,935
Advertising fee	255,259	255,259	36,765
Development fee	—	700,000	100,821
Others	642,867	631,918	91,015
	<u>898,126</u>	<u>9,085,165</u>	<u>1,308,536</u>

The Group is financing the development of the CrossFire New Mobile Game through fund-raising on Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2016, the Group had paid RMB7.5 million (US\$1.1 million) as the financing fee of the total funds raised and to be raised amounting to RMB157.5 million (Note 19). According to the agreement, the Group paid the total financing fee RMB7.5 million upon receipt of the first payment as of December 31, 2016 (Note 19).

## 6. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets are as follows:

	December 31, 2015 RMB	December 31, 2016 RMB	December 31, 2016 US\$ (Note 3)
Prepayments and deposits	3,220,205	6,385,707	919,733
Employee advances	2,717,027	1,927,824	277,664
Others	3,525,917	3,312,185	477,055
	<u>9,463,149</u>	<u>11,625,716</u>	<u>1,674,452</u>

## 7. INVESTMENTS IN EQUITY INVESTEEES

The Group's investments in equity investees comprise the following:

	December 31, 2015 RMB	December 31, 2016 RMB	December 31, 2016 US\$ (Note 3)
Investments accounted for under equity method:			
ZTE9 Network Technology Co., Ltd., Wuxi ("ZTE9")	—	—	—
System Link Corporation Limited ("System Link")<1>	215,631,351	113,836,704	16,395,895
Shanghai Jiucheng Advertisement Co., Ltd. ("Jiucheng Advertisement") <2>	12,751,438	13,142,455	1,892,907
Investments accounted for under cost method:			
Shanghai Institute of Visual Art of Fudan University ("SIVA")	10,000,000	10,000,000	1,440,300
T3 Entertainment Co., Ltd. (previously known as "G10 Entertainment Corporation Ltd.") ("T3")	24,892,921	24,892,921	3,585,326
CrowdStar Inc. ("Crowdstar")	1,627,099	—	—
Tandem Fund II, L.P. ("Tandem Fund")	2,636,885	1,165,421	167,856
Total	<u>267,539,694</u>	<u>163,037,501</u>	<u>23,482,284</u>

## <1> System Link

In August 2014, the Group formed a joint venture, System Link, with Qihoo 360 Technology Co., Ltd., “Qihoo 360”. Pursuant to the joint venture agreement, Qihoo 360 and the Group will each own 50% equity interest in the joint venture and share profits based on the equity interest each party holds in the joint venture. In August 2014, Red 5 Singapore entered into a license agreement with System Link for publishing and operating Firefall under a five-year term in mainland China. Under this license agreement, System Link is expected to pay Red 5 Singapore no less than US\$160 million (inclusive of license fee and royalties) during the term of the agreement. The Group accounts for its investment in System Link as an equity method investment.

In August 2015, System Link has entered into a joint venture agreement with Smilegate Entertainment, Inc. (“Smilegate”) on establishment of a joint venture company, Oriental Shiny Star Limited (“Oriental Shiny”), for the operation of Cross Fire 2. In the event of a successful commercial launch of Cross Fire 2, Smilegate will receive 30% shareholdings in Oriental Shiny Star Limited.

In November 2015, Oriental Shiny entered into a license agreement with Smilegate for publishing and operating Cross Fire 2 on an exclusive basis for a five-year term in the PRC. In consideration for the exclusive license, Oriental Shiny has made an upfront payment of US\$50 million and will make additional payments totaling US\$450 million based on certain development and operation milestones of Cross Fire 2. The payment of license fee is guaranteed by the Group and Qihoo 360 proportional to the equity interest in System Link.

The total capital contribution from the Group was US\$35 million as of both December 31, 2015 and December 31, 2016. The Group recorded a loss of RMB11.0 million and RMB111.1 million (US\$16.0 million) in share of loss in equity method for the year ended December 31, 2015 and December 31, 2016.

The Group has filed System Link Corporation Limited’s consolidated financial statement as indicated in our annual report on Form 20-F for the year ended December 31, 2015 and 2016, as the 20% significant subsidiary test was met for the current year in accordance with Rule 3-09 of SEC Regulation S-X.



## **<2> Jiucheng Advertisement**

In June 2015, the Group granted 33.3% equity interest of Jiucheng Advertisement to two of its employees for nil consideration. The Group recorded shared based compensation of RMB2.7 million as a result of this transaction as the equity interest was considered a shared-based award for their service. In October, 2015, the Group entered into an agreement with Fei Fan Information Technology Co., Ltd. (“Fei Fan”), whereby Jiucheng Advertisement acquired 100% equity interest in Fei Fan in exchange of 30% equity interest in Jiucheng Advertisement. Upon the completion of the exchange, the Group’s equity interest in Jiucheng Advertisement was diluted to 46.7%. The Group accounted for the exchange as a disposal of subsidiary with a gain of RMB3.3 million (US\$0.5 million) recognized upon disposal and an acquisition of an equity method investment in Jiucheng Advertisement at fair value. In November 2015, the Group’s equity interest in Jiucheng Advertisement was further diluted to 42.0% as a result of capital injection by other shareholders. In August 2016, Jiucheng Advertisement raised capital from the Group and a third party, the Group’s equity interest in Jiucheng Advertisement became 43.7%. In October 2016, the Group’s equity interest in Jiucheng Advertisement further increased to 44.5% after the execution of certain terms under the investment agreements among certain investors of Jiucheng Advertisement.

## **<3> Other investments in equity investees**

In October 2014, the Group disposed to a third party, 100% equity interest of Beijing Linkage Technology Co., Ltd. (an equity method investee) for a cash consideration of RMB14 million and further recovered loan receivables of RMB9.8 million to the same equity method investee. The Company had previously fully impaired the investment in 2013 as well as provided a full allowance for the loan receivables due to the tight liquidity position combined with less than satisfactory performance of the investee. The Group recorded a gain of RMB23.8 million as a result of this disposal.

In 2014, the Group disposed 75% of its interest in Tandem Fund for cash consideration of RMB11.0 million, a gain of RMB3.1 million was recognized upon disposal. In December 2016, the Group recorded impairment of Tandem Fund of RMB2.8 million (US\$0.4 million) based on the fair market value of Tandem Fund.

The Group recorded impairment charges relating to its investment in equity investees of nil, nil and RMB2.8million for the years ended December 31, 2014, 2015 and 2016, respectively.

## 8. AVAILABLE-FOR-SALE INVESTMENTS

### Investment in Youjia Group Limited (“Youjia”)

In November 2011, the Group acquired 925,926 redeemable and convertible preferred shares of Youjia, a mobile social application developer based in the PRC, for a consideration of US\$1.0 million. The Group’s investment represented 6.67% of Youjia’s equity interest on an as converted basis as of December 31, 2011. The Group recorded the investment in Youjia as an available-for-sale investment as the redeemable convertible preference share is in substance a debt security. During 2013, based on an evaluation of the financial results and condition of Youjia, the Group provided full impairment provision of RMB6.3 million (US\$1.0 million) of Youjia.

In April 2014, the Group disposed all of its shares in Youjia to a third party for a cash consideration of US\$1.0 million, a gain of RMB6.3 million (US\$0.9 million) for the year ended December 31, 2014 is recognized upon disposal.

### Investment in L&A International Holding Limited (“L&A”)

In June 2016, the Group completed a share exchange transaction between L&A International Holding Limited, or L&A, a Cayman Islands company with shares publicly listed on the Growth Enterprise Market of the Hong Kong Stock Exchange (Stock Code: 8195), with certain other shareholders of Red 5, whereby the Group exchanged approximately 30.6% equity interest (on a fully-diluted basis) in Red 5 for a total of 723,313,020 (after a one-to-five stock split) newly issued shares of L&A after deducting a 6% of total shares received (769,481,940 shares) which was the payment of service fee to a third party consultant. In June 2016, Asian Development, a wholly-owned subsidiary, incorporated in Hong Kong, borrowed a total of HK\$92.3 million from a financial services company, which was secured by a pledge of 417,440,000 shares of L&A (Note 18). As Asian Development is currently in default of the loan due to a sharp decline in stock price of L&A, the lender shall be entitled to foreclose the pledged shares and become the legal and beneficial owner of the pledged shares (Note 33.3). Following the sharp decline of L&A’s stock price, the Group provided a full impairment provision of RMB244.8 million (US\$35.3 million) for the investment in L&A.

## 9. PROPERTY, EQUIPMENT AND SOFTWARE, NET

Property, equipment and software and related accumulated depreciation and amortization are as follows:

	<u>December 31, 2015</u>	<u>December 31, 2016</u>	<u>December 31, 2016</u>
	<u>RMB</u>	<u>RMB</u>	<u>US\$</u>
			<u>(Note 3)</u>
Office buildings	69,276,652	69,341,652	9,987,275
Computer and equipment	118,052,297	109,486,562	15,769,345
Leasehold improvements	11,008,880	11,556,908	1,664,541
Office furniture and fixtures	11,355,064	7,644,476	1,101,034
Motor vehicles	10,889,632	10,490,731	1,510,980
Software	18,424,967	18,601,901	2,679,231
Less: accumulated depreciation and amortization	<u>(205,160,974)</u>	<u>(200,356,406)</u>	<u>(28,857,325)</u>
Net book value	<u>33,846,518</u>	<u>26,765,824</u>	<u>3,855,081</u>

Depreciation and amortization charges for the years ended December 31, 2014, 2015 and 2016 amounted to RMB15.7 million, RMB11.6 million and RMB7.3 million (US\$1.1 million) respectively. The office building was mortgaged for the convertible notes and bank borrowing in year 2015 (Note 21 and 22).

## 10. GOODWILL

The changes in the carrying amount of goodwill for the years ended December 31, 2014, 2015 and 2016 are as follows:

	<u>Gross Amount</u> RMB	<u>Accumulated Impairment Loss</u> RMB	<u>Net Amount</u> RMB
Balance at January 1, 2014	9,710,854	—	9,710,854
Translation difference	35,200	—	35,200
Balance at December 31, 2014	9,746,054	—	9,746,054
Translation difference	596,640	—	596,640
Balance at December 31, 2015	10,342,694	—	10,342,694
Translation difference	219,163	—	219,163
Balance at December 31, 2016	<u>10,561,857</u>	<u>(10,561,857)</u>	<u>—</u>
Balance at December 31, 2016 US\$ (Note 3)	<u>1,521,224</u>	<u>(1,521,224)</u>	<u>—</u>

In 2010, the Group recognized goodwill of US\$1.6 million in connection with the acquisition of Red 5. The Group measures the consideration it transfers at fair value, which may be calculated as the sum of the acquisition-date fair values of the assets transferred, liabilities incurred to former owners of the acquiree, and equity instruments issued. The costs directly attributable to the acquisition are expensed as incurred. Identifiable assets acquired and liabilities assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any noncontrolling interests. Contingent consideration is measured at fair value and recorded as a liability. The excess of (i) the total cost of acquisition, fair value of the noncontrolling interests and acquisition-date fair value of any previously held equity interest in the acquiree over (ii) the fair value of the identifiable net assets of the acquiree is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference would be recognized directly in the consolidated statements of operations and comprehensive loss.

The Group performed annual impairment test on goodwill as of December 31, 2014 and 2015, respectively, as the fair value was greater than carrying value of the reporting unit, no impairment was recorded. In 2016, due to weaker than expected operating performance of Red5, the Group concluded that goodwill was fully impaired and the impairment of RMB10.6 million (US\$1.5 million) was recorded for the year ended December 31, 2016.

## 11. INTANGIBLE ASSETS

Gross carrying amount, accumulated amortization and net book value of the intangible assets as of December 31, 2015 and 2016 are as follows:

	<u>December 31,</u> <u>2015</u> <u>RMB</u>	<u>December 31,</u> <u>2016</u> <u>RMB</u>	<u>December 31,</u> <u>2016</u> <u>US\$</u> <u>(Note 3)</u>
Acquired game licenses	146,925,649	146,925,649	21,161,695
Acquired game development cost	12,285,000	12,285,000	1,769,408
Less: Accumulated amortization	(74,875,427)	(85,026,783)	(12,246,404)
Impairment provision	(4,394,381)	(72,398,186)	(10,427,508)
Translation difference	<u>(1,064,355)</u>	<u>(1,785,680)</u>	<u>(257,191)</u>
Net book value of intangible assets subject to amortization	<u>78,876,486</u>	<u>—</u>	<u>—</u>

In 2015 and 2016, none of acquired game licenses has expired and was written off from the cost basis and accumulated amortization.

Since its acquisition by the Group on April 6, 2010, Red 5 has been substantially devoting its operating activities to fulfill its obligations under a game development and license agreement executed in 2006 and amended in 2009 between Red 5 and a third party game publisher to develop Firefall in exchange for cash consideration from the third party publisher. Prior to the acquisition, Red 5 received a total of US\$24.7 million cash consideration as an advance recoupable against future royalties payable to Red 5. Red 5 retained the ownership of the game and granted the third party publisher an exclusive, non-transferable term license to market and distributes the game and host the game to customers in specified regions after Red 5 completes the game development. Red 5 continues to perform its obligations under the agreement post-acquisition, including the provision of post-contract customer support for the hosted version of the game to the third party publisher during the term of the license. The initial term of the agreement is from February 2006 through the fifth anniversary of the first commercial release of the initial game. Thereafter, the agreement can be renewed in two-year terms.

In September 2011, Red5 Korea, Red 5 Singapore and Red5 entered into a series of agreements with the third party game publisher. Pursuant to the agreement, Red 5 Singapore were substituted in full for the third party publisher as a party under the game development and license agreement between Red 5 and the third party game publisher, including the exclusive, non-transferable term license to market and distribute the game and host the game to customers in specified regions. Under the agreements, the Group paid US\$10.0 million and guaranteed an additional payment of US\$12.7 million to the third party game publisher due within four years. In addition, the Group is subject to additional contingent payments to be calculated based on certain percentages of the proceeds received from future game licensing and royalties, if any. The total consideration paid, including the US\$10 million and the guaranteed amount of US\$12.7 million, was recorded as acquired game license and the contingent payments will be recorded as cost of services when incurred. The balance of accounts payable related to this game license fee was US\$3.1 million (RMB20.0 million) as of December 31, 2016.

The Group pledged the intellectual property in relation to the game to secure the guaranteed amount. Following this license acquisition, the previously recognized backlog of US\$ 0.4 million in relation to the game development and license agreement acquired in Red 5 acquisition was reclassified to acquire game licenses as it was considered to be additional cost to acquire the game license paid in prior year.

Amortization expense related to intangible assets was RMB28.9 million, RMB19.1 million and RMB10.2 million (US\$1.5 million) for the years ended December 31, 2014, 2015 and 2016, respectively.

The Group has been monitoring its licensed games that have not commercially launched, including but not limited to their market acceptance and operational performance in other regions where they are commercially launched and operated by other operators. The Group incorporates these factors into its continuous evaluation of the forecasted results of the respective games and taking into account the Group's expected commercial launch and cash flows in the evaluation of potential impairment of the carrying value of upfront licensing fees. Based on the Group's impairment tests, impairment provisions on upfront licensing fees of nil, nil and RMB68.0 million (US\$9.8 million) were recognized in 2014, 2015 and 2016, respectively.

## **12. LAND USE RIGHT, NET**

Gross carrying amount, accumulated amortization and net book value of land use right are as follows:

	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$ (Note 3)
Land use right	85,160,348	85,160,348	12,265,641
Less: accumulated amortization	<u>(16,807,962)</u>	<u>(18,728,872)</u>	<u>(2,697,518)</u>
Net book value	<u>68,352,386</u>	<u>66,431,476</u>	<u>9,568,123</u>

Amortization charge for the years ended December 31, 2014, 2015 and 2016 amounted to RMB1.9 million, RMB1.9 million and RMB1.9 million (US\$0.3 million), respectively. The land-use right was mortgaged for the convertible notes and bank borrowing in year 2015 (Note 21 and 22).

### 13. OTHER LONG-LIVED ASSETS

Other long-lived assets are as follows:

	<u>December 31, 2015</u>	<u>December 31, 2016</u>	<u>December 31, 2016</u>
	RMB	RMB	US\$
			(Note 3)
Prepaid license fee	—	6,515,200	938,384
Others	<u>1,879,021</u>	<u>103,777</u>	<u>14,947</u>
Total	<u>1,879,021</u>	<u>6,618,977</u>	<u>953,331</u>

Prepaid license fee represents the payment made by the Group pursuant to an IP license agreement with an online game company in January 2016 to use its IP to develop a mobile game.

### 14. PROVISION (REVERSAL OF PROVISION) OF LONG-TERM RECEIVABLES

	<u>December 31,</u>	<u>December 31,</u>	<u>December 31,</u>	<u>December 31,</u>
	2014	2015	2016	2016
	RMB	RMB	RMB	US\$
				(Note 3)
Provision (reversal of provision) of long term receivables	<u>(17,927,763)</u>	<u>8,439,580</u>	<u>—</u>	<u>—</u>
Total	<u>(17,927,763)</u>	<u>8,439,580</u>	<u>—</u>	<u>—</u>

The Group prepaid RMB20.0 million to a supplier for purchasing computers and equipment in 2011. Due to game's performance being much lower than expectations, the Group cancelled the purchase plan and requested for a refund on the prepayment from the supplier in 2013. However, the supplier did not have enough funds to return all prepayment which was deemed a strong indicator that recovery of the refund is doubtful. In February 2014, the Group agreed a repayment schedule with the supplier, under which the prepayment is required to be refunded in four installments during the next three years, and the first installment, which was RMB2.0 million, had been received in March, 2014.

Due to the significant doubts as to the collectability of the remaining amount, management provided an allowance for the remaining prepayment receivable of RMB17.9 million as of December 31, 2013. The Company continued to negotiate with the supplier for the settlement of remaining receivables. In December 2014, the supplier promised to repay all the remaining RMB17.9 million before March 31, 2015. The Group revaluated the collectability of the receivables and determined the payments can be collected and therefore reversed the allowance of RMB17.9 million as of December 31, 2014. In March, 2015, the Group received payment of RMB17.9 million from the supplier.

In 2009, the Group engaged an agent to facilitate the refund to game players and provided an advance payment to the agent for RMB 43.3 million for this purpose. In 2013, 2014 and 2015, nil were refunded to game point card holders through the agent, respectively. In February 2012, the Group entered into an agreement with the agent pursuant to which the agent will refund the advance to the Group in installments over a five year period after deducting any further refunds paid to game point card holders. As of December 31, 2015, the Group wrote off the remaining RMB 8.4 million receivable because it is unlikely that the agent will refund to us since the business relationship between the Group and the agent have been terminated.

## 15. IMPAIRMENT ON PREPAYMENT FOR EQUIPMENT AND OTHER ASSETS

	December 31, 2014 <u>RMB</u>	December 31, 2015 <u>RMB</u>	December 31, 2016 <u>RMB</u>	December 31, 2016 <u>US\$</u> (Note 3)
Impairment on prepayment for equipment and other assets	3,555,845	—	—	—
Total	<u>3,555,845</u>	<u>—</u>	<u>—</u>	<u>—</u>

The Group prepaid RMB 3.6 million to a supplier for game development in 2013. Due to additional advance required from supplier to fund costs on game development and its probability for commercial launch is unlikely which the Group terminated the transaction and wrote off the advance considering its low collectability in 2014.

## 16. FAIR VALUE MEASUREMENTS

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The fair values of the common stock warrants were measured using the Black-Scholes option-pricing model (Note 23). Inputs used to determine estimated fair value of the warrant liabilities include the estimated fair value of the underlying stock at the valuation date, the estimated term of the warrants, risk-free interest rates, expected dividends and the expected volatility of the underlying stock. The significant unobservable inputs used in the fair value measurement of the warrant liability are the fair value of the underlying stock at the valuation date and the estimated term of the warrants. The fair value of convertible note is based on a discounted cash flow model with an unobservable input of discount rate. (Level 3).

In 2015, the Group issued warrants in connection with its convertible notes. The warrants are recorded at fair market value at the date of issuance and subsequently at each reporting date. The following table presents the change in the warrants liability that were measured at fair value on a recurring basis using significant Level 3 inputs during the year 2015 and 2016 (Note 23).

	<u>2015</u> <u>RMB</u>	<u>2016</u> <u>RMB</u>	<u>2016</u> <u>US\$ (Note 3)</u>
Balance at issuance date/the beginning of the year	57,285,780	64,414,941	9,277,681
Unrealized loss recognized in other comprehensive income	<u>7,129,161</u>	<u>(48,057,204)</u>	<u>(6,921,677)</u>
Balance at the end of the year	<u>64,414,941</u>	<u>16,357,737</u>	<u>2,356,004</u>

**Assets and Liabilities Measured at Fair Value on a Non-recurring Basis**

The following table displays assets and liabilities measured at fair value on a non-recurring basis for the years ended December 31, 2014, 2015 and 2016, respectively.

	<b>Fair Value Measurements at Reporting Date Using</b>				<b>Total Losses (gains) RMB</b>
	<b>Year Ended December 31, 2015</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1) RMB</b>	<b>Significant Other Observable Inputs (Level 2) RMB</b>	<b>Significant Unobservable Inputs (Level 3) RMB</b>	
Receivable from WoW game points refund agent (Note 14)	—	—	—	—	8,439,580
<b>Total</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>8,439,580</b>

	<b>Fair Value Measurements at Reporting Date Using</b>				<b>Total Losses (gains) RMB</b>
	<b>Year Ended December 31, 2014</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1) RMB</b>	<b>Significant Other Observable Inputs (Level 2) RMB</b>	<b>Significant Unobservable Inputs (Level 3) RMB</b>	
Prepayment for equipment (Note 14)	—	—	—	—	3,555,845
<b>Total</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>3,555,845</b>



## **17. TAXATION**

### *Cayman Islands and British Virgin Islands*

Under the current tax laws of the Cayman Islands and British Virgin Islands, the Company and its subsidiaries are not subject to tax on their income or capital gains. In addition, upon payment of dividends by the Company to its shareholders, no Cayman Islands withholding tax will be imposed.

### *Hong Kong*

The Group's subsidiaries in Hong Kong did not have assessable profits that were derived in Hong Kong during the years ended December 31, 2014, 2015 and 2016. Therefore, no Hong Kong profit tax has been provided for in the years presented.

