

Shanda Games Ltd
Form 20-F
May 25, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F**

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 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, 2010.

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: 001-34454

Shanda Games Limited

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

No. 1 Office Building

No. 690 Bibo Road

Pudong New Area

Shanghai, China 201203

The People's Republic of China

(Address of principal executive offices)

Qunzhao Tan, Chief Executive Officer

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Shanghai, China 201203

The People's Republic of China

Telephone: +(86 21) 5050-4740

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(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

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

Title of Each Class	Name of Each Exchange on Which Registered
Class A ordinary shares, par value US\$0.01 per share	The NASDAQ Stock Market* (The NASDAQ Global Select Market)

* Not for trading, but only in connection with the listing on the NASDAQ Global Select Market of American Depositary Shares representing such Class A Ordinary Shares

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

None

(Title of Class)

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

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 158,302,254 Class A ordinary shares, par value US\$0.01 per share and 409,087,000 Class B ordinary shares, par value US\$0.01 per share

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

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

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

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements that are based on our current expectations, assumptions, estimates and projections about us and our industry. All statements other than statements of historical fact in this annual report are forward-looking statements. These forward-looking statements can be identified by words or phrases such as may, will, expect, anticipate, estimate, plan, believe, is/are likely to or other similar expressions. Forward-looking statements included in this annual report relate to, among others:

- our goals and strategies;
- our future business development, financial condition and results of operations;
- our projected revenues, earnings, profits and other estimated financial information;
- expected changes in our margins and certain costs or expenditures;
- our plans to expand and diversify the sources of our revenues;
- expected changes in the respective shares of our revenues from particular sources;
- our plans for staffing, research and development and regional focus;
- the projected economic lifespan of our current games, and our plans to launch games and to develop new games in-house or license additional games from third parties, including the timing of any such launches, development or licenses;
- our plans for strategic partnerships with other businesses;
- our acquisition strategy, and our ability to successfully integrate past or future acquisitions with our existing operations;
- competition in the PRC online game industry;
- the outcome of ongoing, or any future, litigation or arbitration;
- the outcome of our annual evaluation as to our status as a passive foreign investment company;
- the expected growth in the number of Internet and broadband users in China, growth of personal computer penetration and developments in the ways most people in China access the Internet;
- changes in PRC governmental preferential tax treatment and financial incentives we currently qualify for and expect to qualify for; and
- PRC governmental policies relating to media and the Internet and Internet content providers and to the provision of advertising over the Internet.

These forward-looking statements involve various risks and uncertainties. Although we believe that our expectations expressed in these forward-looking statements are reasonable, we cannot assure you that our expectations will turn out to be correct. Our actual results could be materially different from and worse than our expectations. Important risks and factors that could cause our actual results to be materially different from our expectations are generally set forth in the Risk Factors section of Item 3 and elsewhere in this annual report. The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

CERTAIN CONVENTIONS

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

China or PRC refers to the People's Republic of China, and for the purpose of this annual report, excludes Hong Kong, Macau and Taiwan;

our PRC companies refers to our PRC subsidiaries and our PRC operating companies;

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our PRC operating companies refers to Shanghai Shulong Technology Development Co., Ltd., or Shanghai Shulong, and its wholly-owned subsidiaries, Shanghai Shulong Computer Technology Co., Ltd., or Shulong Computer, Nanjing Shulong Computer Technology Co., Ltd., or Nanjing Shulong, Chengdu Aurora Technology Development Co., Ltd., or Chengdu Aurora, Chengdu Simo Technology Co., Ltd., or Chengdu Simo, Tianjin Youji Technology Co., Ltd., or Tianjin Youji, and Chengdu Youji Technology Co., Ltd., or Chengdu Youji; and Shanghai Hongli Digital Technology Co., Ltd., or Shanghai Hongli;

our PRC subsidiaries refers to Shengqu Information Technology (Shanghai) Co., Ltd., or Shengqu, Shengji Information Technology (Shanghai) Co., Ltd., or Shengji, Lansha Information Technology (Shanghai) Co., Ltd., or Lansha, and Kuyin Software (Shanghai) Co., Ltd.;

reorganization refers to Shanda Interactive's reorganization effective July 1, 2008, pursuant to which Shanda Interactive transferred substantially all of its assets and liabilities related to its online game business to us, as more fully described in Item 7, Major Shareholders and Related Party Transactions Related Party Transactions Transactions and Agreements with Shanda Interactive ;

Shanda Interactive refers to Shanda Interactive Entertainment Limited, a Cayman Islands company and our indirect controlling shareholder, whose ADSs are listed on the NASDAQ Global Select Market under the symbol SNDA , and, unless the context requires otherwise, its subsidiaries and variable interest entities, or VIEs, but excludes Shanda Games and its subsidiaries and VIEs;

Shanda Group refers to Shanda Interactive and its subsidiaries and VIEs and, unless the context requires otherwise, includes Shanda Games and its subsidiaries and VIEs;

Shanda Online refers to Shanda Investment Holdings Limited, a Cayman Islands company wholly-owned by Shanda Interactive, and, unless the context requires otherwise, its subsidiaries, including Shanda Computer (Shanghai) Co., Ltd., or Shanda Computer, and, in the context of describing its operations, also includes its VIEs, including Shanghai Shanda Networking Co., Ltd., or Shanda Networking, Nanjing Shanda Networking Co., Ltd., or Nanjing Shanda, and Shanghai Shengfutong Electronic Business Co., Ltd., or Shengfutong; and

we , us , our company and our refer to Shanda Games, and, unless the context requires otherwise, its wholly-owned subsidiaries, including Shanda Games Holdings (HK) Limited, or Shanda Games (HK), Shanda Games Technology (HK) Limited, and Goldcool Holdings (HK) Limited, collectively, our HK subsidiaries, Shanda Games International (Pte) Ltd., a Singapore company, Goldcool Holdings Limited, a British Virgin Islands company, Mochi Media, Inc., a Delaware corporation, Eyedentity Games, Inc. or Eyedentity, a Korean company, and Shanda Games Korean Investment Limited, a British Virgin Islands company, and its majority-owned subsidiary, Actoz Soft Co., Ltd., a Korean company publicly listed on the Korea Exchange, or Actoz; and our PRC subsidiaries, and in the context of describing our operations, also include our PRC operating companies; when required by the context, references to we , us , our company and our include the online game business Shanda Interactive operated through its various subsidiaries and VIEs from January 1, 2008 to June 30, 2008.