### *Singapore*

The Group's subsidiaries in Singapore did not have assessable profits that were derived in Singapore during the years ended December 31, 2014, 2015 and 2016. Therefore, no Singapore income tax has been provided for in the years presented.

### *The PRC*

The Group's subsidiaries and VIE subsidiaries 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 PRC Enterprise Income Tax Law ("EIT Law"), which went into effect as of January 1, 2008. The Group's subsidiaries and VIE subsidiaries in the PRC are generally subject to EIT at a statutory rate of 25%. However, the subsidiaries that are located in the Pudong New District of Shanghai enjoy five-year transitional EIT rates, which refer to the phase-in rates of 18%, 20%, 22%, 24% and 25% for the 5 years period from 2008 to 2012 and the subsidiaries that hold a "High and New Technology Enterprise" ("HNTE") qualification are subject to a 15% preferential EIT rate.

In November 2008, Shanghai IT received approval from certain government authorities to be qualified as a HNTE. This approval entitles Shanghai IT to enjoy a 15% preferential EIT rate during the period from 2008 to 2010. The HNTE qualification is valid for three years and every qualified HNTE company is required to re-apply for it in the three years after receiving approval. In October 2014, Shanghai IT renewed its HNTE qualification and obtained approval in 2015, which entitles Shanghai IT to enjoy a preferential EIT rate of 15% during the period from 2014 to 2016. Total tax savings of Shanghai IT were nil for the years ended December 31, 2014, 2015 and 2016, respectively.

### *United States*

The Group's subsidiaries in the U.S. are registered in the state of California and are subject to U.S. federal corporate marginal income tax rate of 34% and state income tax rate of 0.23%, respectively.

*Composition of income tax expense*

The current and deferred portions of income tax expense included in the consolidated statements of operations and comprehensive loss are as follows:

	<b>For the year ended December 31,</b>			
	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>	<b>US\$</b>
				<b>(Note 3)</b>
Current income tax expense	—	—	—	—
China	—	—	—	—
Other jurisdictions	—	—	—	—
Deferred taxation	(21,011,979)	6,324,015	24,295,298	3,499,251
China	(62,051,840)	(31,447,143)	(22,553,453)	(3,248,373)
Other jurisdictions	41,039,861	37,771,158	46,848,751	6,747,624
Change in valuation allowance	21,011,979	(6,324,015)	(30,374,580)	(4,374,850)
China	62,051,840	31,447,143	22,553,453	3,248,373
Other jurisdictions	(41,039,861)	(37,771,158)	(52,928,033)	(7,623,223)
Income tax (expense) benefit	<u>—</u>	<u>—</u>	<u>(6,079,282)</u>	<u>(875,599)</u>

*Reconciliation of the differences between statutory tax rate and the effective tax rate*

Reconciliation between the statutory EIT rate and the Group's effective tax rate is as follows:

	<b>For the year ended December 31, 2014</b>	<b>For the year ended December 31, 2015</b>	<b>For the year ended December 31, 2016</b>
PRC Statutory EIT rate	25%	25%	25%
Effect of different tax rates in other jurisdictions	10%	(1%)	(4%)
Effect of future tax rate change	(1%)	(1%)	(1%)
Change of prior year deferred tax assets	(0%)	(1%)	(1%)
Change of valuation allowance	(16%)	(2%)	(13%)
(Income) not subject to tax and non-deductible expenses, net	2%	(1%)	0%
Effect of expired net operating loss	(20%)	(19%)	(6%)
Effective EIT rate	<u>0%</u>	<u>0%</u>	<u>0%</u>

*Significant components of deferred tax assets*

	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$ (Note 3)
Temporary differences related to expenses and accruals	3,285,994	3,040,257	437,889
Temporary differences related to provision for advances to suppliers	888,961	533,377	76,822
Temporary differences related to provision for doubtful accounts	1,510,153	1,559,187	224,570
Other	5,900,763	8,142,650	1,172,786
Temporary differences related to depreciation, amortization, and impairment of equipment and intangible assets	12,728,642	32,411,960	4,668,293
Startup expenses and advertising fee	26,010,125	20,122,650	2,898,264
Temporary differences related to research and development credits	1,045,470	1,117,823	161,000
Temporary differences related to equity investment	1,531,567	1,629,449	234,689
Foreign tax credits	16,039,192	17,149,210	2,470,000
Temporary differences related to provision for prepayment for equipment	5,000,000	5,000,000	720,150
Tax loss carry forwards	<u>505,784,660</u>	<u>519,393,542</u>	<u>74,808,230</u>
Total deferred tax assets	579,725,527	610,100,105	87,872,693
Less: Valuation allowance	<u>(579,725,527)</u>	<u>(610,100,105)</u>	<u>(87,872,693)</u>
Total deferred tax assets	<u>—</u>	<u>—</u>	<u>—</u>

*Significant components of deferred tax liabilities*

	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$ (Note 3)
Temporary differences related to amortization of intangible assets	5,690,705	—	—

*Movement of valuation allowance on deferred tax assets*

	<u>For the year ended December 31, 2015</u> RMB	<u>For the year ended December 31, 2016</u> RMB	<u>For the year ended December 31, 2016</u> US\$ (Note 3)
Balance at January 1	561,922,818	579,725,527	83,497,844
Increase (decrease) in valuation allowance	<u>17,802,709</u>	<u>30,374,578</u>	<u>4,374,849</u>
Balance at December 31	<u>579,725,527</u>	<u>610,100,105</u>	<u>87,872,693</u>

For the years ended December 31, 2015 and 2016, a reversal of valuation allowance and an increase of valuation allowance of approximately RMB17.8 million and RMB30.4 million (US\$4.4 million) was provided respectively. The Group considers positive and negative evidence to determine whether some portion or all of the deferred tax assets will more likely than not to be realized. This assessment considers, among other matters, the nature, frequency and severity of recent losses, forecasts of future profitability, the duration of statutory carry forward periods, the Group's experience with tax attributes expiring as unused and tax planning alternatives. Valuation allowances have been established for deferred tax assets based on a more-likely-than-not threshold. The Group's ability to realize deferred tax assets depends on its ability to generate sufficient taxable income within the carry forward periods provided for in the tax law.

As of December 31, 2016, the Group's PRC subsidiaries had net operating loss carry forwards of RMB690.1 million, of which RMB301.7 million, RMB192.4 million, RMB 44.6 million, RMB118.2 million and RMB 33.2 million will expire in 2017, 2018, 2019, 2020 and 2021, respectively. The Group has provided a full valuation allowance as it is not more likely than not that the net operating losses can be utilized before expiry.

As of December 31, 2016, Red 5 had net operating loss carry forwards for federal and state income tax purposes of approximately US\$134.6 million and US\$68.7 million, respectively, which will begin to expire in 2027 and 2017, respectively. Red 5 also had credits for increasing research activities available to offset future federal and state taxes payable of approximately US\$0.1 million and US\$0.1 million, respectively, that will begin to expire in 2026 for federal purposes and which have no expiration for state purposes. Red 5 had foreign tax credits for federal purposes of approximately US\$2.5 million, which begin to expire in 2017. Pursuant to US tax laws and regulations, the utilization of an acquired entity's net operation losses and credits are subject to annual limitation computed based on the fair value of the acquired entity. As a result of the limitation, the Group provided a full valuation allowance as it is not more likely than not that the net operating losses and credits carried forward can be utilized before expiration.

In accordance with the Enterprise Income Tax Law ("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 tax treaty between the PRC and Hong Kong, if the foreign investor is incorporated in Hong Kong and qualifies as the 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. The Group plans to indefinitely reinvest undistributed profits earned after December 31, 2007 from its China subsidiaries in its operations in the PRC. Therefore, no withholding income taxes for undistributed profits of the Company's subsidiaries have been provided as of December 31, 2014, 2015 and 2016.

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. The Group has not recorded any such deferred tax liability attributable to the undistributed earnings of its financial interests in VIEs because these entities do not have any accumulated earnings as of December 31, 2014, 2015 and 2016.

The Group made its assessment of the level of authority for each tax position (including the potential application of interests and penalties) based on the tax positions' technical merits, and measured the unrecognized benefits associated with the tax positions. The Group did not have any unrecognized tax benefits as of December 31, 2014, 2015 and 2016. The Group does not anticipate that unrecognized tax benefits will significantly increase or decrease within the next twelve months. For the years ended December 31, 2014, 2015 and 2016, the Group did not have any material interest and penalties associated with its tax positions.

According to PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or withholding agent. The statute of limitations will be extended five years under special circumstances, which are not clearly defined (but an underpayment of tax liability exceeding RMB 0.1 million is specifically listed as a special circumstance). In the case of a related party transaction, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. From inception to 2016, the Group is subject to examination of the PRC tax authorities. Red 5's federal income tax returns and state income tax returns for 2006 through 2016 are open tax years, subject to examination by the relevant tax authorities.

### **18. SHORT-TERM BORROWING**

Short-term borrowing is as follows:

	<u>December 31,</u> <u>2015</u> <u>RMB</u>	<u>December 31,</u> <u>2016</u> <u>RMB</u>	<u>December 31,</u> <u>2016</u> <u>US\$</u> <u>(Note 3)</u>
Bank loan from Bank of Shanghai	—	24,992,214	3,599,628
Pledged loan	—	82,525,153	11,886,094
	<u>—</u>	<u>107,517,367</u>	<u>15,485,722</u>

In March 2016, the Bank of Shanghai, or BOS, issued a commitment letter whereby BOS agreed to grant the Group a one-year credit facility of RMB50 million (US\$7.2 million). In March 2017, the credit facility was extended for one year. The Group can apply to withdraw loans from BOS should they require for its operations. As of December 31, 2016, the Group had withdrawn RMB25.0 million (US\$3.6 million) under this credit facility with annual interest rate of 6.525% and the loans were guaranteed by Jun Zhu and The9 Computer. All of loans remained outstanding as of December 31, 2016.

In June 2016, the Group completed a share exchange transaction with L&A International Holding Limited for a total of 769,481,940 (after 1 to 5 stock split) newly issued shares of L&A. In June 2016, Asian Development borrowed a total of HK\$92.3 million from a financial services company at an annual interest rate of 2% for a term of 24 months, which is secured by a of 417,440,000 shares of L&A. The balance as of December 31, 2016 is RMB 82.5 million (US\$ 11.9 million) as exchange rate changes. As Asian Development is currently in default of the loan due to a sharp decline in stock price of L&A (Note 33.3), all the balances of loan and interest were reclassified as current liabilities.

#### **19. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Other payables and accruals are as follows:

	<u>December 31, 2015</u>	<u>December 31, 2016</u>	<u>December 31, 2016</u>
	RMB	RMB	US\$ (Note 3)
Staff cost related payables	15,705,966	12,841,440	1,849,552
Professional services	12,070,384	10,443,985	1,504,247
Product development services	1,648,410	901,810	129,888
Marketing and promotion	3,988	598	86
Fund raised for Cross Fire New Mobile Game (see below)	—	57,499,910	8,281,710
Others	6,435,676	10,615,155	1,528,900
	<u>35,864,424</u>	<u>92,302,898</u>	<u>13,294,383</u>

The Group is financing the development of Cross Fire New Mobile Game through fund raising on Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2016, the Group had raised RMB57.5 million (US\$8.3 million), and the Group plans to raise an additional RMB100 million (US\$14.4 million) in 2017 until the game is launched. Under this fund raising arrangement, the Group will share certain percentages of the revenues from Cross Fire new mobile game to the investors providing funding to the Group. The Group had also committed to spend certain amounts of the fund raised in the marketing, game server purchases and research and development costs of Cross Fire New Mobile Game.

## **20. Refund of WoW game points**

As a result of the loss of the WoW license on June 7, 2009, the Group announced a refund plan in connection with inactivated WoW game point cards, which the Group recorded as advance from customers. According to the plan, inactivated WoW game point card holders are eligible to receive a cash refund from the Group. The Group recorded a liability in connection with both inactivated points cards and activated but unconsumed point cards of approximately RMB200.4 million, of which RMB4.0 million was refunded in 2009.

Upon the loss of the WoW license, the Group concluded the nature of the obligation substantively changed from deferred revenue, for which the Group had the ability to satisfy the underlying performance obligation, to an obligation to refund players for their unconsumed points. The Group has accounted for this refund liability by applying the derecognition guidance specified in ASC 405-20. In accordance with this guidance, the refund liability associated with these WoW game points, to the extent not refunded, will be recorded as other operating income after the Group is legally released from the obligation to refund amounts under the applicable laws. In consultation with its legal counsel, the Group concluded the legal liability relating to the inactivated WoW game point cards was extinguished in September 2011 on the basis that the legal liability lapsed two years from the date the Group publicly announced the refund policy that applied to these cards. Accordingly, the associated liability amounting to RMB26.0 million (US\$3.7 million) was recognized as other operating income for the year ended December 31, 2011. With respect to the remaining refund liability, based on current PRC laws, to the extent not refunded, the Company, in consultation with legal counsel has determined that it will be legally released from this liability in September 2029, which represents 20 years from the discontinuation of WoW in 2009. However, if the Group were to publicly announce a refund policy, the Group would be legally released from any remaining liability for these activated, but unconsumed points that remained two years from the date of such announcement. To date, the Group has determined not to publicly announce any refund policy with respect to this remaining liability, and no refunds have been claimed. The remaining refund liability relating to the activated, but unconsumed WoW game points is RMB170.0 million (US\$24.5 million) as of December 31, 2016.

## **21. LONG-TERM BORROWING**

In 2015, the Group entered an entrusted bank borrowing agreement, amounted to RMB31.6 million (US\$4.6 million), with a subsidiary of convertible note investor (Note 22) and China Merchants Bank as entrustment bank. The borrowing is due in November 2018, with two years extension and bears an annual interest rate of 12% due up maturity of the loan. The loan is secured by the real property of the office building of the Group. The balance as of December 31, 2016 is RMB 35.1 million (US\$5.1 million) also includes RMB 3.5 million (US\$0.5 million) interest payable.

## 22. CONVERTIBLE NOTES

On November 24, 2015, the Group entered into agreement with a third party investor for a private placement of secured convertible notes and warrants for a gross proceeds of US\$40,050,000, which the transaction was closed on December 11, 2015. Pursuant to the terms of the agreement, the convertible notes shall mature in 2018, subject to an extension for two year at the discretion of the investor. The convertible notes accrue interest at a rate of twelve percent (12%) per annum and payable upon maturity of the notes. The notes are secured by the equity interest of the Group's subsidiaries (The9 Computer and C9I Shanghai) and office buildings with a total net book value of RMB24.3 million. The investor of the notes is entitled to put the notes to the Group upon a change in control and upon an event of default.

The notes are divided into three tranches and can be converted into a total of 11,695,513 shares of the Group's ADS at any time as follows:

Convertible Notes	Principal Amount	Conversion Price
Tranche A	US\$22,250,000	US\$ 2.6
Tranche B	US\$13,350,000	US\$ 5.2
Tranche C	US\$ 4,450,000	US\$ 7.8

The conversion prices are subject to anti-dilution adjustments and in the event the Company issue ordinary shares at a price per share lower than the applicable conversion price in effect immediately prior to the issuance. As of December 31, 2016, no adjustments to the conversion prices had occurred.

The Group has determined that there was BCF attributable to Tranche A convertible loan as the conversion price is lower than market value at the date of issuance of the convertible note. The value of the BCF is determined to be US\$8.1 million (RMB52.7 million), which is equal to the intrinsic value of the conversion feature. The convertible notes are recorded at net carrying value at the date of issuance as follows:

	US\$	RMB
Principal Amount	40,050,000	260,068,680
Less:		
Fair value allocated to warrants (Note 23)	8,821,883	57,285,780
Beneficial conversion feature	8,112,556	52,679,692
Issuance Cost	3,200,000	20,779,520
Net carrying value	19,915,561	129,323,688



The fair value of warrants, BCF and issuance costs are recorded as debt discount and accreted to interest expense over 3 years using the effective interest method. The convertible notes should be repaid with principal and interest based on the agreement, for the years ended December 31, 2015 and 2016, the carrying amount of the convertible notes and interest payable is RMB135.2 million and RMB197.3 million (US\$28.4 million), respectively. Interest expenses recognized related to the convertible notes are RMB5.9 million and RMB50.4 million (US\$7.3 million) for the year ended December 31, 2015 and 2016.

### 23. WARRANTS

The warrants are exercisable at any time after the commitment date to purchase up to 4,778,846 shares of the Company's ADS as follows:

Warrants	Principal Amount	Exercise Price
Tranche I	US\$5,000,000	US\$ 1.5
Tranche A	US\$2,750,000	US\$ 2.6
Tranche B	US\$1,650,000	US\$ 5.2
Tranche C	US\$ 550,000	US\$ 7.8

For the tranche A, B, C, the expiration date is the third anniversary of the issuance date or if the holder has exercised its option to extend the maturity date of all or any portion of the convertible notes in accordance with the terms and conditions thereof, the fifth anniversary of the issuance date.

The exercise prices of the warrants are subject to anti-dilution adjustments and in the event the Company issue ordinary shares at a price per share lower than the applicable exercise price in effect immediately prior to the issuance. As of December 31, 2016, no adjustments to the exercise prices had occurred.

The Group performs valuations of the warrants using a probability weighted Black-Scholes option pricing model. This model requires input of assumptions including the risk-free interest rates, volatility, expected life and dividend rates, and has also considered the likelihood of "down-round" financings. Selection of these inputs involves management's judgment and may impact net income.

The assumptions used in the Black-Scholes option pricing model for the warrants were as follows:

Warrants	Tranche I	Tranche A	Tranche B	Tranche C
Risk-free interest rate	1.68	1.17	1.17	1.17%
Expected volatility of common stock	70.04	80.65	80.65	80.65%
Dividend yield	0.00	0.00	0.00	0.00%
Expected life of warrants	3.9 years	1.9 years	1.9 years	1.9 years

The fair value of the warrants as of issuance date, December 31, 2015 and 2016 is RMB57.3 million, RMB64.4 million, and RMB16.4 million (US\$2.4 million) respectively. The change in fair value of the warrant liability resulted in a loss of RMB7.1 million and a gain of RMB48.1 million (US\$6.9 million) for the year ended December 31, 2015 and 2016, respectively.

#### **24. SHAREHOLDER RIGHTS PLAN**

On January 8, 2009, the Company adopted a shareholder rights plan. The shareholder rights plan is designed to protect the best interests of the Company and its shareholders by discouraging third parties from seeking to obtain control of the Company in a tender offer or similar hostile transaction. The shareholder rights plan was amended on March 9, 2009.

Pursuant to the terms of the shareholder rights plan, as amended, one right was distributed with respect to each ordinary share of the Company outstanding at the close of business on January 22, 2009. The rights will become exercisable only if a person or group (the “Acquiring Person”) obtains ownership of 15% or more of the Company’s voting securities (including by acquisition of the Company’s ADSs representing ordinary shares) (a “Triggering Event”), subject to certain exceptions. In the case of a Triggering Event, the rights plan entitles shareholders other than the Acquiring Person to purchase, for an exercise price of US\$19.50, a number of shares with a value twice that of the exercise price. The number of shares each such shareholder will be entitled to purchase is equal to the product of (i) the number of shares then owned by such shareholder and (ii) two times the exercise price divided by the then current market price per share. The rights plan will continue in effect until January 8, 2019, unless the plan is terminated by the Company or the rights are redeemed by the Company before the plan expires. The plan has not been exercisable yet.

#### **25. EMPLOYEE BENEFITS**

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 and comprehensive loss for such employee benefits amounted to RMB19.5 million, RMB13.1 million and RMB15.4 million (US\$2.2 million) for the years ended December 31, 2014, 2015 and 2016, respectively. The PRC government is responsible for the medical benefits and ultimate pension liability to these employees.

## 26. SHARE-BASED COMPENSATION

### 26.1 Share Option Plan

On December 15, 2004, in connection with its initial public offering, the Company adopted a share option plan (“2004 Option Plan”). As of December 31, 2013, the total number of ordinary shares reserved in the 2004 Option Plan was 6,449,614 shares. The maximum contractual term of the awards under this plan shall be no more than five years from the date of grant. The options granted under this plan shall be at the money on the date of grant and typically vest over a three-year period, with one third of the options to vest on the each of the anniversary after the grant date. The 2004 Option Plan was amended in November 2015 to increase the maximum aggregate number of ordinary shares to 14,449,614 Shares. The 2004 Option Plan was amended in August 2016 to increase the maximum aggregate number of ordinary shares to 34,449,614 Shares. As of December 31, 2016, options to purchase 18,135,200 ordinary shares were outstanding and options to purchase 14,649,543 ordinary shares were available for future grant under the 2004 Option Plan.

#### Stock Options

The following table summarizes the Company’s share option activities with its employees and directors:

	<u>Number of Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term (years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2016	4,677,718	US\$ 1.53	4.41	Nil
Granted	—	—	—	—
Exercised	(13,900)	US\$ 1.53	—	Nil
Forfeited	(178,618)	US\$ 1.57	—	Nil
Outstanding at December 31, 2016	<u>4,485,200</u>	<u>US\$ 1.53</u>	<u>3.43</u>	<u>Nil</u>
Vested and expected to vest at December 31, 2016	<u>4,485,200</u>	<u>US\$ 1.53</u>	<u>3.43</u>	<u>Nil</u>
Exercisable at December 31, 2016	<u>3,575,928</u>	<u>US\$ 1.53</u>	<u>3.42</u>	<u>Nil</u>

The options expected to vest are estimated by applying the pre-vesting forfeiture rate assumptions to total unvested options. The total intrinsic value of options exercised during the year was US\$21,701, nil and nil for years ended December 31, 2014, 2015 and 2016 respectively.

The weighted-average grant-date fair value of options granted during the year 2015 was US\$0.65. The fair value of the share options were measured on the respective grant dates based on the Black-Scholes option pricing model, with below assumptions made regarding expected term and volatility, risk-free interest rate and dividend yield:

	<u>For the year ended December 31, 2015</u>
Risk-free interest rate	1.22%
Expected life (years)	3.35
Expected dividend yield	0
Volatility	59.74%
Fair value of options at grant date	US\$ 0.65

On November 17, 2015, The Group granted three tranches of share options to certain directors, officers and key employees totaling 8,200,000 shares with predetermined market conditions as summarized below:

Options	Target Price (US\$)	Number of Options Vesting
Tranche I	2.6	4,555,556
Tranche II	5.2	2,733,334
Tranche III	7.8	911,110
Total		<u>8,200,000</u>

Of these share options granted, 7,000,000 options is subject only to the predetermined market condition and will vest immediately when the Company's ADS stock price reaches the respective target stock prices as noted above ("Predetermined Market Condition"). The Vesting of the remaining 1,200,000 options are subject to a derived service period in addition to Predetermined Market Condition.

Activities relating to share options subject to with only Predetermined Market Condition are summarized as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2016	7,000,000	US\$ 1.53	4.88	Nil
Granted	—	—	—	—
Exercised	(200,000)	US\$ 1.53	—	Nil
Forfeited	(300,000)	US\$ 1.53	—	Nil
Outstanding at December 31, 2016	<u>6,500,000</u>	<u>US\$ 1.53</u>	<u>3.88</u>	<u>Nil</u>
Vested and expected to vest at December 31, 2016	<u>6,500,000</u>	<u>US\$ 1.53</u>	<u>3.88</u>	<u>Nil</u>
Exercisable at December 31, 2016	<u>3,611,112</u>	<u>US\$ 1.53</u>	<u>3.88</u>	<u>Nil</u>

The weighted-average grant-date fair value of shares options with only Predetermined Market Condition during 2015 was US\$0.69, US\$0.68, US\$0.60 for Tranche I, II and III, respectively. The fair values for these shares options was calculated using the Monte Carlo Simulation model with the key following assumptions:

Risk-free interest rate	1.66%
Expected life (years)	4.49-5.0
Expected dividend yield	0
Volatility	62%
Fair value of options at grant date	US\$0.60-US\$0.69

The share options subject to both Predetermined Market Condition and service conditions are as followed:

	<u>Number of Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term (years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2016	1,200,000	US\$ 1.53	4.88	Nil
Granted:	—	—	—	—
Exercised	—	—	—	—
Forfeited	(50,000)	US\$ 1.53	—	Nil
Outstanding at December 31, 2016	<u>1,150,000</u>	<u>US\$ 1.53</u>	<u>3.88</u>	<u>Nil</u>
Vested and expected to vest at December 31, 2016	<u>1,150,000</u>	<u>US\$ 1.53</u>	<u>3.88</u>	<u>Nil</u>
Exercisable at December 31, 2016	<u>230,890</u>	<u>US\$ 1.53</u>	<u>3.88</u>	<u>Nil</u>

The weighted-average grant-date fair value of options granted with multiple conditions during the year 2015 was US\$0.71, US\$0.68, US\$0.60 for Tranche I, II and III, respectively. The fair values of the awards that are based on the market condition were calculated using the Monte Carlo Simulation mode with the key following assumption:

Risk-free interest rate	1.66%
Expected life (years)	4.49-5.0
Expected dividend yield	0
Volatility	62%
Fair value of options at grant date	US\$0.60-US\$0.71

On August 6, 2016, The Group granted share options totaling 6,000,000 shares to Zhu Jun and a third-party consultant as a reward for facilitating the Mongolia funding platform with total funding amount of RMB157.5 million (US\$22.7 million) to the Company. According to ASC 718, the share option was applicable to the performance condition due to the share options would be vested in line with the percentage of funding received by the Company.

The following table summarizes the share option activities subject to performance condition:

	<u>Number of Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term (years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2016	—	—	—	—
Granted:	6,000,000	US\$ 1.86	—	—
Exercised	—	—	—	—
Forfeited	—	—	—	—
Outstanding at December 31, 2016	<u>6,000,000</u>	<u>US\$ 1.86</u>	<u>4.60</u>	<u>Nil</u>
Vested and expected to vest at December 31, 2016	<u>6,000,000</u>	<u>US\$ 1.86</u>	<u>4.60</u>	<u>Nil</u>
Exercisable at December 31, 2016	<u>2,190,476</u>	<u>US\$ 1.86</u>	<u>4.60</u>	<u>Nil</u>

The grant-date fair value of share options with performance condition during the year 2016 was US\$0.93. The fair value of the awards that are based on the performance condition was calculated using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	0.85%
Expected life (years)	2.9
Expected dividend yield	0
Volatility	78%
Fair value of options at grant date	US\$0.93

#### ***Modification of Share-Based Awards***

On April 22, 2013, the Company modified the exercise prices of share options granted to 234 directors, officers and employees granted to US\$2.41 per share, which was the market price on the date of modification. The original exercise price of the modified options ranged from US\$7.36 to US\$4.78.

On June 13, 2015, the company extended the expiration dates of the stock options granted to 25 directors, officers and employees, with expirations dates of August 26, 2015 and December 10, 2015 to August 26, 2020, and the exercise price of these share options was also reduced to US\$1.78 which was the closing sale price on June 12, 2015.

On November 17, 2015, the Company modified the exercise prices of share options granted to 15 directors, officers and employees to US\$1.53 per share, the closing price of the last trading day. The original exercise price of the modified options ranged from US\$1.78 to US\$2.41.

During 2014, 2015 and 2016, as a result of these modifications, the Group recognized incremental compensation cost of RMB0.9 million (US\$0.2 million), RMB11.8 million (US\$1.8 million) and nil respectively upon modification for the vested portion.

The fair value of options, of which exercise prices were modified in April 2013, June 2015 and November 2015, were measured on the modification date based on the Black-Scholes option pricing model with the following assumptions:

	<b>For the year ended December 31, 2013</b>	<b>For the year ended December 31, 2015</b>
Risk-free interest rate	0.09%-0.24%	0.50%-1.12%
Expected remaining life (years)	0.57-2.20	1.32-2.61
Expected dividend yield	0	0
Volatility	36%-65%	64%-71%
Fair value of incremental cost	US\$0.16-US\$0.43	US\$0.21-US\$0.73

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

For the years ended December 31, 2014, 2015 and 2016, the Company recorded share-based compensation of RMB0.1 million, RMB32.0 million and RMB25.8 million (US\$3.7 million), respectively, for options granted to the Company's employees and directors, including incremental compensation cost due to the modification of the option exercise prices in April 2013, June 2015 and November 2015.

As of December 31, 2016, there was approximately RMB39.7 million (US\$5.7 million) unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested options, including RMB19.0 million (US\$2.8 million) for options with service condition and market condition and RMB20.5 million (US\$3.0 million) for options with performance condition issued to Mr. Zhu Jun. Regarding the option with performance condition issued to non-employee, a third-party consultant, subject to ASC 505-50, unrecognized compensation cost would be addressed in Commitment ( Note 33). The cost related to service and market condition options is expected to be recognized over a weighted-average period of 1.4 years. Total unrecognized compensation cost may be adjusted for future changes in estimated forfeitures.

#### ***26.2 Ordinary shares granted to IncSight Limited ("IncSight")***

IncSight is a company incorporated in the British Virgin Islands and wholly owned by Mr. Zhu Jun. On December 8, 2010, as approved by the Board of Directors, the Company granted 1,500,000 ordinary shares to IncSight, subject to performance conditions, of which 500,000 shares granted will vest when the Group achieves breakeven and 1,000,000 shares will vest when the Group's cumulative profit reaches US\$5 million in a quarter subsequent to the quarter in which the Group breaks even. The ordinary shares granted are not entitled to receive dividends until vested. The Board considered the grant of ordinary shares as an incentive to retain Mr. Zhu's services with the Group. The awarded nonvested shares would be valid for five years from December 8, 2010. For the quarter ended September 30, 2014, the Group achieved breakeven. It is considered probable the performance targets will be met for the total of 1,500,000 ordinary shares. The fair value of the granted nonvested shares was US\$6.48 per share, the market price on the date of grant. On December 7, 2015, 500,000 shares granted to IncSight Limited were vested. The awarded non-vested shares would be valid for additional three years and expired on December 7, 2018. The Group recorded share-based compensation of RMB2.2 million, RMB1.2 million and RMB1.9 million (US\$0.3 million) for the years ended December 31, 2014, 2015 and 2016, respectively. The following table reflected the activity of non-vested shares for the year ended December 31, 2016:

	<b>Number of Options</b>	<b>Weighted-Average Grant-Date Fair Value</b>
Non-vested at January 1, 2016	1,000,000	US\$ 6.48
Granted	—	—
Forfeited	—	—
Vested	—	—
Non-vested at December 31, 2016	<u>1,000,000</u>	<u>US\$ 6.48</u>

### 26.3 Stock options and ordinary shares granted by Red 5

In February 2006, Red 5 adopted a Stock Incentive Plan (“Red 5 Stock Incentive Plan”) under which Red 5 may grant to its employees, director and consultants stock option to purchase common stock or restricted stock. As of December 31, 2010, 13,626,955 shares were reserved under Red 5 Stock Incentive Plan. In September, 2011, Red 5 further increased the number of common stocks reserved to 22,855,591 shares. If an option shall expire or terminate for any reason without having been exercised in full, the reserved shares subject to such option shall again be available for subsequent option grants under the plan. From the inception of this plan to December 31, 2016, Red 5 granted a total of 38,191,879 options to its employees and directors at the exercise price ranging from US\$0.0001 to US\$0.2450 per share, which vest over four years commencing from grant date. Options expire within a period of not more than ten years from the grant date. An option granted to a person who is a greater than 10% shareholder on the date of grant may not be exercisable more than five years after the grant date. As of December 31, 2016, option to purchase 6,621,336 shares of common stock were outstanding and options to purchase 14,330,001 shares of common stock were available for future grant.

The following table summarizes the Red 5’s share option activities with its employees and directors:

	<u>Number of Options</u>	<u>Weighted-Average Exercise Price per Option</u>	<u>Weighted-Average Remaining Contractual Term (years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2016	10,649,893	US\$ 0.061	4.73	Nil
Granted	—	—	—	—
Exercised	(2,090,685)	US\$ 0.075	—	Nil
Forfeited	(1,937,872)	US\$ 0.075	—	Nil
Outstanding at December 31, 2016	<u>6,621,336</u>	<u>US\$ 0.053</u>	<u>4.09</u>	<u>Nil</u>
Vested and expected to vest at December 31, 2016	<u>6,621,336</u>	<u>US\$ 0.053</u>	<u>4.09</u>	<u>Nil</u>
Exercisable at December 31, 2016	<u>3,144,254</u>	<u>US\$ 0.058</u>	<u>3.92</u>	<u>Nil</u>



The option's intrinsic value was calculated by the excess of the estimated fair value of Red 5's common shares, which was determined by the company with the assistance of an independent valuation firm.

The options expected to vest are estimated by applying the pre-vesting forfeiture rate assumptions to total unvested options. The total intrinsic value of options exercised for the year ended December 31, 2014, 2015 and 2016 were US\$162,279, US\$1,200 and nil, respectively.

The fair value of options granted ranged from US\$0.012 to US\$0.149, measured on the grant date based on the Black-Scholes option pricing model with assumptions made regarding expected term and volatility, risk-free interest rate and dividend yield:

Risk-free interest rate	0.78%-5.00%
Expected life (years)	4.00-6.00
Expected dividend yield	0
Volatility	38.89%-69.36%

In September 2012, Red 5 granted 6,122,435 shares of restricted common stock to two directors of Red 5 including Mr. Zhu for their services to Red 5. Of these shares, 60% were vested on the grant date. The remaining shares shall become vested in a series of 36 successive equal monthly installments upon grantees' completion of each month of service to Red 5 over the 36-month period measured from the grant date.

Red 5 recorded share-based compensation of RMB1.0 million, RMB0.8 million and RMB0.4 million (US\$0.1million) for options and shares of restricted common stock granted for the year ended December 31, 2014, 2015 and 2016, respectively. The share-based payment awards were recorded as a component of noncontrolling interest in the consolidated financial statements.

As of December 31, 2016, there was approximately RMB0.4 million (US\$0.1million) of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested share-based awards granted to Red 5 grantees. This cost is expected to be recognized over 2.2 years. Total unrecognized compensation cost may be adjusted for future changes in estimated forfeitures.

#### *26.4 Nonvested equity interest of Jiushi granted to employees*

In July 2011, the Group granted 20% equity interest of the newly established Jiushi to two employees as an incentive to retain these two employees' services, which they will earn over three-year period. The fair value of the granted equity interest was estimated to be RMB2.2 million. The Group recorded share-based compensation of RMB0.4 million, nil and nil for the years ended December 31, 2014, 2015 and 2016, respectively.

## **27. RELATED PARTY TRANSACTIONS AND BALANCES**

### *Transaction with equity investee*

In 2013, the Group entered into an agreement with ZTE9, an equity investee of the Group, to jointly operate IPTV games in China jointly. According to the agreement, the group pays ZTE9 a royalty fee for providing game contents on IPTV. Net royalty and other service fee related to IPTV business charged by ZTE9 to the Group amounted to RMB11.7 million and RMB13.0 million (US\$1.9 million) for year ended December 31, 2015 and 2016, respectively. In 2016, the Group provided IPTV related advertisement service to ZTE9 amounted to RMB0.5 million (US\$0.07 million). Total amount due to ZTE9 for IPTV business was RMB10.1 million and RMB16.8 million (US\$2.4 million) as of December 31, 2015 and 2016, respectively. In 2015, the Group lent RMB9.9 million to ZTE9 to fund its operation. In 2016, the Group lent RMB2.8 million (US\$0.4 million) to ZTE9 to fund its operation. The loan was interest-free and due in December, 2017. Total amount due from ZTE9 for loan was RMB9.9 million and RMB12.7 million (US\$1.8 million) as of December 31, 2015 and 2016, respectively.

In 2016, the Group charged service fee, including IDC rental fee, office rental fee and etc., to Jiuchen Advertisement amounted to RMB4.5 million (US\$0.7 million) and the service fee was paid in 2016.

In 2014, the Group entered a license agreement with System Link, a 50% joint venture of the Group, for publishing and operating Firefall for a five-year term in mainland China. Under this license agreement, System Link is expected to pay to Red 5 Singapore no less than US\$160 million (including license fee and royalties) during the term of the agreement. In 2015, System Link paid US\$10 million to the Group as license fee. The Group records the amount as amount due to the related party and amortizes the amount over the five-year period. As of December 31, 2016, the balance of amount due to System Link (non-current) is RMB 54.1 million (US\$7.8 million) and revenue recognized is RMB13.6 million (US\$ 2.0 million).

### *Transaction with T3*

In 2016, Asian Way entered into a license agreement with T3, an equity investee of the Group, for developing a game using augmented reality (AR) technologies based on the intellectual property relating to the game Audition. Upon commercial launch, Asian Way will share certain percentages of revenues of the game to T3. The game is still under development as of December 31, 2016.

### Transaction with Zhu Jun

In 2016, Mr. Zhu Jun, the chairman and chief executive officer, extended aggregate of RMB60.0 million (US\$8.6 million) in loan to the Group. The loan was interest-free. As of December 2016, RMB25.2 million (US\$3.6 million) of such loan remained outstanding.

## 28. LOSS PER SHARE

Loss per share is calculated as follows:

	For the year ended December 31, 2014	For the year ended December 31, 2015	For the year ended December 31, 2016	For the year ended December 31, 2016
	RMB	RMB	RMB	US\$ (Note 3)
<b>Numerator:</b>				
Net loss attributable to ordinary shareholders before accretion on redeemable noncontrolling interest	(86,622,470)	(304,828,354)	(593,781,589)	(85,522,338)
Accretion on redeemable noncontrolling interest	(21,076,744)	(79,805,706)	(82,890,188)	(11,938,670)
Net loss attributable to ordinary shareholders	(107,699,214)	(384,634,060)	(676,671,777)	(97,461,008)
<b>Denominator:</b>				
Denominator for basic and diluted loss per share – weighted-average shares outstanding	23,164,695	23,235,848	23,874,102	23,874,102
<b>Loss per share</b>				
- Basic and diluted	(4.65)	(16.55)	(28.34)	(4.08)

The Company had 4,570,491, 18,656,564 and 22,914,046 stock options, warrants and nonvested shares outstanding as of December 31, 2014, 2015 and 2016, respectively, which were excluded in the computation of diluted loss per share in the periods presented, as their effect would have been anti-dilutive due to the net loss reported in such periods.

## 29. 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 reserved 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 reserved 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 reserved fund reaches 50% of their registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserved funds can only be used for specific purposes of enterprise expansion and staff bonus and welfare are not distributable as cash dividends. The appropriation to these reserves by the Group's PRC entities were nil, nil and nil for the years ended December 31, 2014, 2015 and 2016. The accumulated reserves as of December 31, 2016 was RMB3.8 million (US\$0.6 million). In addition, due to restrictions on the distribution of registered capital from the Company's PRC subsidiaries, the PRC subsidiaries' registered capital of RMB16.4 million (US\$2.4 million) as of December 31, 2016, were considered restricted. As a result of these PRC laws and regulations, as of December 31, 2016, approximately RMB20.2 million (US\$2.9 million), were not available for distribution to the Company by its PRC subsidiaries in the form of dividends, loans or advances.

### 30. NONCONTROLLING INTEREST

As of December 31, 2016, the Group's non-controlling interest mainly included equity interests in Red 5, The9 Education, and equity awards granted as compensation by the Group's subsidiaries. The following schedule shows the effects of changes in the ownership interest of The9 Limited in its subsidiaries on equity attributed to The9 Limited for the years ended December 31, 2014, 2015 and 2016.

	<u>December 31,</u> <u>2014</u>	<u>December 31,</u> <u>2015</u>	<u>December 31,</u> <u>2016</u>
	<u>RMB</u>	<u>RMB</u>	<u>RMB</u>
Net loss attributable to The9 Limited	(86,622,470)	(304,828,354)	(593,781,589)
Transfers (to) from the noncontrolling interest			
Increase in The9 Limited's additional paid-in capital for issuance of shares by Red 5 upon stock option exercise	552,426	75,563	436,128
Change in equity interest attributable to non-controlling interest due to restructuring of Red 5 Singapore(1)	15,068,103	—	—
Change in The9 Limited's additional paid-in capital for adjustment on noncontrolling interest due to change in ownership interest as a result of loan conversion (2)	(31,784,850)	—	—
Change in The9 Limited's additional paid-in capital for adjustment on non-controlling interest as a result of issuance of common shares of Red 5 upon vesting of stock options and restricted shares (3)	<u>(42,692,211)</u>	<u>80,903</u>	<u>253,396,755</u>
Change from net loss attributable to The9 Limited and transfers (to) from noncontrolling interests	<u>(145,479,002)</u>	<u>(304,671,888)</u>	<u>(339,948,706)</u>

- (1) In August 2014, Red 5 issued 27,438,952 Series B redeemable convertible preferred shares of Red 5 to a new investor (see Note 31). As the license to publish Firefall belongs to Red 5 Singapore (Note 11), as a condition for the investment by the new investor, the Group is required to transfer the license to Red 5. As such, in June 2014, the Group transferred its equity interests in Red 5 Singapore, a wholly owned subsidiary of the Group to Red 5, a 79.2% owned subsidiary at a nominal price. At the time of transfer, 20.8% of the accumulated deficit of Red 5 Singapore, amounted to RMB 15,068,103, was attributable to the noncontrolling interest of Red 5 with no consideration, which was recorded as an equity transaction in the Consolidated Statements of Changes in Equity.

- (2) In August 2014, the Group converted its convertible loan and certain other loans due from Red 5 with a book value of US\$50.0 million (RMB307.6 million), into 63,301,276 common shares of Red 5. The equity of Red 5 increased by RMB307.6 million while the impact attributable to noncontrolling interest of Red 5 was RMB31,784,850 as a result of the loan conversion.
- (3) In June 2016, the Group completed a share exchange transaction with L&A International Holding Limited and certain other shareholders of Red 5, whereby the Group exchanged approximately 30.6% equity interest (on a fully-diluted basis) owned in Red 5 for a total of 723,313,020 (after a one-to-five stock split) newly issued shares of L&A after deducting a 6% of total shares received (769,481,940 shares) which was the payment of service fee to a third party consultant. As a result, the percentage of noncontrolling interest in Red 5 changed from 10.4% to 58.1% after deducting shares of SBPS from total shares of Red 5.

### 31. REDEEMABLE NON-CONTROLLING INTEREST

In January 2014, Red 5 issued 27,438,952 Series B redeemable convertible preferred shares (“SBPS”) to a third party investor, Shanghai Oriental Pearl Culture Development Co., Ltd., (“Oriental Pearl”), for an aggregate consideration of RMB118.3 million (US\$19.2 million). In conjunction with the issuance of SBPS, Oriental Pearl also purchased 5,948,488 common shares of Red 5 from two executives of Red 5 at the same per share price as the per share price of SBPS for an aggregate consideration of RMB25.6 million (US\$4.2 million). The purchase price for these common shares was determined to be less than fair value as the transaction as contemplated in conjunction with the issuance of the SBPS. The difference between the purchase price and fair value of SBPS as determined by the Group with the assistance of independent valuation firm, which amounted to RMB131.3 million (US\$21.2 million), was recognized as a compensation paid to the two executives in the amount of RMB13.0 million (US\$2.1 million).

Due to stock exchange transaction with L&A in 2016, 63% share of SBPS was owned by L&A. As of December 31, 2016, the holder details of SBPS are as follows:

Holder	December 31, 2015 Number of Shares	December 31, 2016 Number of Shares
L&A International Holdings Ltd.	—	17,258,399
Shanghai Oriental Pearl Culture Development Co.,Ltd.	27,438,952	10,180,553

As of December 31, 2014, the Group considered the redemption of the SBPS to be probable. The Group accreted the carrying value of SBPS to redemption value using the effective interest rate method over the period from the issuance date to the Redemption Date.

The key terms of the SBPS are as follows:

#### *Conversion*

Each SBPS may be converted at any time into common shares at the then applicable conversion price. The initial conversion ratio is 1:1, subject to adjustment in the event of (i) share splits, share combinations, share dividends or distribution, other dividends, recapitalizations and similar events, or (ii) issuance of common shares at a price per share less than the conversion price in effect on the date of or immediately prior to such issuance. In that case, the conversion price shall be reduced concurrently to the subscription price of such issuance.

The SBPS shall be automatically converted into common shares immediately prior to the consummation of a public offering of Red 5's shares wherein gross proceeds are at least US\$30,000,000, immediately following the public offering (the "Qualifying IPO").