Unless otherwise noted, this annual report contains translations of Renminbi, or RMB, amounts into U.S. dollars at a rate of RMB6.600 to US\$1.00, the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2010, solely for the convenience of the reader. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, or at all.

References in this annual report to the operations of our business, financial condition and results of operations with respect to the period from January 1, 2008 to June 30, 2008 are to Shanda Interactive's online game business operations as conducted by Shanda Interactive's subsidiaries and VIEs prior to the reorganization. References in this annual report to the operations of our business, financial condition and results of operations with respect to the period from July 1, 2008 to December 31, 2010 are to our operations as a standalone company subsequent to the reorganization. The results of operations of Actoz have been consolidated into our results of operations during the periods presented in this annual report.

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Not Applicable

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable

Item 3. KEY INFORMATION**A. SELECTED FINANCIAL DATA**

The following selected consolidated statement of operations data for the three years ended December 31, 2010 and the consolidated balance sheet data as of December 31, 2009 and 2010 have been derived from our audited consolidated financial statements included in this annual report on Form 20-F, which have been audited by PricewaterhouseCoopers Zhong Tian CPAs Limited Company, an independent registered public accounting firm. The report of PricewaterhouseCoopers Zhong Tian CPAs Limited Company on our consolidated financial statements as of December 31, 2009 and 2010 and for each of the three years in the period ended December 31, 2010 is included elsewhere in this annual report on Form 20-F. Our selected consolidated statement of operations data for the year ended December 31, 2007 and our consolidated balance sheet as of December 31, 2007 and 2008 have been derived from our audited consolidated financial statements which are not included in this annual report on Form 20-F. You should read the selected consolidated financial data in conjunction with the consolidated financial statements and the related notes included under Item 18. Financial Statements and Item 5. Operating and Financial Review and Prospects included elsewhere in this annual report on Form 20-F, including without limitation, the notes regarding our acquisitions of Mochi Media, Inc., Goldcool Holdings Limited and Eyedentity Games, Inc. in 2010. Our consolidated financial statements are prepared and presented in accordance with U.S. GAAP. Our historical results do not necessarily indicate our results expected for any future periods.

	For the Year Ended December 31,				
	2007	2008	2009	2010	
	(in millions)				
	RMB	RMB	RMB	RMB	US\$(¹)
Consolidated Statements of Operation and Comprehensive Income Data:					
Net revenues:					
MMORPG revenues ⁽²⁾	1,996.9	2,948.5	4,422.1	4,018.3	608.8
Advanced casual game revenues ⁽³⁾	278.9	355.8	305.6	300.6	45.5
Other revenues ⁽⁴⁾	47.0	72.5	79.0	185.8	28.2
Total net revenues	2,322.8	3,376.8	4,806.7	4,504.7	682.5
Cost of revenues:					
Third parties	(492.0)	(768.3)	(1,049.3)	(1,032.7)	(156.4)
Related parties	(769.1)	(721.1)	(884.2)	(804.5)	(121.9)
Total cost of revenues	(1,261.1)	(1,489.4)	(1,933.5)	(1,837.2)	(278.3)
Gross profit	1,061.7	1,887.4	2,873.2	2,667.5	404.2
Operating expenses:					
Product development	(136.4)	(238.8)	(339.8)	(465.8)	(70.6)
Sales and marketing					
Third parties	(125.4)	(124.4)	(206.7)	(275.3)	(41.7)
Related parties		(80.1)	(226.2)	(226.5)	(34.3)
General and administrative	(175.2)	(287.2)	(366.1)	(367.0)	(55.6)

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Total operating expenses	(437.0)	(730.5)	(1,138.8)	(1,334.6)	(202.2)
Income from operations	624.7	1,156.9	1,734.4	1,332.9	202.0
Interest income	26.3	33.4	26.3	61.7	9.3
Investment income			0.2	0.2	*
Other income, net	28.7	6.1	169.4	215.6	32.7
Income before income tax expenses, equity in earnings (loss) of affiliated companies	679.7	1,196.4	1,930.3	1,610.4	244.0
Income tax expenses	(67.1)	(249.9)	(428.7)	(300.3)	(45.5)
Equity in earnings (loss) of affiliated companies	(13.6)	0.9	(30.0)	(5.4)	(0.8)
Net income	599.0	947.4	1,471.6	1,304.7	197.7
Less: Net income attributable to non-controlling interests	(7.1)	(11.9)	(18.6)	(15.9)	(2.4)
Net income attributable to Shanda Games Limited	591.9	935.5	1,453.0	1,288.8	195.3

* Less than 0.1

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	For the Year Ended December 31,				
	2007	2008	2009	2010	
	RMB	RMB	RMB	RMB	US\$(¹)
Earnings per share data:					
Earnings per share, basic	1.08	1.70	2.61	2.26	0.34
Earnings per share, diluted	1.08	1.70	2.60	