The conversion option can only be settled by issuance of common shares except that fractional shares may be settled in cash.

#### *Dividends*

The holder of each share of SBPS shall be entitled to receive dividends at the rate per share of \$0.038237 per annum if and when a dividend is declared. The Preferred Shares participate in dividends on an as-converted basis and must be paid prior to any payment on common shares.

Upon conversion, any declared or accrued but unpaid dividends will be converted into common shares at the same applicable conversion price.

#### *Redemption*

At any time on or after April 1, 2017, if requested by at least 50% of the holders of SBPS then outstanding, Red 5 shall redeem all of the outstanding SBPS at a redemption price equal to 200% of the issuance price in three equal annual installments. The full amount of the redemption price due but not paid shall accrue interest daily at a rate of 10% per annum from the issuance date of SBPS.

### *Voting*

Each SBPS has voting rights equivalent to the number of common shares to which it is convertible at the record date. The holders of SBPS shall vote together with the common shareholders, and not as a separate class or series, on all matters put before the shareholders.

### *Liquidation*

The holders of Preferred Shares have preference over holders of common shares with respect to distribution of assets upon voluntary or involuntary liquidation of the Company. The holders of Preferred Shares shall be entitled to receive 100% of the original issue price (“preferred liquidation”). The holders of Preferred Shares are also entitled to distribution of remaining assets from preferred liquidation, along with other shareholders, while the total distribution entitled to the holders of Preferred Shares should not exceed 200% of the original issue price.

A reconciliation of Redeemable noncontrolling interest is as follows:

	<u>Year ended December 31,</u>	
	<u>2015</u>	<u>2016</u>
Redeemable noncontrolling interest opening balance	131,497,104	178,605,097
Issuance of Redeemable noncontrolling interest	—	—
Net loss attributable to redeemable noncontrolling interest	(32,697,713)	(14,724,152)
Accretion of Redeemable noncontrolling interest	<u>79,805,706</u>	<u>82,890,188</u>
Redeemable noncontrolling interest ending balance	178,605,097	246,771,133

### **32. DISPOSAL OF SUBSIDIARIES**

In July 2014, the Group entered into an agreement to sell its VIE, Huopu Cloud, for a total consideration of RMB200 million (US\$32.2 million) to a third-party purchaser. Pursuant to the agreement, the Group paid RMB30 million (US\$4.8 million) to Huopu Cloud’s development team to retain them in Huopu Cloud and undertook Huopu Cloud’s operating costs and expenses from the date of disposal to December 31, 2014 in the amount of RMB19 million (US\$3.1million). Huopu Cloud developed and held a web game QiJiGuiLai. As of the transfer date, the net assets held by Huopu Cloud amounted to RMB11 million(US\$1.8 million). The Group recognized a net gain of RMB 140 million (US\$22.5million)upon the disposal of Huopu Cloud in 2014.

In 2014, the Group established a subsidiary with two individual shareholders, Shanghai Kaiyue Information and Technology Co., Ltd. (“Kaiyue”), while the Group owned 85% equity interest of Kaiyue. Kaiyue developed and held a mobile application named KingReader for online reading. In December 2014, the Company sold their 85% equity interest of Kaiyue to a third-party investor for an aggregate consideration of RMB 25.5 million (US\$4.1 million), and recognized a net gain of RMB 25.5 million (US\$4.1 million) upon the disposal of the subsidiary in 2014.

### 33. COMMITMENTS AND CONTINGENCIES

#### 33.1 Operating lease commitments

The Group has entered into operating lease arrangements relating to the use of certain premises and internet data centers. Future minimum lease payments for non-cancellable operating leases as of December 31, 2016 are as follows:

	<u>RMB</u>	<u>US\$</u> <u>(Note 3)</u>
2017	3,276,215	471,873
2018	273,391	39,377
2019	—	—
2020	—	—
2021	—	—
	<u>3,549,606</u>	<u>511,250</u>

Total rental expenses amounted to RMB22.2 million, RMB19.4 million and RMB12.7 million (US\$1.8 million) for the years ended December 31, 2014, 2015 and 2016, respectively.

#### 33.2 Other operating commitments

The Group is financing the development of CrossFire New Mobile Game through fund-raising on Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2016, the Group had raised RMB57.5 million (US\$8.3 million), and the Group plans to raise an additional RMB100 million (US\$14.4 million) in 2017 until the game is launched. Under this fund raising arrangement, the Group will share certain percentages of the revenues from Cross Fire New Mobile Game to the investors providing funding to the Group. The revenues to be shared to the investors will be deposited to a bank account monitored by the Group, Inner Mongolia Culture Assets and Equity Exchange and the funding advisor. The Group had also committed to spend certain amounts of the fund raised in the marketing, game server purchases and research and development costs of Cross Fire New Mobile Game.



In August 2016, the Group granted a third party consultant 1,000,000 option as reward, which provided consulting service to the RMB157.5 million financing plan of Cross Fire Mobile Game with Inner Mongolia Culture Assets and Equity Exchange. The option would be vested in accordance with the schedule of the actual funding to be received. In October 2016, 365,079 options were vested after the Group received the first funding of RMB57.5 million. As December 31 of 2016, there are still 634,921 options remain unvested.

In October 2016, the Group entered into a game development agreement with a third party game developer. According to the agreement, the Group will pay RMB8.6 million (US\$1.2 million) to the third party game developer as development fee. As December 31, 2016, the Group had paid RMB1.8 million (US\$0.3 million) to the third party game developer. In addition, the Group is subject to additional contingent payments to be calculated based on certain percentages of the future revenue from the game.

In December 2016, the Group entered into an agreement with the third party investors of Jiucheng Advertisement, an equity-method investee. According to the agreement, the Group will need to repurchase the 19.11% equity interest of Jiucheng Advertisement with total amount of RMB18.3 million (US\$2.6 million) from those third party investors if Jiucheng Advertisement does not get listed on the National Equities Exchange and Quotations, commonly known as the New Third Board, before December 31, 2017.

### *33.3 Contingencies*

In June 2016, Asian Development borrowed a total of HK\$92.3 million (US\$11.9 million) from a financial services company at an annual interest rate of 2% for a term of 24 months, which is secured by a pledge of 417,440,000 shares of L&A (Note 18). Pursuant to the financing agreement (“Agreement”), such loan is considered as default since the market price of the pledged shares had fallen below the collateralized stock price by more than 35% for ten consecutive trading days and Asian Development had not made any remediation pursuant to the Agreement. Upon default, the lender shall be entitled to foreclose the pledged shares and become the legal and beneficial owner of the pledged shares. If the market value of the pledged shares cannot cover the total outstanding amount owed by Asian Development to the lender under the Agreement, the lender may claim against Asian Development to recover any outstanding amounts under the Agreement, in addition to foreclosure of the Pledged Securities as mentioned above. The Group may be subject to other legal or administrative proceedings in the ordinary course of business. The Group does not believe that any currently pending legal or administrative proceeding to which the Group is a party will have a material adverse effect on the business or financial condition.

### 34. SEGMENT REPORTING

The Group operates in one segment whose business is developing and operating online games and related services. The Group's chief operating decision maker is the chief executive officer, who reviews consolidated results when making decisions about allocating resources and assessing performance of the Group. The Group generates its revenues from customers in the Greater China, North America and other areas.

The following geographic area information includes revenue based on location of players for the years ended December 31, 2014, 2015 and 2016:

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2016</u>
	RMB	RMB	RMB	US\$(Note 3)
Greater China	41,969,350	33,201,421	48,041,372	6,919,397
North America	14,906,530	8,382,753	3,012,901	433,948
Other areas	7,401,011	4,827,157	5,145,013	741,035
Total	64,276,891	46,411,331	56,199,286	8,094,380

A majority of the Group's assets are located in Greater China.

### 35. SUBSEQUENT EVENTS

#### *Redeemable noncontrolling interest*

As described in Note 31, in August 2014, Red 5 issued 27,438,952 Series B redeemable convertible preferred shares of Red 5 to a new investor, Oriental Pearl. Due to the stock exchange transaction with L&A in 2016, 63% share of SBPS was owned by L&A as of December 31, 2016 (see Note 31). Per the Articles of Red 5, major holders of the outstanding shares of Series B Preferred Stock, at any time on or after April 1, 2017 (the "Redemption Election"), can require Red 5 to redeem all, but not less than all, of the outstanding shares of Series B Preferred Stock, as applicable, in three equal annual installments. New Star, a wholly owned subsidiary of the Group, owns 39,766,589 Series A redeemable convertible preferred shares which have similar terms with the Series B redeemable convertible preferred shares. As of the report date, there was no such preferred shareholder requiring Red 5 to redeem the Preferred Stock. The redemption value of Series B Preferred Stock was US\$16.5 million for the first installment. Since Red5 is in a net liability position, the Group does not believe the preferred shareholders will request such redemption.

**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY -**

**FINANCIAL STATEMENTS SCHEDULE I**

**THE9 LIMITED**

**FINANCIAL INFORMATION OF PARENT COMPANY**

**CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

	<u>2014</u> RMB	<u>2015</u> RMB	<u>2016</u> RMB	<u>2016</u> US\$
Cost of revenue	—	—	—	—
Gross loss	—	—	—	—
Operating expenses:				
Product development	632,437	(70,941)	(34,101)	(4,912)
Sales and marketing	—	(120,735)	(262,674)	(37,833)
General and administrative	(9,392,137)	(38,475,787)	(40,881,238)	(5,888,123)
Total operating expenses	<u>(8,759,700)</u>	<u>(38,667,463)</u>	<u>(41,178,013)</u>	<u>(5,930,868)</u>
Loss from operations	(8,759,700)	(38,667,463)	(41,178,013)	(5,930,868)
Interest income (expenses), net	32	(5,858,848)	(50,409,271)	(7,260,445)
Fair value change on convertible bonds and warrants	—	(7,129,161)	48,057,204	6,921,677
Other income (expenses), net	9,756	(2,267,335)	(11,163,638)	(1,607,898)
Loss before income tax expense and share of loss in equity method investments	(8,749,912)	(53,922,807)	(54,693,718)	(7,877,534)
Income tax expense	—	—		
Equity in income (loss) of subsidiaries and VIEs	<u>(77,872,558)</u>	<u>(250,905,547)</u>	<u>(539,087,871)</u>	<u>(77,644,804)</u>
Net loss	<u>(86,622,470)</u>	<u>(304,828,354)</u>	<u>(593,781,589)</u>	<u>(85,522,338)</u>
Other comprehensive income (loss)				
Unrealized loss on available-for-sale investment	—	—		
Currency translation adjustments	348,437	5,266,016	5,954,611	857,642
Total comprehensive loss	<u>(86,274,033)</u>	<u>(299,562,338)</u>	<u>(587,826,978)</u>	<u>(84,664,696)</u>

**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY -**

**FINANCIAL STATEMENTS SCHEDULE I**

**THE9 LIMITED**

**FINANCIAL INFORMATION OF PARENT COMPANY**

**CONDENSED BALANCE SHEETS**

	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$
<b>ASSETS</b>			
Cash and cash equivalents	28,984	58,919	8,486
Prepayments and other current assets, net	912,003	974,277	140,325
Amounts due from intercompany	1,425,500,136	1,401,819,738	201,904,038
<b>Total current assets</b>	<u>1,426,441,123</u>	<u>1,402,852,934</u>	<u>202,052,849</u>
Investments in subsidiaries	(1,420,228,235)	(1,522,384,543)	(219,268,982)
<b>Total assets</b>	<u>6,212,888</u>	<u>(119,531,609)</u>	<u>(17,216,133)</u>
<b>LIABILITIES</b>			
Current liabilities:			
Accounts payable	148,204	—	—
Other payables and accruals	3,829,603	6,442,626	927,931
Warrants	64,414,941	16,357,737	2,356,004
<b>Total current liabilities</b>	<u>68,392,748</u>	<u>22,800,363</u>	<u>3,283,935</u>
Convertible notes	135,182,536	197,284,836	28,414,927
<b>Total liabilities</b>	<u>203,575,284</u>	<u>220,085,199</u>	<u>31,698,862</u>
<b>SHAREHOLDERS' EQUITY</b>			
Ordinary shares	1,917,620	1,931,642	278,214
Additional paid-in capital	2,080,041,288	2,525,599,832	363,762,038
Statutory reserves	28,071,982	28,071,982	4,043,206
Accumulated other comprehensive loss	(3,372,588)	2,582,023	371,889
Accumulated deficit	(2,304,020,698)	(2,897,802,287)	(417,370,342)
<b>Total shareholders' equity</b>	<u>(197,362,396)</u>	<u>(339,616,808)</u>	<u>(48,914,995)</u>
<b>Total liabilities and shareholders' equity</b>	<u>6,212,888</u>	<u>(119,531,609)</u>	<u>(17,216,133)</u>

**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY -**

**FINANCIAL STATEMENTS SCHEDULE I**

**THE9 LIMITED**

**FINANCIAL INFORMATION OF PARENT COMPANY**

**CONDENSED STATEMENTS OF CASH FLOWS**

	2014 RMB	2015 RMB	2016 RMB	2016 US\$
<b>Cash flows from operating activities:</b>				
Net loss	(86,622,470)	(304,828,354)	(593,781,589)	(85,522,338)
Adjustments for:				
Employee share-based compensation expense	2,337,019	33,184,307	27,689,259	3,988,083
Fair value change on warrants liability	—	7,129,161	(48,057,204)	(6,921,677)
Amortization of discount and interest on convertible note	—	2,609,771	50,409,270	7,260,445
Exchange loss (gain)	—		17,116,102	2,465,231
Equity in loss (income) of subsidiaries and VIEs	77,872,558	250,905,547	539,087,871	77,644,804
Change in prepayments and other current assets	(199)	(856,745)	(62,274)	(8,969)
Change in accounts payable	(27,382)	(15,958)	(148,204)	(21,346)
Change in amounts due from intercompany	4,294,984	(236,543,924)	3,021,127	435,133
Change in other payables and accruals	(1,702,034)	6,401,724	2,613,023	376,354
Net cash used in operating activities	(3,847,524)	(242,014,471)	(2,112,619)	(304,280)
<b>Cash flows from financing activities:</b>				
Proceeds from stock option exercises	812,635	—	2,142,554	308,592
Proceeds from the issuance of convertible bonds	—	260,068,680	—	—
Payment for the issuance cost related to convertible bonds	—	(20,779,520)	—	—
Repurchase of ordinary shares	—	—	—	—
Net cash provided by (used in) financing activities	812,635	239,289,160	2,142,554	308,592
Net change in cash and cash equivalents	(3,034,889)	(2,725,311)	29,935	4,312
Cash and cash equivalents, beginning of year	5,789,184	2,754,295	28,984	4,174
Cash and cash equivalents, end of year	2,754,295	28,984	58,919	8,486

**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY -**

**FINANCIAL STATEMENTS SCHEDULE I**

**THE9 LIMITED**

**FINANCIAL INFORMATION OF PARENT COMPANY**

**NOTES 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) As disclosed in Note 1 to the consolidated financial statements, the Company was incorporated in December, 1999 in the Cayman Islands to be the holding company of the Group principally engaged in the development and operation of online games and internet related businesses, including massively multiplayer online games (“MMOGs”), mobile games, web games and TV games.

3) The condensed financial information has been prepared using the same accounting policies as set out in the consolidated financial statements except that the equity method has been used to account for investments in its subsidiaries and VIE. For the parent company, the Company records its investments in subsidiaries and VIE under the equity method of accounting as prescribed in *ASC 323, Investments-Equity Method and Joint Ventures*. Such investments are presented on the Condensed Balance Sheets as “Investment in subsidiaries and VIE” and the subsidiaries and VIE’ profit or loss as “Equity in income/loss of subsidiaries” on the Condensed Statements of Comprehensive Loss. Ordinarily under the equity, an investor in an equity method investee would cease to recognize its share of the losses of an investee once the carrying value of the investment has been reduced to nil absent an undertaking by the investor to provide continuing support and fund losses. For the purpose of this Schedule I, the parent company has continued to reflect its share, based on its proportionate interest, of the losses of subsidiaries and VIE regardless of the carrying value of the investment even though the parent company is not obligated to provide continuing support or fund losses.

4) As of December 31, 2015 and 2016, there were no material contingencies, significant provisions of long-term obligations, mandatory dividend or redemption requirements of redeemable stocks or guarantees of the Company. No dividend was paid by the Company’s subsidiaries to the Company in 2014, 2015 and 2016.

5) Translations of balances in the additional financial information of Parent Company — Financial Statements Schedule I from RMB into US\$ as of and for the year ended December 31, 2015 and 2016 are solely for the convenience of the readers and were calculated at the rate of US\$1.00 = RMB6.9430, representing the noon buying rate set forth in the H.10 statistical release of the U.S. Federal Reserve Board on December 31, 2016. No representation is made that the RMB amounts could have been, or could be, converted, realized or settled into US\$ at that rate on December 31, 2016, or at any other rate.

THE9 LIMITED

**SIXTH AMENDED AND RESTATED 2004 STOCK OPTION PLAN**

1. Purposes of the Plan

The purposes of this Plan are:

- (a) to attract and retain the best available personnel for positions of substantial responsibility,
- (b) to provide additional incentive to Employees, Directors and Consultants, and
- (c) to motivate the participating personnel, promote their dedication, and encourage them to devote themselves to the success of the Company's business.

Stock Purchase Rights may also be granted under the Plan.

2. Definitions

“Administrative Committee”	the Board or any of its Committees as shall be designated to administer the Plan in accordance with Section 4 below.
“Applicable Laws”	the requirements relating to the administration of stock option plans under any stock exchange or quotation system on which the Ordinary Shares are listed or quoted and the laws of any country or jurisdiction which apply to the grant of Options or Stock Purchase Rights under the Plan.
“Board”	the Board of Directors of the Company.
“Committee”	a committee of Directors appointed by the Board.
“Company”	The9 Limited, a company incorporated under the laws of Cayman Islands.
“Consultant”	any person who renders or has rendered consulting or advisory services to the Company or any Subsidiary.

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“Director”	a member of the Board.
“Disability”	any total and permanent disability which prevents a Service Provider from performing his duties under the relevant contract of employment, engagement, appointment or service (as the case may be) or otherwise from continuing in such capacity.
“Employee”	<p>any person employed by the Company or any Subsidiary of the Company, including but not limited to the directors of such Subsidiary. A person shall not cease to be an Employee in the case of:</p> <ul style="list-style-type: none"><li>(i) any leave of absence approved by the Company; or</li><li>(ii) any transfers or secondment between any locations of the Company or between the Company and any Subsidiary.</li></ul>
“Fair Market Value”	<p>as of any date, the value of Ordinary Shares as determined in the following manners:</p> <ul style="list-style-type: none"><li>(i) if the Ordinary Shares are listed or publicly traded on any established stock exchange or a national market system, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system on the date of determination or on the last market trading day prior to the date of determination (if the date of determination is not a market trading day), as reported in <i>The Wall Street Journal</i> or such other sources as the Administrative Committee deems reliable;</li></ul>



(ii) if the Ordinary Shares are regularly quoted by a principal recognized securities dealer but selling prices are not reported, its Fair Market Value shall be the average between the high bid and low asked prices for the Ordinary Shares on the date of determination or on the last market trading day prior to the date of determination (if the date of determination is not a market trading day); or

(iii) in the absence of an established market for the Ordinary Shares, its Fair Market Value shall be determined in good faith by the Administrative Committee after consultation with legal and accounting experts as the Administrative Committee may deem advisable.

“Option”	a stock option granted pursuant to the Plan which confers the holder a right to purchase a specified amount of Ordinary Shares from the Company on and subject to the pre- determined terms and conditions stipulated in the Option Agreement.
“Option Agreement”	a written or electronic agreement between the Company and an Optionee evidencing the terms and conditions of an individual Option grant. The Option Agreement is subject to the terms and conditions of the Plan.
“Optioned Stock”	the Ordinary Shares subject to an Option or a Stock Purchase Right, as adjusted in accordance with Section 12 below.
“Optionee”	the holder of an outstanding Option or Stock Purchase Right granted under the Plan.
“Ordinary Shares”	the ordinary shares of the Company, par value US\$0.01 per share.
“Plan”	this 2004 Stock Option Plan.
“Restricted Stock”	Ordinary Shares acquired by an Optionee upon exercise of the Stock Purchase Right, which is granted pursuant to Section 10 below.

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“Restricted Stock Purchase Agreement”	a written or electronic agreement between the Company and an Optionee evidencing the terms and conditions of an individual grant of Stock Purchase Right. The Restricted Stock Purchase Agreement is subject to the terms and conditions of the Plan.
“Securities Act”	the securities exchange legislation of any applicable jurisdiction as amended from time to time.
“Service Provider”	an Employee, a Director or a Consultant.
“Stock Purchase Right”	a right to purchase Ordinary Shares pursuant to Section 10 below.
“Subsidiary”	any entity in which the Company holds directly or indirectly fifty point one percent (50.1%) or more of the voting equity.
“Tax Law”	the relevant tax law of the applicable jurisdiction, as amended from time to time.

Except where otherwise indicated by the context herein, references to the masculine gender shall also include the feminine gender and the neuter and vice versa, and references to the singular shall also include the plural and vice versa.

### 3. Stock Subject to the Plan

Subject to the provisions of Section 12 of the Plan, the maximum aggregate number of Ordinary Shares which may be subject to Option or Stock Purchase Right and sold under the Plan is 34,449,614 Ordinary Shares. At all times during the term of the Plan and while any Option(s) or Stock Purchase Right(s) are outstanding, the Company shall retain as authorized and unissued stock, or as treasury stock, at least the number of Ordinary Shares from time to time required under the provisions of the Plan for such outstanding Option(s) and Stock Purchase Right(s), or otherwise assure itself of its ability to perform its obligations hereunder.

If an Option or Stock Purchase Right expires or terminates for any reason or becomes unexercisable without having been exercised in full, or is surrendered, the unacquired or unpurchased Ordinary Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated). However, Ordinary Shares that have actually been issued under the Plan, upon exercise of either an Option or Stock Purchase Right, shall not be reverted to the Plan and shall not become available for future distribution under the Plan, except that if Restricted Stock are repurchased by the Company at their original purchase price and cancelled pursuant to Section 10, the Ordinary Shares so repurchased (which will then be authorized but unissued Ordinary Shares) shall become available for future grant under the Plan.

4. Administration of the Plan

(a) *Administrative Committee*

The Plan shall be administered by the Board or a Committee appointed by the Board (the “Administrative Committee”), which Administrative Committee shall be constituted to comply with the Applicable Laws. Unless it is prohibited by the Applicable Laws, in which event the Plan shall be administered by the Board, the Administrative Committee, if appointed, shall comprise two directors of the Company nominated by each of Jun ZHU and Bosma Limited.

(b) *Powers of the Administrative Committee*

Subject to the provisions of the Plan and, in the case of an Administrative Committee, the specific duties delegated by the Board to such Administrative Committee, and subject to the approval of any relevant authorities, the Administrative Committee shall have, in addition to its other authority provided herein, the authority at its sole discretion:

- (i) to determine the Fair Market Value in the manners as set out in the definition of Fair Market Value under Section 2 above;
- (ii) to select from time to time the Service Providers (excluding the Directors, Option or Stock Purchase Right grants to whom shall be determined by the compensation committee of the Board, or before the appointment of compensation committee, by the Board) to whom Options and Stock Purchase Rights may be granted hereunder;
- (iii) to determine the number of Ordinary Shares to be covered by each grant of Option or Stock Purchase Right hereunder to the Service Providers (excluding the Directors, Option or Stock Purchase Right grants to whom shall be determined by the compensation committee of the Board, or before the appointment of compensation committee, by the Board);

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- (iv) to approve forms of agreement for use under the Plan;
  - (v) to determine the terms and conditions, of any Option or Stock Purchase Right granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Option or Stock Purchase Rights may be exercised (which may be based on performance criteria or a pre-determined vesting period), any forfeiture restrictions, any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any Option or Stock Purchase Right or the Ordinary Shares relating thereto, based in each case on such factors as the Administrative Committee, at its sole discretion, shall determine;
  - (vi) to determine whether and under what circumstances an Option may be settled in cash under subsection 9(e) below instead of Ordinary Shares;
  - (vii) to reduce the exercise price of any Option or Stock Purchase Right to the then current Fair Market Value if the Fair Market Value of the Ordinary Shares covered by such Option or Stock Purchase Right has declined since the date the Option or Stock Purchase Right was granted;
  - (viii) to prescribe, amend and rescind rules and regulations relating to the Plan (but not the Plan per se), including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax law;
  - (ix) to allow Optionees to satisfy withholding tax obligations by electing to have the Company withhold from the Ordinary Shares to be issued upon exercise of an Option or Stock Purchase Right that number of Ordinary Shares having a Fair Market Value equal to the amount required to be withheld. The Fair Market Value of the Ordinary Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined or the tax liability arises or the tax is due to be paid, or any other date as the Administrative Committee may deem appropriate. All elections by Optionees to have Ordinary Shares withheld for this purpose shall be made in such form and under such conditions as the Administrative Committee may deem necessary or advisable;

- (x) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan; and
- (xi) to take any other actions as the Administrative Committee shall consider appropriate for the proper administration of the Plan.

(c) *Effect of Administrative Committee's Decision*

All decisions, determinations and interpretations of the Administrative Committee pursuant to the provisions of the Plan shall be final conclusive and binding on all Optionees.

5. Eligibility

- (a) Options and Stock Purchase Rights may be granted to Service Providers.
- (b) Neither the Plan nor any Option or Stock Purchase Right shall confer upon any Optionee any right with respect to continuing the Optionee's relationship as a Service Provider with the Company, nor shall it interfere in any way with his or her right or the Company's right to terminate such relationship at any time, with or without cause.

6. Term of Plan

The Plan shall become effective upon its adoption by the Board. It shall continue in effect for a term of twenty (20) years unless sooner terminated under Section 14 below.

7. Term of Option

The term of each Option shall be stated in the Option Agreement; provided, however, that the term shall be no more than five (5) years from the date of grant thereof.

8. Option Exercise Price and Consideration

- (a) The per share exercise price for the Ordinary Shares to be issued upon exercise of an Option shall be such price as is determined by the Administrative Committee.

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- (b) The terms, conditions and restrictions for the issuance of the Ordinary Shares upon exercise of an Option, including the method of payment, shall be determined by the Administrative Committee. The Administrative Committee may at its sole discretion authorize or accept payment in one or more of the following manners:
- (i) cash,
  - (ii) check payable to the order of the Company,
  - (iii) promissory note,
  - (iv) surrender to the Company of other Ordinary Shares which (x) in the case of Ordinary Shares acquired upon exercise of an Option, have been owned by the Optionee for more than six (6) months on the date of surrender, and (y) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Ordinary Shares as to which such Option shall be exercised,
  - (v) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan, or
  - (vi) any combination of the foregoing methods of payment.

In making its determination as to the above, the Administrative Committee shall consider the best interest of and advantage to the Company.

9. Exercise of Option

(a) *Procedure for Exercise; Rights as a Shareholder*

Any Option granted hereunder shall be exercisable according to the terms hereof at such times and under such conditions as determined by the Administrative Committee and set forth in the Option Agreement. Except in the case of Options granted to the Directors and Consultants, Options shall become exercisable at a rate of no more than one third (1/3rd) per year or one thirty-sixth (1/36th) per month over three (3) years from the date the Options are granted. Unless the Administrative Committee provides otherwise, vesting of Options granted hereunder to Directors shall be tolled during any unpaid leave of absence. An Option may not be exercised for a fraction of an Ordinary Share.

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An Option shall be deemed exercised when the Company receives:

- (i) written or electronic notice of exercise (in accordance with the Option Agreement) from the person entitled to exercise the Option, and
- (ii) full payment for the Ordinary Shares with respect to which the Option is exercised.

Full payment may consist of any consideration and method of payment authorized by the Administrative Committee and permitted by the Option Agreement and the Plan. After the Option is exercised, the Company shall promptly issue (or cause to be issued) such number of Ordinary Shares as covered by such Option. Ordinary Shares issued upon exercise of an Option shall be issued in the name of the Optionee or, if requested by the Optionee, in the joint name of the Optionee and his or her spouse. Until the Ordinary Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to attend general meeting of the Company, vote or receive dividends or other distributions or any other rights as a shareholder shall exist with respect to the Ordinary Shares, notwithstanding the exercise of the Option. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Ordinary Shares are issued, except as provided in Section 12 below.

Exercise of an Option in any manner shall result in a decrease in the number of Ordinary Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Ordinary Shares as to which the Option is exercised.

(b) *Termination of Relationship as Service Provider*

If an Optionee ceases to be a Service Provider (save and except due to the Optionee's Disability, in which event subsection 9(c) below shall apply or due to the Optionee's death, in which event subsection 9(d) below shall apply), such Optionee may exercise his or her Option within such period of time as is specified in the Option Agreement (of at least thirty (30) days but in no event later than the expiration of the term of the Option as set forth in the Option Agreement) to the extent that the Option is vested on the date of such cessation. In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for three (3) months following the Optionee's cessation as aforesaid (but in no event later than the expiration of the term of the Option as set forth in the Option Agreement). If, on the date of cessation, the Optionee is not vested as to his or her entire Option, the Ordinary Shares covered by the unvested portion of the Option shall revert to the Plan. If, after the cessation, the Optionee does not exercise his or her Option to the fullest extent vested within the time specified in the Option Agreement or stipulated herein as the case may be, the Option shall lapse automatically, and the Ordinary Shares covered by such unexercised portion of the Option shall revert to the Plan and the Optionee shall have no claim for compensation or otherwise against the Company whatsoever.

(c) *Disability of Optionee*

If an Optionee ceases to be a Service Provider as a result of the Optionee's Disability, the Optionee may exercise his or her Option within such period of time as is specified in the Option Agreement (of at least six (6) months but in no event later than the expiration of the term of such Option as set forth in the Option Agreement) to the extent the Option is vested on the date of such cessation. In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for twelve (12) months following the Optionee's cessation as aforesaid (but in no event later than the expiration of the term of such Option as set forth in the Option Agreement). If, on the date of cessation, the Optionee is not vested as to his or her entire Option, the Ordinary Shares covered by the unvested portion of the Option shall revert to the Plan. If, after the cessation, the Optionee does not exercise his or her Option to the fullest extent vested within the time specified in the Option Agreement or stipulated herein as the case may be, the Option shall lapse automatically, and the Ordinary Shares covered by such unexercised portion of the Option shall revert to the Plan and the Optionee shall have no claim for compensation or otherwise against the Company whatsoever.

(d) *Death of Optionee*

If an Optionee dies while being a Service Provider, the Option may be exercised within such period of time as is specified in the Option Agreement (of at least six (6) months but in no event later than the expiration of the term of such Option as set forth in the Option Agreement) to the extent that the Option is vested on the date of death by the Optionee's estate or by a person who acquires the right to exercise the Option by bequest or inheritance (collectively, the "Optionee's Representative"). In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for twelve (12) months following the Optionee's death (but in no event later than the expiration of the term of such Option as set forth in the Option Agreement). If, at the time of death, the Optionee is not vested as to the entire Option, the Ordinary Shares covered by the unvested portion of the Option shall immediately revert to the Plan. If the Option is not exercised by the Optionee's Representative to the fullest extent vested within the time specified in the Option Agreement or stipulated herein as the case may be, the Option shall lapse automatically, and the Ordinary Shares covered by such unexercised portion of the Option shall revert to the Plan and the Optionee's estate and the Optionee's Representative shall have no claim for compensation or otherwise against the Company whatsoever.



(e) *Buyout Provisions*

The Administrative Committee may at any time offer to buy out an Option previously granted for a payment in cash or Ordinary Shares, based on such fair and reasonable terms and conditions as the Administrative Committee shall establish and communicate to the Optionee at the time that such offer is made or as set forth in the Option Agreement.

10. Stock Purchase Rights

(a) *Rights to Purchase*

Stock Purchase Rights may be issued in favour of the Optionees either alone, in addition to, or in tandem with other awards granted under the Plan and/or cash awards made by the Company outside of the Plan. After the Administrative Committee determines that it will offer Stock Purchase Rights under the Plan, it shall advise the offeree in writing or electronically of the terms, conditions and restrictions related to the offer, including the number of Ordinary Shares that such person shall be entitled to purchase, the price to be paid, the forfeiture restrictions, the time limit for the exercise of the Stock Purchase Rights and the time within which such person must accept such offer.

(b) *Repurchase Option*

Unless the Administrative Committee determines otherwise, the Restricted Stock Purchase Agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the Optionee as a Service Provider for any reason (including death or Disability). The purchase price for Ordinary Shares repurchased pursuant to the Restricted Stock Purchase Agreement shall be the original price paid by the Optionee and may be paid by cancellation of any indebtedness of the Optionee to the Company. The repurchase option shall lapse at such rate as the Administrative Committee may determine at its sole discretion. Except with respect to Ordinary Shares purchased by the Directors and Consultants, the repurchase option shall in no case lapse at a rate of less than 25% per year over four (4) years from the date of purchase.

(c) *Other Provisions*

The Restricted Stock Purchase Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Administrative Committee at its sole discretion.

(d) *Rights as a Shareholder*

Once the Stock Purchase Right is exercised, the purchaser shall have rights equivalent to those of a shareholder and shall be a shareholder when his or her purchase and personal particulars are entered upon the records of the Company or of the duly authorized transfer agent of the Company. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the Stock Purchase Right is exercised, except as provided in Section 12 below.

11. Non-Transferability of Options and Stock Purchase Rights

The Option and Stock Purchase Rights may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of succession and may be exercised, during the lifetime of the Optionee, only by the Optionee except as provided in subsection 9(d) above.

12. Adjustments Upon Changes in Capitalization, Merger or Asset Sale

(a) (i) *Changes in Capitalization*

Subject to any action of the shareholders of the Company as necessitated by the Applicable Laws, the number of Ordinary Shares covered by each outstanding Option or Stock Purchase Right, and the number of Ordinary Shares which have been authorized for issuance under the Plan but as to which no Options or Stock Purchase Rights have yet been granted or which have been reverted to the Plan upon cancellation or expiration of an Option or Stock Purchase Right, as well as the price per Ordinary Share covered by each such outstanding Option or Stock Purchase Right, shall be proportionately adjusted for any increase or decrease in the number of issued Ordinary Shares effected without receipt of consideration by the Company. The conversion of any convertible securities of the Company shall not be deemed to have been “effected without receipt of consideration”. Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Ordinary Shares subject to an Option or Stock Purchase Right.

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(ii) *Adjustments for Stock Split, Stock Dividend, Etc.*

If the Company shall at any time increase or decrease the number of its outstanding Ordinary Shares, or change in any way the rights and privileges of its outstanding Ordinary Shares, by means of the payment of a stock dividend or any other distribution upon such Ordinary Shares, or through a stock split, subdivision, consolidation, combination, reclassification or recapitalization involving such Ordinary Shares, then in relation to the Ordinary Shares that are covered by the Options or Stock Purchase Rights granted or available under the Plan and are affected by one or more of the above events, the numbers, rights and privileges of the following shall be increased, decreased or changed in like manner as if such Ordinary Shares had been issued and outstanding, fully paid and non-assessable at the time of such occurrence.

(b) *Dissolution or Liquidation*

In the event of the proposed dissolution or liquidation of the Company, the Administrative Committee shall notify each Optionee as soon as practicable prior to the effective date of such proposed dissolution or liquidation. The Administrative Committee may at its sole discretion provide for an Optionee to have the right to exercise his or her Option or Stock Purchase Right at any time until fifteen (15) days prior to the commencement of such proposed dissolution or liquidation. In addition, the Administrative Committee may at its sole discretion provide that any repurchase option of the Company applicable to any Restricted Stock and/or any right of the Company to buy out outstanding Options under subsection 9(e) shall lapse upon dissolution or liquidation of the Company, provided the proposed dissolution or liquidation takes place at the time and in the manner contemplated.

(c) *Merger or Asset Sale*

In the event of a merger of the Company with or into another corporation, or the sale of substantially all of the assets of the Company, each outstanding Option and Stock Purchase Right shall be assumed or an equivalent option or right substituted by the successor corporation or its holding company (meaning any entity which holds directly or indirectly at least fifty point one percent of the voting equity of the successor corporation) or subsidiary (meaning any entity in which the successor corporation holds directly or indirectly fifty point one percent or more of the voting equity). In the event that the successor corporation or its holding company or subsidiary refuses to assume or substitute for the Option or Stock Purchase Right, the Optionee shall fully vest in and have the right to exercise the Option or Stock Purchase Right as to all of the Optioned Stock, including such part of the Optioned Stock as to which it would not otherwise be vested or exercisable and the repurchase option of the Company applicable to any Restricted Stock and/or any right of the Company to buy out outstanding Options under subsection 9(e) shall lapse upon consummation of such merger or sale of assets. If an Option or Stock Purchase Right becomes fully vested and exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrative Committee shall accordingly notify the Optionee in writing or electronically in which event the Option or Stock Purchase Right shall be fully exercisable for a period of fifteen (15) days from the date of such notice, and the Option or Stock Purchase Right shall terminate upon the expiration of such fifteen (15) day period. For the purposes of this paragraph, the Option or Stock Purchase Right shall be considered assumed if, following the merger or sale of assets, the outstanding Option or Stock Purchase Right confers the right to purchase or receive proportionately the consideration (whether stock, cash, or other securities or property) received by holders of Ordinary Shares in the merger or sale of assets; provided, however, that if such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its holding company or subsidiary, the Administrative Committee may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Option or Stock Purchase Right to be solely common stock of the successor corporation or its holding company or subsidiary equal in fair market value to the per share consideration received by holders of Ordinary Shares in the merger or sale of assets, such fair market value to be conclusively determined by the Administrative Committee.

(d) *General Adjustment Rules*

If any adjustment or substitution provided for in this Section 12 shall result in the creation of a fractional Ordinary Share under any Option, the Company shall, in lieu of issuing such fractional Ordinary Share, pay to the Optionee a cash sum in the amount equal to the product of such fraction multiplied by the Fair Market Value of an Ordinary Share on the date the fractional Ordinary Share otherwise would have been issued.

(e) *Determination by Administrative Committee*

Adjustments under this Section 12 shall be made by the Administrative Committee whose determinations with regard thereto shall be final, conclusive and binding upon all parties.

13. Time of Granting Options and Stock Purchase Rights

The date of grant of an Option or Stock Purchase Right shall, for all purposes, be the date on which the Administrative Committee makes the determination granting such Option or Stock Purchase Right, or such other date as determined by the Administrative Committee. Notice of the determination shall be given to each Service Provider to whom an Option or Stock Purchase Right is so granted within a reasonable time after the date of such grant.

14. Amendment and Termination of the Plan

(a) *Amendment and Termination*

Subject to Subsection 14(b) below, the Board may at any time amend, alter, suspend or terminate the Plan.

(b) *Shareholder Approval*

The Board shall obtain shareholder approval of any amendment to the Plan to the extent necessary and desirable to comply with Applicable Laws.

(c) *Effect of Amendment or Termination*

No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Optionee, unless mutually agreed otherwise between the Optionee and the Administrative Committee. Termination of the Plan shall not affect the Administrative Committee's ability to exercise the powers granted to it hereunder with respect to Options granted under the Plan prior to the date of such termination.

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15. Conditions Upon Issuance of Shares

(a) *Legal Compliance*

Ordinary Shares shall not be issued pursuant to the exercise of an Option or Stock Purchase Right unless the exercise of such Option or Stock Purchase Right and the issuance and delivery of such Ordinary Shares shall comply with Applicable Laws and shall be further subject to the approval of legal counsel for the Company with respect to such compliance.

(b) *Cash Payment*

The payment of cash pursuant to the Plan shall be subject to all Applicable Laws.

(c) *Investment Representations*

The Company may require any person to whom an Option or a Stock Purchase Right is granted, as a condition of exercising such Option or Stock Purchase Right or receiving Ordinary Shares pursuant to the Plan, to give written assurances, in the substance and form satisfactory to the Company and its legal counsel, to the effect that such person is acquiring the Ordinary Shares subject to the Option or Stock Purchase Right for his own account for investment and not with any present intention of selling or otherwise distributing the same, and to such other effects as the Company deems necessary or appropriate in order to comply with applicable securities laws.

(d) *Restrictions*

The Administrative Committee may provide that Ordinary Shares issuable upon the exercise of an Option or Stock Purchase Right shall, under certain conditions, be subject to restrictions whereby the Company has a right of first refusal with respect to such Ordinary Shares, which restrictions may survive an Optionee's term of employment, engagement, appointment or service with the Company.

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16. Inability to Obtain Regulatory Approval

The inability of the Company to obtain approval from any regulatory body having jurisdiction over the Company with respect to issuance of Ordinary Shares pursuant to this Plan shall relieve the Company of any liability in respect of the failure to issue such Ordinary Shares as to which such requisite approval shall not have been obtained.

17. Shareholder Approval

The Plan shall be subject to approval by the shareholders of the Company within twelve (12) months after the date the Plan is adopted by the Board. Such shareholder approval shall be obtained in the degree and manner required under Applicable Laws.

18. Information to Optionees and Purchasers

The Company shall provide to each Optionee and to each individual who acquires Ordinary Shares pursuant to the Plan, not less frequently than annually during the period such Optionee or purchaser has one or more Options or Stock Purchase Rights outstanding, and, in the case of an individual who acquires Ordinary Shares pursuant to the Plan, during the period such individual owns such Ordinary Shares, copies of annual financial statements. The Company shall not be required to provide such statements to key employees whose duties in connection with the Company assure their access to equivalent information.

19. Withholding

The Company's obligations to deliver Ordinary Shares upon the exercise of an Option or Stock Purchase Right shall be subject to the Optionee's satisfaction of all Applicable Laws related to tax withholding as a result of such exercise.

20. Non-exclusivity of the Plan

Neither the adoption of the Plan by the Board nor the submission of the Plan to shareholders of the Company for approval shall be construed as creating any limitations on the power or authority of the Board to adopt such other or additional incentive or other compensation arrangements of whatever nature as the Board may deem necessary or desirable or preclude or limit the continuation of any other plan, practice or arrangement for the payment of compensation or fringe benefits to employees generally, or to any class or group of employees, which the Company or any Subsidiary now has lawfully put into effect, including, without limitation, any retirement, pension, savings and stock purchase plan, insurance, death and disability benefits and executive short-term incentive plans.

21. No Transfer or Assignment

The Option or Stock Purchase Right granted hereunder shall not be transferred or assigned without the approval in writing of the Administrative Committee.

22. Governing Law

The terms and conditions of this Plan shall be governed by and construed in accordance with the laws of the Cayman Islands.

**- E N D -**



**Significant and Other Principal Subsidiaries and Affiliated Entities of The Registrant**  
(as of the date of the annual report)

**Subsidiaries**

<u>Name of Subsidiary</u>	<u>Jurisdiction of Incorporation</u>
GameNow.net (Hong Kong) Limited	Hong Kong
China The9 Interactive Limited	Hong Kong
New Star International Development Limited	Hong Kong
Silver Express Investments Limited	Hong Kong
City Channel Limited	Hong Kong
China Crown Technology Limited	Hong Kong
Asian Development Limited	Hong Kong
The9 Interactive, Inc.	Delaware, USA
Red 5 Studios, Inc.	Delaware, USA
Red 5 Singapore Pte. Ltd.	Singapore
The9 Computer Technology Consulting (Shanghai) Co., Ltd.	China
China The9 Interactive (Shanghai) Limited	China
China The9 Interactive (Beijing) Limited	China
Jiu Jing Era Information Technology (Beijing) Limited	China
Jiu Tuo (Shanghai) Information Technology Limited	China
Shanghai Jiuchang Investment Co., Ltd.	China

**Consolidated affiliated entities**

<u>Name of Consolidated Affiliated Entity</u>	<u>Jurisdiction of Incorporation</u>
Shanghai The9 Information Technology Co., Ltd.	China
Shanghai Jiushi Interactive Network Technology Co., Ltd.	China
Shanghai Fire Wing Information Technology Co., Ltd.	China
Shanghai The9 Education Technology Co., Ltd.	China
Hangzhou Fire Rain Network Technology Co., Ltd.	China
Shanghai Shencai Chengjiu Information Technology Co., Ltd.	China
Wuxi The9 Chuangyou Technology Co., Ltd.	China
Shanghai Wenhui Network Technology Co., Ltd.	China
Wuxi Interest Dynamic Network Technology Co., Ltd.	China
Changsha Quxiang Network Technology Co., Ltd.	China
Shanghai Yuyou Network Technology Co., Ltd.	China

**Certification by the Chief Executive Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Jun Zhu, certify that:

1. I have reviewed this annual report on Form 20-F of The9 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 the 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 7, 2017

By: /s/ Jun Zhu

Name: Jun Zhu

Title: Chief Executive Officer

**Certification by the Chief Financial Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, George Lai, certify that:

1. I have reviewed this annual report on Form 20-F of The9 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 the 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 function):

(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 7, 2017

By: /s/ George Lai

Name: George Lai

Title: Chief Financial Officer

**Certification by the Chief Executive Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of The9 Limited (the “Company”) on Form 20-F for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Jun Zhu, 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 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 7, 2017

By: /s/ Jun Zhu

Name: Jun Zhu

Title: Chief Executive Officer

**Certification by the Chief Financial Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of The9 Limited (the “Company”) on Form 20-F for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, George Lai, 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 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 7, 2017

By: /s/ George Lai  
Name: George Lai  
Title: Chief Financial Officer

**Our ref:** MJL/604835-000001/10851546v2  
**Direct** +852 3690 7490  
**Email** michael.li@maplesandcalder.com

The9 Limited  
Building No. 3, 690 Bibo Road  
Zhang Jiang Hi-Tech Park  
Pudong New Area, Pudong  
Shanghai 201203  
People's Republic of China

7 April 2017

Dear Sirs,

**The9 Limited (the “Company”)**

We consent to the reference to our firm under the heading “Item 10.E. Additional Information — Taxation — Cayman Islands Taxation” in the Company’s Annual Report on Form 20-F for the year ended December 31, 2016 (the “**Annual Report**”), which will be filed with the Securities and Exchange Commission (the “**SEC**”) in the month of April 2017, and further consent to the incorporation by reference of our opinions under these headings into the Registration Statements on Form S-8 (No. 333-127700, No. 333-156306, No. 333-168780 and No. 333-210693) pertaining to the Company’s 2004 Stock Option Plan, as amended and restated, and the Registration Statement on Form F-3 (No. 333-210692) of the Company.

We also consent to the filing with the SEC of this consent letter as an exhibit to the Annual Report. In giving such consent, we do not thereby admit that we come within the category of persons whose consent is required under Section 7 of the Securities Act of 1933, or under the Securities Exchange Act of 1934, in each case, as amended, or the regulations promulgated thereunder.

Yours faithfully

/s/ Maples and Calder (Hong Kong) LLP

Maples and Calder (Hong Kong) LLP



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网址 <http://www.zhonglun.com>

April 7, 2017

The9 Limited  
Building No. 3, 690 Bibo Road  
Zhangjiang Hi-tech Park  
Pudong New Area, Pudong  
Shanghai 201203  
People's Republic of China

Dear Sir/Madam:

We consent to the reference to our firm under the headings of "Government Regulations" and "Arrangements with Affiliated PRC Entities" in The9 Limited's Annual Report on Form 20-F for year ended December 31, 2016 (the "Annual Report"), which will be filed with the Securities and Exchange Commission in the month of April 2017, and further consent to the incorporation by reference of our opinions under these headings into the Registration Statements on Form S-8 (No. 333-127700, No. 333-156306, No. 333-168780 and No. 333-210693) pertaining to The9 Limited's 2004 Stock Option Plan, as amended and restated, and the Registration Statement on Form F-3 (No. 333-210692) of The9 Limited.

In giving such consent, we do not hereby admit that we come within the category of persons whose consent is required under Section 7 of the Securities Act of 1933, or under the Securities Exchange Act of 1934, in each case, as amended, or the regulations promulgated thereunder.

Yours faithfully,

/s/ Zhong Lun Law Firm

**Zhong Lun Law Firm**

北京 BEIJING • 上海 SHANGHAI • 深圳 SHENZHEN • 广州 GUANGZHOU • 武汉 WUHAN  
成都 CHENGDU • 重庆 CHONGQING • 青岛 QINGDAO • 东京 TOKYO • 香港 HONG KONG  
伦敦 LONDON • 纽约 NEWYORK • 洛杉矶 LOS ANGELES • 旧金山 SAN FRANCISCO

本所为特殊的普通合伙制事务所 LIMITED LIABILITY PARTNERSHIP

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated April 7, 2017, with respect to the consolidated financial statements and financial statement schedule of The9 Limited, its subsidiaries and its variable interest entities included in the annual report of The9 Limited on Form 20-F for the year ended December 31, 2016. We consent to the incorporation by reference of the Report in the Registration Statements of The9 Limited on Forms S-8 (No. 333-127700, No. 333-156306, No. 333-168780 and No. 333-210693) and Form F-3 (No. 333-210692).

/s/ Grant Thornton  
Shanghai, China  
April 7, 2017



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statements on Form S-8 (No. 333-127700, No. 333-156306, No. 333-168780 and No. 333-210693) and Form F-3 (No. 333-210692) of our report dated April 11, 2016, relating to the consolidated balance sheets as of December 31, 2015 and the related consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for each of the two years in the period ended December 31, 2015 and related financial statement schedule of The9 Limited, its subsidiaries and its variable interest entities (the “Group”) (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the translation of Renminbi amounts to United States dollar amounts for the convenience of readers in the United States), appearing in this Annual Report on Form 20-F of The9 Limited for the year ended December 31, 2016.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP  
Shanghai, China  
April 7, 2017

## SYSTEM LINK CORPORATION LIMITED

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of System Link Corporation Limited:

We have audited the accompanying consolidated balance sheet of System Link Corporation Limited, its subsidiaries and its variable interest entities (the "Group") as of December 31, 2016, and related consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for the year ended December 31, 2016. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Group's internal control over financial reporting. Our audit 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of System Link Corporation Limited, its subsidiaries and its variable interest entities as of December 31, 2016, and the results of their operations and their cash flows for the year ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton  
Shanghai, China  
April 7, 2017

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of System Link Corporation Limited:

We have audited the accompanying consolidated financial statements of System Link Corporation Limited, its subsidiaries and variable interest entity (the "Group") which comprise the balance sheet as of December 31, 2015, and the related consolidated statements of operations and comprehensive loss, change in equity, and cash flows for the year then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2015, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Our audit also comprehended the translation of Renminbi amounts into United States dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 3. Such United States dollar amounts are presented solely for the convenience of readers in the United States of America.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP  
Shanghai, China  
April 11, 2016

**SYSTEM LINK CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**FOR THE PERIOD FROM MAY 26, 2014 (DATE OF ESTABLISHMENT) TO DECEMBER 31, 2014 AND**  
**FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2016**

	For the period from May 26, 2014 (date of establishment) to December 31, 2014 RMB (Unaudited)	Year ended December 31, 2015 RMB	Year ended December 31, 2016 RMB	Year ended December 31, 2016 US\$ (Note 3)
Net revenues	—	547,593	173,897	25,046
Cost of revenue	—	(7,105,782)	(150,304,972)	(21,648,419)
<b>Gross loss</b>	—	(6,558,189)	(150,131,075)	(21,623,373)
Operating expenses:				
Product development	—	(13,463,378)	(3,483,762)	(501,766)
Sales and marketing	—	(9,736,145)	(197,728)	(28,479)
General and administrative	(33,355)	(755,732)	(970,914)	(139,841)
Impairment on equipment and intangible assets	—	—	(64,057,538)	(9,226,205)
<b>Total operating expenses</b>	(33,355)	(23,955,255)	(68,709,942)	(9,896,291)
<b>Loss from operations</b>	(33,355)	(30,513,444)	(218,841,017)	(31,519,664)
Interest income	—	14,165	6,111	880
Other income and (expenses), net	—	1,461,875	3,661,995	527,437
<b>Loss before income tax benefit</b>	(33,355)	(29,037,404)	(215,172,911)	(30,991,347)
Income tax benefit (expense)	—	6,929,847	(6,929,847)	(998,106)
<b>Net loss for the year</b>	(33,355)	(22,107,557)	(222,102,758)	(31,989,453)
<b>Net income (loss) attributable to:</b>				
Noncontrolling interest	—	91	2	—
System Link Corporation Limited	(33,355)	(22,107,648)	(222,102,760)	(31,989,453)
Currency translation income	—	6,546,512	18,513,488	2,666,497
<b>Total comprehensive loss</b>	(33,355)	(15,561,045)	(203,589,270)	(29,322,956)
<b>Comprehensive income (loss) attributable to:</b>				
Noncontrolling interest	—	99	24	3
System Link Corporation Limited	(33,355)	(15,561,144)	(203,589,294)	(29,322,959)

The accompanying notes are an integral part of these consolidated financial statements.

**SYSTEM LINK CORPORATION LIMITED**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 31, 2015 AND 2016**

	December 31, 2015 RMB	December 31, 2016 RMB	December 31, 2016 US\$ (Note 3)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	16,140,861	268,896	38,729
Accounts receivable	82,178	—	—
Amounts due from a related party	273,316	10,286,241	1,481,527
Advances to suppliers	373,135	2,921	421
Prepayments and other current assets	351,414	168,547	24,276
Valued-added tax recoverable	860,836	1,043,878	150,350
<b>Total current assets</b>	<b>18,081,740</b>	<b>11,770,483</b>	<b>1,695,303</b>
Deferred tax assets	6,929,847	—	—
Property and equipment, net	8,284,643	45,940	6,617
Intangible assets, net	63,384,751	—	—
Other long-lived asset	324,680,000	346,850,000	49,956,791
<b>Total assets</b>	<b>421,360,981</b>	<b>358,666,423</b>	<b>51,658,711</b>
<b>LIABILITIES</b>			
Current liabilities:			
Accounts payable (including accounts payable of the consolidated VIE without recourse to the Group of RMB630,613 and RMB438,926 as of December 31, 2015 and 2016, respectively)	12,578,815	14,165,045	2,040,191
Amounts due to related parties (including amounts due to related parties of the consolidated VIE without recourse to the Group of RMB1,343,088 and RMB4,211,665 as of December 31, 2015 and 2016 respectively)	1,523,790	143,457,748	20,662,214
Deferred revenue (including deferred revenue of the consolidated VIE without recourse to the Group of RMB35,616 and RMB35,461 as of December 31, 2015 and 2016, respectively)	35,616	35,461	5,107
Accrued expenses and other current liabilities (including accrued expenses and other current liabilities of the consolidated VIE without recourse to the Group of RMB1,277,776 and RMB49,396 as of December 31, 2015 and 2016, respectively)	2,684,725	59,404	8,556
<b>Total current liabilities</b>	<b>16,822,946</b>	<b>157,717,658</b>	<b>22,716,068</b>
<b>Total liabilities</b>	<b>16,822,946</b>	<b>157,717,658</b>	<b>22,716,068</b>
<b>SHAREHOLDERS' EQUITY</b>			
Ordinary shares (US\$1,000 par value per share, 12,000 shares issued and outstanding as of December 31, 2015 and 2016)	73,476,548	73,476,548	10,582,824
Additional paid-in capital	346,655,500	346,655,500	49,928,777
Accumulated other comprehensive income	6,546,504	25,059,970	3,609,386
Accumulated deficit	(22,141,003)	(244,243,763)	(35,178,419)
Noncontrolling interest	486	510	75
<b>Total shareholders' equity</b>	<b>404,538,035</b>	<b>200,948,765</b>	<b>28,942,643</b>
<b>Total liabilities and shareholders' equity</b>	<b>421,360,981</b>	<b>358,666,423</b>	<b>51,658,711</b>

The accompanying notes are an integral part of these consolidated financial statements.

**SYSTEM LINK CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
**FOR THE PERIOD FROM MAY 26, 2014 (DATE OF ESTABLISHMENT) TO DECEMBER 31, 2014 AND FOR THE YEARS**  
**ENDED DECEMBER 31, 2015 AND 2016**  
**System Link Corporation Limited shareholder's equity**

	Number of shares	Ordinary shares Amount RMB	Additional paid-in capital RMB	Accumulated other comprehensive income RMB	Accumulated deficit RMB	Equity attributable to System Link Corporation Limited RMB	Noncontrolling interest RMB	Total Equity RMB
<b>Balance as of May 26, 2014 (date of establishment) (Unaudited)</b>	—	—	—	—	—	—	—	—
Capital contribution from shareholders	1	—	—	—	—	—	—	—
Net loss	—	—	—	—	(33,355)	(33,355)	—	(33,355)
<b>Balance as of December 31, 2014 (Unaudited)</b>	1	—	—	—	(33,355)	(33,355)	—	(33,355)
Capital contribution from shareholders	11,999	73,476,548	346,655,500	—	—	420,132,048	387	420,132,435
Currency translation adjustments	—	—	—	6,546,504	—	6,546,504	8	6,546,512
Net income (loss)	—	—	—	—	(22,107,648)	(22,107,648)	91	(22,107,557)
<b>Balance as of December 31, 2015</b>	12,000	73,476,548	346,655,500	6,546,504	(22,141,003)	404,537,549	486	404,538,035
Currency translation adjustments	—	—	—	18,513,466	—	18,513,466	22	18,513,488
Net income (loss)	—	—	—	—	(222,102,760)	(222,102,760)	2	(222,102,758)
<b>Balance as of December 31, 2016</b>	12,000	73,476,548	346,655,500	25,059,970	(244,243,763)	200,948,255	510	200,948,765
<b>Balance as of December 31, 2016 (US\$ except share data, Note 3)</b>	12,000	10,582,824	49,928,777	3,609,386	(35,178,419)	28,942,568	75	28,942,643

**SYSTEM LINK CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE PERIOD FROM MAY 26, 2014 (DATE OF ESTABLISHMENT) TO DECEMBER 31, 2014 AND**  
**FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2016**

	For the period from May 26, 2014 (date of establishment) to December 31, 2014 RMB (Unaudited)	Year ended December 31, 2015 RMB	Year ended December 31, 2016 RMB	Year ended December 31, 2016 US\$ (Note 3)
<b>Cash flows from operating activities:</b>				
Net loss	(33,355)	(22,107,557)	(222,102,758)	(31,989,453)
Adjustments for:				
Depreciation and amortization	—	2,491,735	9,172,942	1,321,179
Deferred tax assets	—	(6,929,847)	6,929,847	998,106
Impairment on equipment and intangible assets	—	—	64,057,538	9,226,205
Exchange gain	—	(1,461,875)	(3,661,995)	(527,437)
Changes in operating assets and liabilities:				
Change in account receivable	—	(82,178)	82,178	11,836
Change in amount due from a related party	—	(273,316)	(10,012,925)	(1,442,161)
Change in prepayments and other current assets	—	(351,414)	182,867	26,338
Change in advances to suppliers	—	(373,135)	370,214	53,322
Change in value-added tax recoverable	—	(860,836)	(183,042)	(26,364)
Change in accounts payable	—	8,538,365	(20,796)	(2,995)
Change in amount due to related parties	—	1,523,790	141,933,958	20,442,742
Change in accrued expenses and other current liabilities	33,355	2,651,370	(2,625,321)	(378,125)
Change in deferred revenue	—	35,616	(155)	(22)
Net cash used in operating activities	—	(17,199,282)	(15,877,448)	(2,286,829)
<b>Cash flows from investing activities:</b>				
Purchases of property and equipment	—	(5,184,679)	—	—
Payment of upfront license fee (Note 7)	—	(324,680,000)	—	—
Purchases of intangible assets	—	(64,936,000)	—	—
Net cash used in investing activities	—	(394,800,679)	—	—
<b>Cash flows from financing activities:</b>				
Capital contribution from shareholders	—	420,132,435	—	—
Net cash provided by financing activities	—	420,132,435	—	—
Effect of foreign exchange rate changes on cash and cash equivalents	—	8,008,387	5,483	790
Net increase (decrease) in cash and cash equivalents	—	16,140,861	(15,871,965)	(2,286,039)
Cash and cash equivalents				
Beginning of the year	—	—	16,140,861	2,324,768
End of the year	—	16,140,861	268,896	38,729
Supplemental disclosure of non-cash investing and financing activities:				
Accrued purchases of property and equipment	—	4,040,450	1,607,026	231,460

The accompanying notes are an integral part of these consolidated financial statements.



**SYSTEM LINK CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE PERIOD FROM MAY 26, 2014 (DATE OF ESTABLISHMENT) TO DECEMBER 31, 2014**  
**(UNAUDITED) AND FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2016**

***I. ORGANIZATION AND NATURE OF OPERATIONS***

The accompanying consolidated financial statements include the financial statements of System Link Corporation Limited (the “Company”), which was incorporated on May 26, 2014 in Hong Kong, its subsidiaries and variable interest entities (“VIE subsidiaries” or “VIE”). The Company, its subsidiaries and VIE subsidiaries are collectively referred to as the “Group”. The Group is principally engaged in the operation of massively multiplayer online games (“MMOGs”) in the People’s Republic of China (“PRC”).

Globe Wealthy Link Limited was incorporated in April 2015 in Hong Kong as a wholly-owned subsidiary of the Company. Oriental Shiny Star Limited was incorporated in June 2015 in Hong Kong as a subsidiary of Globe Wealthy Link Limited with a purpose to hold all the ownership in the capital of Oriental Shiny Star Information Technology (Beijing) Co., Ltd.. In February 2016, Oriental Shiny Star Information Technology (Beijing) Co., Ltd. was incorporated in the PRC as a wholly-owned subsidiary of Oriental Shiny Star Limited with a purpose to control Beijing Zhi Ao Network Technology Co., Ltd. and engage in such activities as the Board may determine from time to time. In October 2015, Beijing Zhi Ao Network Technology Co., Ltd. was incorporated in the PRC as a VIE of Oriental Shiny Star Information Technology (Beijing) Co., Ltd. with a purpose to carry on the business of marketing, operating and distributing Cross Fire 2 in PRC, excluding Taiwan, Hong Kong, and Macau (“Territory”) and such other games as agreed by Beijing Zhi Ao Network Technology Co., Ltd. and Smilegate Entertainment, Inc. from time to time.

The Company’s principal subsidiaries and VIE subsidiaries are as follows as of December 31, 2016:

<u>Name of entity</u>	<u>Date of incorporation</u>	<u>Place of incorporation</u>	<u>Relationship</u>	<u>Legal ownership</u>
Globe Wealthy Link Limited (“Globe Wealthy”)	Apr-15	Hong Kong	Subsidiary	100%
Oriental Shiny Star Limited (“Oriental Shiny”)	Jun-15	Hong Kong	Subsidiary	99.99%
Jiuhuo Qitian Information Technology (Shanghai) Co., Ltd. (“Jiuhuo Qitian”)	Apr-15	PRC	Subsidiary	100%
Shanghai Ao Zhi Network Technology Co., Ltd. (“Shanghai Aozhi”)	Mar-11	PRC	VIE subsidiary	None
Oriental Shiny Star Information Technology (Beijing) Co., Ltd. (“Oriental IT”)	Feb-16	PRC	Subsidiary	99.99%
Beijing Zhi Ao Network Technology Co., Ltd. (“Beijing Zhi Ao”)	Oct-15	PRC	VIE subsidiary	None

## **2. PRINCIPAL ACCOUNTING POLICIES**

### **<1> Basis of presentation**

The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

### **<2> Consolidation**

The consolidated financial statements include the financial statements of the Company, its subsidiaries and VIEs in which it has a controlling financial interest. The results of the subsidiaries are consolidated from the date on which the Company obtained control and continue to be consolidated until the date that such control ceases. A controlling financial interest is typically determined when a company holds a majority of the voting equity interest in an entity. However, if the company demonstrates its ability to control the VIEs through its rights to all the residual benefits of the VIE and its obligation to fund losses of the VIEs then the entity is consolidated. All intercompany balances and transactions between the Company, its subsidiaries and VIEs have been eliminated in consolidation.

PRC laws and regulations currently prohibit or restrict foreign ownership of internet-related business. In September 2009, the General Administration of Press and Publication (“GAPP”) further promulgated the Circular Regarding the Implementation of the Department Reorganization Regulation by State Council and Relevant Interpretation by State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-approval on Online Games and Approval on Import Online Games, or the GAPP Circular. Pursuant to Administrative Measures on Network Publication, or the Network Publication Measures jointly issued by General Administration of Press and Publication Radio, Film and Television (“GRAPPRFT”) and Ministry of Industry and Information Technology (“MIIT”) on February 4, 2016, effective from March 2016, wholly foreign-owned enterprises, Sino-foreign equity joint ventures and Sino-foreign cooperative enterprises shall not engage in the provision of web publishing services, including online game services. Prior examination and approval by GAPPRFT are required on project cooperation involving internet publishing services between an internet publishing services and a wholly foreign-owned enterprise, Sino-foreign equity joint venture, or Sino-foreign cooperative enterprise within China or an overseas organization or individual. It is unclear whether authorities will deem VIEs structure of the Group as a kind of such “manners of cooperation” by foreign investors to gain control over or participate in domestic online game operators, and it is not clear whether GAPPRFT and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China. Therefore, the Group believes that its ability to direct the activities of VIEs that most significantly impact their economic performance is not affected by the GAPP Circular.

### **<3> Use of estimates**

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affected the reported amount of the assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported revenues and expenses during the reported periods. Significant accounting estimates reflected in the Group's consolidated financial statements include the allowance for doubtful accounts and prepayment, revenue recognition, assessment of impairment of other long-lived assets, consolidation of VIEs, valuation allowances for deferred tax assets and contingencies. 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> Foreign currency translation**

The Group's reporting currency is Renminbi ("RMB"). The Group's functional currency is USD.

Transactions denominated in currencies other than functional currencies, are translated into functional currencies at the exchange rates prevailing at the dates of the transactions. Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations and comprehensive loss. The aggregate foreign exchange net gain was nil and RMB1.5 million and RMB3.7 million for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively. Monetary assets and liabilities denominated in foreign currencies are translated into functional currencies using the applicable exchange rates at the balance sheet dates. All such exchange gains and losses are included in other income (expense) in the consolidated statements of operations and comprehensive loss.

### **<5> Cash and cash equivalents**

Cash and cash equivalents represent cash on hand and highly-liquid investments with an original maturity date of three months or less. At December 31, 2016, cash equivalents comprised primarily of bank deposits. Included in cash and cash equivalents as of December 31, 2015 and 2016 are amounts denominated in US Dollar totaling US\$0.1 million and US\$0.04 million, respectively.

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 the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in China's foreign exchange trading system market. The Company's aggregate amount of cash and cash equivalents denominated in RMB amounted to RMB15.8 million and RMB0.01 million as of December 31, 2015 and 2016, respectively.

**<6> Allowance for doubtful accounts**

Accounts receivable mainly consist of receivables from prepaid card distributors and third party game platforms, and are recorded net of allowance for doubtful accounts. The Group determines the allowances for doubtful accounts when facts and circumstances indicate that the receivable is unlikely to be collected. Allowances for doubtful accounts are charged to general and administrative expenses. If the financial condition of the Group's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company provided allowance for doubtful accounts of nil, nil and nil in the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively.

**<7> Prepaid royalties and deferred costs**

Royalties paid to the licensors of games are initially recognized as prepaid royalties when paid and subsequently recognized as deferred costs upon the customers' online registration and activation of their cards or online points. Royalties payable to the licensors or receivable from collection agents upon customers' charging their accounts are initially recorded as deferred costs upon the customers' online registration and activation of their cards or online points. Deferred costs are then ultimately recognized as cost of services in the consolidated statements of operations and comprehensive loss based upon the actual consumption of game premium features or usage of the game playing time by the customers or when the likelihood that the Group would provide further services to those customers becomes remote.

**<8> Property and equipment, net**

Property, equipment and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

Computer and equipment	3 to 4 years
Software	5 years

**<9> Intangible assets, net**

Intangible assets consist primarily of acquired game licenses.

Acquired game licenses are amortized on a straight-line basis over the shorter of the useful economic life of the relevant online game or license period, which range from two to seven years. Amortization of acquired game licenses commences upon the monetization of the related online game.

#### **<10> Impairment of long-lived assets**

The Group evaluates its long-lived assets, including finite-lived intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable or that the useful life is shorter than the Group had originally estimated. The Group assesses the recoverability of the long-lived assets by comparing the carrying amount to the estimated future undiscounted cash flow expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets, the Group would recognize an impairment loss based on the fair value of the assets.

Indefinite-lived intangible assets are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the intangible asset to its carrying amount. If the carrying amount exceeds the fair value, an impairment loss is recognized in an amount equal to that excess. No impairment of long-lived assets has been recorded.

#### **<11>Revenue recognition**

##### *Online game services*

The Group earns revenue from provision of online game operation services to players on the Group's game servers. The Group recognizes revenues when persuasive evidence of an arrangement exists, services are delivered or performed, our price is fixed or determinable and collectability is reasonably assured.

The Group sells its prepaid online points to players. The Group also sells the points directly to players via certain online payment platforms. The Group adopts virtual item / service consumption model for the online game services.

Players can access certain games free of charge, but may purchase game points to acquire in-game premium features. The distribution of points to players is typically made by sales of prepaid game cards and prepaid online points. Fees for prepaid game cards and prepaid online points are deferred when received. Revenue is recognized over the estimated life of the premium features or as the premium features are consumed.

For in-game premium features that are immediately consumed, revenue is recognized upon consumption. For premium features with a stated expiration time, which range from one to 180 days, revenue is recognized ratably over the period starting from when the feature is first used to the expiration time. For perpetual features with no predetermined expiration, revenue is recognized ratably over the estimated average lives of the perpetual features, which are typically less than one year. When estimating the average lives of the in-game perpetual features, the Group considers the average period that players typically play the game, other player behavior patterns, and factors including the acceptance and popularity of expansion packs, promotional events launched, and market conditions. Future usage patterns of players may differ from the historical usage patterns on which the virtual item / service consumption revenue recognition model is based. The Group continually monitors the operational statistics and usage patterns.

#### **<12>Advances from customers and deferred revenue**

Online points that have been sold but not activated are recognized as advances from customers. Online points that have been activated but for which online game services will be rendered in the future are recognized as deferred revenue. Deferred revenue is recognized as income based upon the actual consumption of in-game premium features by players or when the likelihood that the Group would provide further online game service to those customers is remote.

#### **<13>Cost of revenue**

Cost of revenue consists primarily of online game royalties, payroll, depreciation, maintenance and rental of internet data center sites, depreciation and amortization of computer equipment and software, intangible assets amortization and other overhead expenses directly attributable to the services provided.

#### **<14>Product development costs**

For software development costs, including online games, to be sold or marketed to customers, 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 an online game is released, the capitalized product development costs are amortized over the estimated product life. To date, the Group has essentially completed its software development concurrently with the establishment of technological feasibility, and, accordingly, no costs have been capitalized.

For website and internally used software development costs, the Group expenses all costs that are incurred in connection with the planning and implementation phases of development and costs that are associated with repair or maintenance of the existing websites and software. Costs incurred in the application and infrastructure development phase are capitalized and amortized over the estimated product life. Since the inception of the Group, the amount of internally generated costs qualifying for capitalization has been immaterial and, as a result, all website and internally used software development costs have been expensed as incurred.

Product development costs consist primarily of outsourced research and development expenses, payroll, depreciation charge and other overhead expenses for the development of the Group's proprietary games. Other overhead product development costs include costs incurred by the Group to develop, maintain, monitor, and manage its websites.

#### **<15>Sales and marketing expenses**

Sales and marketing expenses consist primarily of advertising and promotional expenses, payroll and other overhead expenses incurred by the Group's sales and marketing personnel. The Group recorded nil, RMB9.7 million and RMB0.2 million (US\$0.03 million) for sales and marketing expenses for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively.

#### **<16>Income taxes**

Current income taxes are provided for in accordance with the laws and regulations applicable to the Group as enacted by the relevant tax authorities. Income taxes are accounted for under the asset and liability method. Deferred taxes are determined based upon differences between the financial reporting and tax bases of assets and liabilities at currently enacted statutory tax rates for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized as income in the period of change. A valuation allowance is provided on deferred tax assets to the extent that it is more likely than not that such deferred tax assets will not be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred tax assets and liabilities.

The Group recognizes the impact of an uncertain income tax position at the largest amount that is more-likely-than not to be sustained upon audit by the relevant tax authority. Income tax related interest is classified as interest expenses and penalties as income tax expense.

### **<17> Certain risks and concentration**

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash and cash equivalents, accounts receivable and prepayments and other current assets. As of December 31, 2016, substantially all of the Group's cash and cash equivalents were held by major financial institutions, which management believes are of high credit worthiness.

### **<18> Fair value measurements**

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability. The fair value measurement guidance provides a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement as follows:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets that the management has the ability to access at the measurement date.

Level 2 inputs include quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable for the asset (i.e., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 inputs include unobservable inputs to the valuation methodology that reflect management's assumptions about the assumptions that market participants would use in pricing the asset. The management develops these inputs based on the best information available, including their own data.

### **<19>Financial instruments**

Financial instruments consist of cash and cash equivalents, accounts receivable and accounts payable. The carrying value of the Group's cash and cash equivalents, accounts receivable and accounts payable approximate their market values due to the short-term nature of these instruments. The Group does not use derivative instruments to manage risks.



## <20> Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued an accounting standard update on revenue recognition that will be applied to all contracts with customers. The update requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance will be required to be applied on a retrospective basis, using one of two methodologies, and will be effective for fiscal years beginning after December 15, 2018, with early application permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Group continues to evaluate the effect of these accounting pronouncements on its financial statements and will adopt this new guidance on January 1, 2018 using the modified retrospective application method.

In February 2015, the FASB issued ASU 2015-02 to respond to stakeholders' concerns about the current accounting for consolidation of certain legal entities. Stakeholders expressed concerns that current generally accepted accounting principles (GAAP) might require a reporting entity to consolidate another legal entity in situations in which the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. Financial statement users asserted that in certain of those situations in which consolidation is ultimately required, deconsolidated financial statements are necessary to better analyze the reporting entity's economic and operational results. Previously, the FASB issued an indefinite deferral for certain entities to partially address those concerns. However, the amendments in this Update rescind that deferral and address those concerns by making changes to the consolidation guidance. The ASU is effective for fiscal years beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The Group is in the process of evaluating the impact of the standard on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, to simplify the presentation of deferred income taxes, which requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Update. The adoption of this guidance did not have a material effect on the Group's financial condition, results of operations and cash flows.

In January 2016, the FASB issued ASU 2016-01, to improve and to achieve convergence of their respective standards on the accounting for financial instruments and enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments in this Update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The Board also is addressing measurement of credit losses on financial assets in a separate project. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Group is in the process of evaluating the impact of the standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, which replaces existing lease guidance. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. The new guidance will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of income. The standard is effective for the Group beginning January 1, 2019, with early application permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented with various optional practical expedients. The Group is currently evaluating the potential effects of this pronouncement.

### ***3. CONVENIENCE TRANSLATION***

The Group maintains its accounting records and prepares its financial statements in RMB. The United States dollar (“US dollar” or “US\$”) amounts disclosed in the accompanying financial statements are presented solely for the convenience of the readers at the rate of US\$1.00 = RMB6.9430, representing the noon buying rate in the City of New York for cable transfers of RMB, as certified for customs purposes by the Federal Reserve Bank of New York, on December 31, 2016. Such translations should not be construed as representations that the RMB amounts represent, or have been or could be converted into, United States dollars at that or any other rate.

### ***4. VARIABLE INTEREST ENTITIES***

#### **<1>Shanghai Ao Zhi**

The Group is the primary beneficiary of a VIE, Shanghai Ao Zhi which was designed by the Group to comply with PRC regulations that prohibit direct foreign ownership of businesses that operate online games in the PRC.

There are a few key contractual arrangements between Jiuhuo Qitian (the “WOFE”) and related VIE that provide the Group with a controlling financial interest over the VIE and upon which the Group concluded that it is required to consolidate these entities pursuant to the guidance in ASC 810.

A summary of the contractual agreements referenced above is as follows:

- 1) **Loan Agreement.** The WOFE entered into loan agreements with each shareholder of the relevant VIE. Pursuant to the terms of these loan agreements, the WOFE granted an interest-free loan to each shareholder of the VIE for the explicit purpose of making a capital contribution to the VIE. The loans have an unspecified term and will remain outstanding for the duration of WOFE or until such time that the WOFE elects to terminate the agreement (which is at the WOFE’s sole discretion) at which point the loans are payable on demand. The shareholders of the VIE may not prepay all or any portion of the loans without the WOFE’s prior written request.
- 2) **Equity Pledge Agreement.** The shareholders of the VIE entered into equity pledge agreements with the WOFE. Under the equity pledge agreements, the shareholders of the VIE pledged all of their equity interests in the VIE to the WOFE as collateral for all of their payments due to the WOFE and to secure performance of all obligations of the VIE and their shareholders under the above loan agreements. In addition, the dividend distributions to the shareholders of VIE, if any, will be deposited in an escrow account over which the WOFE has exclusive control. The pledge shall remain effective until all obligations under such agreements have been fully performed. The shareholder has the obligation to maintain ownership and effective control over the pledged equity. Under no circumstances, without the prior written consent of the WOFE, may the shareholder transfer or otherwise encumber any equity interests in the VIE. If any event of default as provided for therein occurs, the WOFE, as the pledgee, will be entitled to dispose of the pledged equity interests through transfer or assignment and use the proceeds to repay the loans or make other payments due under the above loan agreements up to the loan amounts.
- 3) **Call Option Agreement.** The VIE and their shareholders entered into equity call option agreements with the WOFE. Pursuant to such agreements, the shareholders of the VIE grant the WOFE an irrevocable and exclusive option to purchase the shares of VIE at a purchase price equal to the amount of the registered capital of the VIE or the loan provided by the WOFE, permissible by the then-applicable PRC laws and regulations. WOFE may exercise such right at any time during the term of the agreement. Moreover, under the call option agreements, neither the VIE nor their shareholders may take actions that could materially affect the VIE’ assets, liabilities, operations, equity or other legal rights without the prior written approval of the WOFE, including, without limitation, declaration and distribution of dividends and profits; sale, assignment, mortgage or disposition of, or encumbrances on, the VIE’s equity; merger or consolidation; acquisition of and investment in any third-party entities; creation, assumption, guarantee or incurrence of any indebtedness; entering into other materials contracts. The agreements shall not expire until such time as the WOFE acquires all equity interests of the relevant VIE subject to applicable PRC laws.

- 4) Shareholder Voting Proxy Agreement. Each of the VIE's shareholders executed an irrevocable power of proxy to appoint the WOFE as the attorney-in-fact to act on his or her behalf on all matters pertaining to the VIE and to exercise all of his or her rights as a shareholder of the VIE, including the right to attend shareholders meetings, to exercise voting rights and to appoint directors, a general manager, and other senior management of the VIE. The power of proxy is irrevocable and may only be terminated at the discretion of the WOFE.
- 5) Exclusive Technical Service Agreement. Under the exclusive technical service agreement, the VIE agreed to engage the WOFE as their exclusive provider of technology consulting and other services for a service fee equal to 90% of all operating profit generated by the VIE. According to the relevant PRC rules and regulations, related party transactions should be negotiated at the arm's length basis and apply reasonable transfer pricing methods. However, the determination of service fees is under the sole discretion of the WOFE. These agreements do not have specific clauses on renewal or a term. By virtue of the governance rights the WOFE maintains over the VIE, through the terms of the other agreements noted above, the Company is able to unilaterally renew, extend or amend the service agreements at its discretion.

The Group shall be deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

- a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance; and
- b. The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In determining the Group has "the power to direct the activities of the VIE that most significantly impact the VIE's economic performance," the Group looked to the specific provisions of the Call Option Agreement and Shareholder Voting Proxy Agreement. These agreements, as summarized above, provide the WOFE effective control over all of the corporate and operating decisions of the VIE, and as such, the Group's management concluded that the WOFE has the requisite power to direct the activities of the VIE that most significantly impact the VIE's economic performance. In assessing the Group's obligation to absorb losses, the Group notes that it has funded through the loan agreements all of the entities' share capital and also provides financial support as necessary to the entities through intercompany transactions. The Group's rights to receive economic benefits that are significant to the VIE are embodied firstly in the Equity Pledge Agreements that secure the equity owners' obligations under the relevant agreements, and ascribes to the WOFE all of the economic benefits of the equity interests including rights to any dividends declared. Secondly, the Exclusive Technical Service Agreement further secures the ability of WOFE to receive substantially all of the economic benefits from each of the VIE on behalf of the Group.

In conclusion, because the Group, through its wholly owned subsidiary Jiuho Qitian, has (1) the power to direct the activities of the VIE that most significantly affect the VIE's economic performance and (2) the right to receive benefits from the VIE that could potentially be significant to the VIE, it has been deemed to be the primary beneficiary of the VIE and has consolidated the respective VIE since the date of execution of such agreements.

Shareholders of the VIE may potentially have conflicts of interest with the Company, and they may breach their contracts with the PRC subsidiaries or cause such contracts to be amended in a manner contrary to the interests of the Company. As a result, the Company may have to initiate legal proceedings, which involve significant uncertainty. Such disputes and proceedings may significantly disrupt the Company's business operations and adversely affect the Company's ability to control the VIE. In light of the fact that most of the shareholders of the VIE are directors, officers, shareholders or employees of the Company or the PRC subsidiaries, management is of the view that the risk that misaligned interests may lead to deconsolidation in the foreseeable future is remote and insignificant.

PRC laws and regulations currently limit foreign ownership of companies that provide Internet content services, which include operating online games. In addition, foreign invested enterprises are currently not eligible to apply for the required licenses for operating online games in the PRC. The Company is incorporated in Hong Kong and is considered a foreign entity under the PRC laws. Due to restrictions on foreign ownership of the provision of online games, the Company is dependent on the licenses held by Shanghai Ao Zhi to conduct its online games business through its subsidiary in the PRC. Shanghai Ao Zhi holds the necessary licenses and approvals that are essential for the online game business. Jiuho Qitian has entered into contractual arrangements with Shanghai Ao Zhi for use of its relevant licenses and websites. Shanghai Ao Zhi is principally owned by certain employees of the Group's shareholder. Pursuant to certain other agreements and undertakings, the Company in substance controls Shanghai Ao Zhi. In the opinion of the Company's directors, the Company's current ownership structures and its contractual arrangements with Shanghai Ao Zhi, and its equity owners as well as its operations, are in compliance with all existing PRC laws and regulations. However, there may be changes and other developments in the PRC laws and regulations or their interpretation. Specifically following the recent promulgation of the GAPP Circular, it is unclear whether the authorities will deem our VIE structure and contractual arrangements with Shanghai Ao Zhi as an "indirect or disguised" way by foreign investors to gain control over or participate in domestic online game operators, and challenge our VIE structure accordingly. If the Company, its PRC subsidiary and VIE are found to be in violation of any existing or future PRC laws or regulations, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including requiring the Company to undergo a costly and disruptive restructuring such as forcing the Company to transfer its equity interest in the PRC subsidiaries to a domestic entity or invalidating the VIE agreements. If the PRC government authorities impose penalties which cause the Company to lose its rights to direct the activities of and receive economic benefits from the VIE, the Company may lose the ability to consolidate and reflect in its financial statements the financial condition, and results of operation of the VIE.

## <2> Beijing Zhi Ao

The Group is the primary beneficiary of a VIE, Beijing Zhi Ao which was designed by the Group to comply with PRC regulations that prohibit direct foreign ownership of businesses that operate online games in the PRC.

There are a few key contractual arrangements between Oriental IT (the “WFOE”) and related VIE that provide the Group with a controlling financial interest over the VIE and upon which the Group concluded that it is required to consolidate these entities pursuant to the guidance in ASC 810.

A summary of the contractual agreements referenced above is as follows:

- 1) **Loan Agreement.** The WFOE entered into loan agreements with each shareholder of the relevant VIE. Pursuant to the terms of these loan agreements, the WFOE granted an interest-free loan to each shareholder of the VIE for the explicit purpose of making a capital contribution to the VIE. The loans have an unspecified term and will remain outstanding for the duration of WFOE or until such time that the WFOE elects to terminate the agreement (which is at the WFOE’s sole discretion) at which point the loans are payable on demand. The shareholders of the VIE may not prepay all or any portion of the loans without the WFOE’s prior written request.
- 2) **Equity Pledge Agreement.** The shareholders of the VIE entered into equity pledge agreements with the WFOE. Under the equity pledge agreements, the shareholders of the VIE pledged all of their equity interests in the VIE to the WFOE as collateral for all of their payments due to the WFOE and to secure performance of all obligations of the VIE and their shareholders under the above loan agreements. In addition, the dividend distributions to the shareholders of VIE, if any, will be deposited in an escrow account over which the WFOE has exclusive control. The pledge shall remain effective until all obligations under such agreements have been fully performed. The shareholder has the obligation to maintain ownership and effective control over the pledged equity. Under no circumstances, without the prior written consent of the WFOE, may the shareholder transfer or otherwise encumber any equity interests in the VIE. If any event of default as provided for therein occurs, the WFOE, as the pledgee, will be entitled to dispose of the pledged equity interests through transfer or assignment and use the proceeds to repay the loans or make other payments due under the above loan agreements up to the loan amounts.

- 3) Call Option Agreement. The VIE and their shareholders entered into equity call option agreements with the WOFE. Pursuant to such agreements, the shareholders of the VIE grant the WOFE an irrevocable and exclusive option to purchase the shares of VIE at a purchase price equal to the amount of the registered capital of the VIE or the loan provided by the WOFE, permissible by the then-applicable PRC laws and regulations. WOFE may exercise such right at any time during the term of the agreement. Moreover, under the call option agreements, neither the VIE nor their shareholders may take actions that could materially affect the VIE' assets, liabilities, operations, equity or other legal rights without the prior written approval of the WOFE, including, without limitation, declaration and distribution of dividends and profits; sale, assignment, mortgage or disposition of, or encumbrances on, the VIE's equity; merger or consolidation; acquisition of and investment in any third-party entities; creation, assumption, guarantee or incurrence of any indebtedness; entering into other materials contracts. The agreements shall not expire until such time as the WOFE acquires all equity interests of the relevant VIE subject to applicable PRC laws.
- 4) Shareholder Voting Proxy Agreement. Each of the VIE's shareholders executed an irrevocable power of proxy to appoint the WOFE as the attorney-in-fact to act on his or her behalf on all matters pertaining to the VIE and to exercise all of his or her rights as a shareholder of the VIE, including the right to attend shareholders meetings, to exercise voting rights and to appoint directors, a general manager, and other senior management of the VIE. The power of proxy is irrevocable and may only be terminated at the discretion of the WOFE.
- 5) Exclusive Technical Service Agreement. Under the exclusive technical service agreement, the VIE agreed to engage the WOFE as their exclusive provider of technology consulting and other services for a service fee equal to 90% of all operating profit generated by the VIE. According to the relevant PRC rules and regulations, related party transactions should be negotiated at the arm's length basis and apply reasonable transfer pricing methods. However, the determination of service fees is under the sole discretion of the WOFE. These agreements do not have specific clauses on renewal or a term. By virtue of the governance rights the WOFE maintains over the VIE, through the terms of the other agreements noted above, the Company is able to unilaterally renew, extend or amend the service agreements at its discretion.

The Group shall be deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

- a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance; and
- b. The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In determining the Group has “the power to direct the activities of the VIE that most significantly impact the VIE’ economic performance,” the Group looked to the specific provisions of the Call Option Agreement and Shareholder Voting Proxy Agreement. These agreements, as summarized above, provide the WOFE effective control over all of the corporate and operating decisions of the VIE, and as such, the Group’s management concluded that the WOFE has the requisite power to direct the activities of the VIE that most significantly impact the VIE’ economic performance. In assessing the Group’s obligation to absorb losses, the Group notes that it has funded through the loan agreements all of the entities’ share capital and also provides financial support as necessary to the entities through intercompany transactions. The Group’s rights to receive economic benefits that are significant to the VIE are embodied firstly in the Equity Pledge Agreements that secure the equity owners’ obligations under the relevant agreements, and ascribes to the WOFE all of the economic benefits of the equity interests including rights to any dividends declared. Secondly, the Exclusive Technical Service Agreement further secures the ability of WOFE to receive substantially all of the economic benefits from each of the VIE on behalf of the Group.

In conclusion, because the Group, through its majority owned subsidiary Oriental IT has (1) the power to direct the activities of the VIE that most significantly affect the VIE’s economic performance and (2) the right to receive benefits from the VIE that could potentially be significant to the VIE, it has been deemed to be the primary beneficiary of the VIE and has consolidated the respective VIE since the date of execution of such agreements.

Shareholders of the VIE may potentially have conflicts of interest with the Company, and they may breach their contracts with the PRC subsidiaries or cause such contracts to be amended in a manner contrary to the interests of the Company. As a result, the Company may have to initiate legal proceedings, which involve significant uncertainty. Such disputes and proceedings may significantly disrupt the Company’s business operations and adversely affect the Company’s ability to control the VIE. In light of the fact that one of the Shareholders of the VIE is employee of a subsidiary of the Company, and a majority of the directors of the VIE shall be nominated by the subsidiary of the Company according to the Joint Venture Agreement and other relevant arrangements, management is of the view that the risk that misaligned interests may lead to deconsolidation in the foreseeable future is remote and insignificant. PRC laws and regulations currently limit foreign ownership of companies that provide Internet content services, which include operating online games. In addition, foreign invested enterprises are currently not eligible to apply for the required licenses for operating online games in the PRC. The Company is incorporated in Hong Kong and is considered a foreign entity under the PRC laws. Due to restrictions on foreign ownership of the provision of online games, the Company is dependent on the licenses held by Beijing Zhi Ao to conduct its online games business through its subsidiary in the PRC. Beijing Zhi Ao holds the necessary licenses and approvals that are essential for the online game business. Oriental IT has entered into contractual arrangements with Beijing Zhi Ao for use of its relevant licenses and websites. Pursuant to certain other agreements and undertakings, the Company in substance controls Beijing Zhi Ao. In the opinion of the Company’s directors, the Company’s current ownership structures and its contractual arrangements with Beijing Zhi Ao, and its equity owners as well as its operations, are in compliance with all existing PRC laws and regulations. However, there may be changes and other developments in the PRC laws and regulations or their interpretation. Specifically following the recent promulgation of the GAPP Circular, it is unclear whether the authorities will deem our VIE structure and contractual arrangements with Beijing Zhi Ao as an “indirect or disguised” way by foreign investors to gain control over or participate in domestic online game operators, and challenge our VIE structure accordingly. If the Company, its PRC subsidiary and VIE are found to be in violation of any existing or future PRC laws or regulations, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including requiring the Company to undergo a costly and disruptive restructuring such as forcing the Company to transfer its equity interest in the PRC subsidiaries to a domestic entity or invalidating the VIE agreements. If the PRC government authorities impose penalties which cause the Company to lose its rights to direct the activities of and receive economic benefits from the VIE, the Company may lose the ability to consolidate and reflect in its financial statements the financial condition, and results of operation of the VIE.



The Group has concluded that the aforementioned contractual arrangements are legally enforceable and provide the Group with full control of the VIE. However, the aforementioned contractual arrangements with the VIE and their respective shareholders are subject to risks and uncertainties:

- The VIE or their shareholders could fail to obtain the proper operating licenses or fail to comply with other regulatory requirements. As a result, the PRC government could impose fines, new requirements or other penalties on the VIE or the Group, mandate a change in ownership structure or operations for the VIE or the Group, restrict the VIE or the Group's use of financing sources or otherwise restrict the VIE or the Group's ability to conduct business.
- The aforementioned contractual agreements may be unenforceable or difficult to enforce. The equity pledge agreements may be deemed improperly registered or the VIE or the Group may fail to meet other requirements. Even if the agreements are enforceable, they may be difficult to enforce given the uncertainties in the PRC legal system.
- The PRC government may declare the aforementioned contractual agreements invalid. They may modify the relevant regulation, have a different interpretation of such regulations, or otherwise determine that the Group or the VIE have failed to comply with the legal obligations required to effectuate such contractual arrangements.
- It may be difficult to finance the VIE by means of loans or capital contributions. Loans from our offshore parent company to the VIE must be approved by the relevant PRC government body and such approval may be difficult or impossible to obtain. Because the VIE are domestic PRC enterprises owned by nominee shareholders, the Group is not likely to finance their activities by means of direct capital contributions either.

If the Company, its PRC subsidiary and VIE are found to be in violation of any existing or future PRC laws or regulations, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including requiring the Company to undergo a costly and disruptive restructuring such as forcing the Company to transfer its equity interest in the PRC subsidiaries to a domestic entity or invalidating the VIE agreements. If the PRC government authorities impose penalties which cause the Company to lose its rights to direct the activities of and receive economic benefits from the VIE, the Company may lose the ability to consolidate and reflect in its financial statements the results of operation of the VIE. The Company, however, does not believe such actions would result in the liquidation or dissolution of the Company, the WFOE or VIE.

Summary financial information of the VIE subsidiaries included in the accompanying consolidated financial statements with intercompany balances and transactions eliminated are as follows:

	<u>December 31, 2015</u> RMB	<u>December 31, 2016</u> RMB	<u>December 31, 2016</u> US\$ (Note 3)
Total assets	4,725,371	624,065	89,884
Total liabilities	3,287,093	4,300,785	619,442
	<u>For the year ended December 31, 2015</u> RMB	<u>For the year ended December 31, 2016</u> RMB	<u>For the year ended December 31, 2016</u> US\$ (Note 3)
Revenue	3,613,630	173,897	25,046
Net loss	(8,476,011)	(9,546,837)	(1,375,031)

All VIEs incurred operating loss for the years ended December 31, 2015 and 2016, thus no service fee was charged by WFOE during the years ended December 31, 2015 and 2016, respectively.

The VIEs contributed an aggregate of 100% of the consolidated net revenues for the years ended December 31, 2015 and 2016, respectively. As of the fiscal years ended December 31, 2015 and 2016, the VIEs accounted for an aggregate of 1.1 % and 0.2%, respectively of the consolidated total assets, and 19.5% and 2.7%, respectively of the consolidated total liabilities.

There are no consolidated VIE's assets that are collateralized for the VIE's obligations and can only be used to settle the VIE's obligations.

Relevant PRC laws and regulations restrict the VIE 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 12 for disclosure of restricted net assets.

#### 5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of following:

	<u>December 31, 2015</u>	<u>December 31, 2016</u>	<u>December 31, 2016</u>
	RMB	RMB	US\$ (Note 3)
Property and equipment	9,225,129	10,832,155	1,560,155
Less: accumulated depreciation and amortization	(940,486)	(10,786,215)	(1,553,538)
Net book value	<u>8,284,643</u>	<u>45,940</u>	<u>6,617</u>

Depreciation charges for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016 amounted to nil, RMB0.9 million and RMB2.7 million (US\$0.4 million) respectively.

Due to weaker than expected operating performance of certain games, the Group recognized impairment provisions of nil, nil and RMB7.2 million (US\$1.0 million) for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively.

#### 6. INTANGIBLE ASSETS, NET

Gross carrying amount, accumulated amortization and net book value of the intangible assets as of December 31, 2015 and 2016 are as follows:

	<u>December 31, 2015</u>	<u>December 31, 2016</u>	<u>December 31, 2016</u>
	RMB	RMB	US\$ (Note 3)
Acquired game licenses	64,936,000	64,936,000	9,352,729
Less: Accumulated amortization	(1,551,249)	(8,044,849)	(1,158,699)
Impairment Loss	—	(56,891,151)	(8,194,030)
Net book value of intangible assets subject to amortization	<u>63,384,751</u>	<u>—</u>	<u>—</u>

In August 2014, the Group entered into a license agreement with Red 5 Singapore Pte. Ltd. (“Red 5 Singapore”), a subsidiary of The9 Limited, parent company of a shareholder of the Group, for publishing and operating Firefall for a five-year term in the PRC. The Group paid license fee of US\$10 million in 2015.

Amortization expense related to intangible assets was nil, RMB1.6 million and RMB6.5 million (US\$0.9 million) for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively.

The Group has been monitoring its licensed games that have not been commercially launched, including but not limited to their market acceptance and operational performance in other regions where they are commercially launched and operated by other operators. The Group incorporates these factors into its continuous evaluation of the forecasted results of the respective games and taking into account the Group’s expected commercial launch and cash flows in the evaluation of potential impairment of the carrying value of upfront licensing fees. Based on the Group’s impairment tests, impairment provisions on upfront licensing fees of nil, nil and RMB56.9 million (US\$8.2 million) were recognized in the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively.

## 7. OTHER LONG-LIVED ASSETS

Other long-lived assets are as follows:

	<u>December 31,</u> <u>2015</u> <u>RMB</u>	<u>December 31,</u> <u>2016</u> <u>RMB</u>	<u>December 31,</u> <u>2016</u> <u>US\$</u> <u>(Note 3)</u>
Prepaid license fee	324,680,000	324,680,000	46,763,647
Translation difference	—	22,170,000	3,193,144
<b>Total</b>	<u>324,680,000</u>	<u>346,850,000</u>	<u>49,956,791</u>

In November 2015, the Group entered into a license agreement with Smilegate Entertainment, Inc. (“SG”), a leading Korean game developer, for publishing and operating Cross Fire 2 on an exclusive basis for a five-year term in the PRC. In consideration for the exclusive license, the Group made an upfront payment of US\$50 million and will make additional payments totaling US\$450 million based on certain development and operation milestones of Cross Fire 2.

In August 2015, the Group has entered into a joint venture agreement with SG on establishment of a joint venture company, Oriental Shiny, for the operation of Cross Fire 2. In the event of a successful commercial launch of Cross Fire 2, SG will receive 30% shareholdings in Oriental Shiny. In addition, the Group will share certain percentages of the revenues from Cross Fire 2 to SG after commercial launch.

## 8. TAXATION

### *Hong Kong*

The Group's subsidiaries in Hong Kong did not have assessable profits that were derived in Hong Kong during the years ended December 31, 2016. Therefore, no Hong Kong profit tax has been provided for in the years presented.

### *The PRC*

The Group's subsidiaries and VIE subsidiaries 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 PRC Enterprise Income Tax Law ("EIT Law"), which went into effect as of January 1, 2016. The Group's subsidiaries and VIE subsidiary in the PRC are generally subject to EIT at a statutory rate of 25%.

### *Composition of income tax expense*

The current and deferred portions of income tax expense included in the consolidated statements of operations and comprehensive loss are as follows:

	For the period from May 26, 2014 (date of establishment) to December 31, 2014 RMB (Unaudited)	For the year ended December 31, 2015 RMB	For the year ended December 31, 2016 RMB	For the year ended December 31, 2016 US\$ (Note 3)
Current income tax expense	—	—	—	—
Deferred taxation	—	6,929,847	4,714,121	678,974
Change in valuation allowance	—	—	(11,643,968)	(1,677,080)
Income tax (expense) benefit	—	6,929,847	(6,929,847)	(998,106)

### *Reconciliation of the differences between statutory tax rate and the effective tax rate*

Reconciliation between the statutory EIT rate and the Group's effective tax rate is as follows:

	For the period from May 26, 2014 (date of establishment) to December 31, 2014	For the year ended December 31, 2015	For the year ended December 31, 2016
PRC Statutory EIT rate	25.0%	25.0%	25.0%
Effect of different tax rates in other jurisdictions	—	(0.9%)	(19.5%)
Effect of future tax rate change	—	—	—
Change of prior year deferred tax assets	—	—	(1.5%)
Change of valuation allowance	—	—	(3.9%)
Income not subject to tax and non-deductible expenses, net	(25.0%)	(0.2%)	(0.1%)
Effect of expired net operating loss	—	—	—
Effective EIT rate	<u>—</u>	<u>23.9%</u>	<u>—</u>

*Significant components of deferred tax assets*

	December 31, 2015 RMB	December 31, 2016 RMB	December 31, 2016 US\$ (Note 3)
Temporary differences related to expenses and accruals	528,904	14,763	2,126
Temporary differences related to depreciation, amortization, and impairment of equipment and intangible assets	100,788	2,087,039	300,596
Startup expenses and advertising fee	2,291,276	2,325,029	334,874
Tax loss carry forwards	4,008,879	7,217,137	1,039,484
Deferred tax assets	6,929,847	11,643,968	1,677,080
Less: Valuation allowance	—	(11,643,968)	(1,677,080)
Total deferred tax assets	<u>6,929,847</u>	<u>—</u>	<u>—</u>

The Group considers positive and negative evidence to determine whether some portion or all of the deferred tax assets will be more likely than not realized. This assessment considers, among other matters, the nature, frequency and severity of recent losses, forecasts of future profitability, the duration of statutory carry forward periods, the Group's experience with tax attributes expiring unused and tax planning alternatives. These assumptions require significant judgment and the forecasts of future taxable income are consistent with the plans and estimates the Group is using to manage the underlying businesses. Valuation allowances are established for deferred tax assets based on a more likely than not threshold. The Group's ability to realize deferred tax assets depends on its ability to generate sufficient taxable income within the carry forward periods provided for in the tax law. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry-forward period are reduced. As of December 31, 2016, the Group's PRC subsidiaries had net operating loss carry forwards of RMB28.8 million. The loss carrying forward will begin to expire in 2020. A valuation allowance is provided on deferred tax assets to the extent that it is more likely than not that such deferred tax assets will not be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred tax assets and liabilities. In accordance with the Enterprise Income Tax Law ("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 tax treaty between the PRC and Hong Kong, if the foreign investor is incorporated in Hong Kong and qualifies as the 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. The Group plans to indefinitely reinvest undistributed profits earned after December 31, 2007 from its China subsidiaries in its operations in the PRC. Therefore, no withholding income taxes for undistributed profits of the Company's subsidiaries have been provided as of December 31, 2016.

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. The Group has not recorded any such deferred tax liability attributable to the undistributed earnings of its financial interests in VIE because these entities do not have any accumulated earnings as of December 31, 2016.

The Group made its assessment of the level of authority for each tax position (including the potential application of interests and penalties) based on the tax positions' technical merits, and measured the unrecognized benefits associated with the tax positions. The Group did not have any unrecognized tax benefits as of December 31, 2016. The Group does not anticipate that unrecognized tax benefits will significantly increase or decrease within the next twelve months. For the years ended December 31, 2016, the Group did not have any material interest and penalties associated with its tax positions.

According to PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or withholding agent. The statute of limitations will be extended five years under special circumstances, which are not clearly defined (but an underpayment of tax liability exceeding RMB 0.3 million is specifically listed as a special circumstance). In the case of a related party transaction, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. From inception to 2016, the Group is subject to examination of the PRC tax authorities.

## **9. EMPLOYEE BENEFITS**

The full-time employees of the Company's subsidiaries and VIE subsidiary 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 and comprehensive loss for such employee benefits amounted to nil, RMB2.7 million, RMB1.0 million (US\$0.1 million) for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively. The PRC government is responsible for the medical benefits and ultimate pension liability to these employees.

## **10. RELATED PARTY TRANSACTIONS AND BALANCES**

In August 2014, the Group entered into a license agreement with Red 5 Singapore, a subsidiary of a shareholder of the Group, for publishing and operating Firefall for a five-years term in China. The Group paid license fee of US\$10 million for this license, and the amortization expense amounted to RMB1.6 million and RMB6.5 million (US\$0.9 million) for the years ended December 31, 2015 and 2016, respectively. The royalty payable by the Group to Red 5 Singapore amounted to RMB0.2 million and RMB138.7 million (US\$20 million) as of December 31, 2015 and 2016, respectively.

In 2015, the Group entered into a rental agreement with Beijing Star World Technology Co. Ltd. ("Star World"), a subsidiary of the investor of the Group. According to the agreement, the Group pays a rental fee to Star World for providing the workspace and facility. Net rental charged by to the Group amounted to RMB0.8 million and RMB1.1 million (US\$0.2 million) for years ended December 31, 2015 and 2016, respectively.

In addition, the amount due to certain subsidiaries of a shareholder of the Group amounted to RMB1.5 million and RMB143.5 million (US\$20.7 million) as of December 31, 2015 and 2016, respectively.

## **11. STATUTORY RESERVE**

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 reserved funds. These reserved 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 reserved 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 reserved fund reaches 50% of their registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserved funds can only be used for specific purposes of enterprise expansion and staff bonus and welfare are not distributable as cash dividends. The appropriation to these reserves by the Group's PRC entities were nil, nil and nil for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively. The accumulated reserves as of December 31, 2015 and 2016 are nil and nil, respectively.



## ***12. RESTRICTED NET ASSETS***

In accordance with the regulations in the PRC and their respective articles of association, the subsidiaries and the VIEs of the Group incorporated in the PRC are required to make an appropriation of statutory reserve from retained earnings equal to at least 10% of their respective after-tax profits, calculated in accordance with the PRC accounting standards and regulations. Appropriations are classified in the consolidated balance sheet as statutory reserves and are recorded upon board resolution on the appropriations. Appropriations to these reserves are not required after these reserves have reached 50% of the registered capital of the respective companies.

In addition, at the discretion of the respective boards of directors: (1) the subsidiaries may allocate a portion of their after-tax profit to the enterprise expansion fund or staff welfare and bonus reserve, and (2) the above VIEs may allocate a portion of their respective after-tax profits to discretionary surplus reserve. The use of staff welfare and bonus reserve is restricted to employee welfare benefits and is not available for distribution to equity owners except in liquidation. Appropriations to the staff welfare and bonus reserve are charged to income as general and administrative expense, and any unutilized balance is included in current liabilities.

These statutory reserves are not transferable to the Company in the form of dividends, advances, or loans. There are no legal requirements in the PRC to fund these reserves by transfer of cash to any restricted accounts, and the Group does not do so. PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with PRC accounting standards and regulations. The subsidiaries and the Group's VIEs can only distribute dividends after they have met the PRC requirements for appropriation to statutory reserves. Additionally, as the Company does not have any direct ownership in the VIEs, the VIEs cannot directly distribute dividends to the Company. The appropriation to these reserves by the Group's PRC entities were nil, nil and nil for the period from May 26, 2014 (date of establishment) to December 31, 2014 (unaudited) and for the years ended December 31, 2015 and 2016, respectively. As of December 31, 2015 and 2016, the restricted net assets amounted to nil and nil, respectively.

### **13. COMMITMENTS AND CONTINGENCIES**

#### *13.1 Capital obligations*

In August 2014, the Group entered into a license agreement with Red 5 Singapore for publishing and operating Firefall for a five-year term in China. The Group paid license fee of US\$10 million for this license. Under this license agreement, the Group is committed to pay to Red 5 Singapore at least an additional US\$150 million royalties during the contract period.

Under an agreement dated August 20, 2015, if the Board of the Group decides to start the closed beta testing or commercial launch of Cross Fire 2, Globe Wealthy shall contribute to Oriental Shiny an initial capital of US\$50 million, and additional capital of US\$70 million and US\$180 million after the closed beta testing and commercial launch of Cross Fire 2, respectively. Such capital shall be used to pay the license fee for the initial three years term under the Cross Fire 2 license agreement between Oriental Shiny and SG. In addition, Globe Wealthy will make additional cash contributions to Oriental Shiny as may be necessary for publishing, operating and marketing Cross Fire 2. If the Cross Fire 2 license is extended for two years for an additional license fee of US\$200 million pursuant to the terms of the license agreement, Globe Wealthy will be required to make an additional capital contribution of US\$200 million to Oriental Shiny for the payment of such additional license fee. In the event of a successful commercial launch of Cross Fire 2, SG will receive 30% shareholding in Oriental Shiny.

#### *13.2 Contingencies*

<1> According to the Firefall license agreement with Red 5 Singapore, the Group is obligated to pay the minimum guarantee payment to Red 5 Singapore by the end of each year after the commercial launch of Firefall. Firefall commenced the commercial launch in November 2015. Therefore the Group is obligated to pay the first year minimum guarantee payment of US\$20 million to Red 5 Singapore by November 2016. As of the report date, the Group has not made this payment yet. The Group recorded US\$20 million under current liabilities as of December 31, 2016. As of the report date, the Group cannot assess the likelihood of Red 5 Singapore's potential legal action and the potential loss for the remaining US\$130 million minimum guarantee payment obligation to Red 5 Singapore.

<2> In July 2016, a supplier filed a lawsuit in the court against Jiuhuo Qitian and Shanghai Aozhi for claiming an advertisement fee of RMB1.89 million (US\$0.27 million). In July 2016, another supplier has filed a lawsuit in the court demanding Jiuhuo Qitian to return equipment previously sold with a compensation damage of approximately RMB0.88 million (US\$0.13 million). As of report date, no decision is made by court and the Group has fully recorded the amount under current liabilities as of December 31, 2016. The Group does not believe that any currently pending legal or administrative proceeding to which the Group is a party will have a material adverse effect on the business or financial condition.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated April 7, 2017, with respect to the consolidated financial statements of System Link Corporation Limited, its subsidiaries and its variable interest entities (the "Report") included in the annual report of The9 Limited on Form 20-F for the year ended December 31, 2016. We consent to the incorporation by reference of the Report in the Registration Statements of The9 Limited on Forms S-8 (No. 333-127700, No. 333-156306, No. 333-168780 and No. 333-210693) and Form F-3 (No. 333-210692).

/s/ Grant Thornton  
Shanghai, China  
April 7, 2017

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statements on Form S-8 (No. 333-127700, No. 333-156306, No. 333-168780 and No. 333-210693) and Form F-3 (No. 333-210692) of our report dated April 11, 2016, relating to the consolidated financial statements as of and for the year ended December 31, 2015 of System Link Corporation Limited, its subsidiary and its variable interest entities (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the translation of Renminbi amounts to United States dollar amounts for the convenience of readers in the United States), appearing in this Annual Report on Form 20-F of The9 Limited for the year ended December 31, 2016.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP  
Shanghai, China  
April 7, 2017

April 7, 2017

Securities and Exchange Commission  
100 F Street, N.E. Washington, D.C.  
20549-7561

Dear Sirs/Madams:

We have read Item 16F of The9 Limited's Form 20-F dated April 7, 2017 and have the following comments:

1. We agree with the statements made in the first sentence of paragraph 1 and paragraphs 2 and 4 of Item 16F for which we have a basis on which to comment on, and we agree with, the disclosures.
2. We have no basis on which to agree or disagree with the statements made in sentence 2 of paragraph 1 and paragraph 3 of Item 16F.

Yours faithfully,

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP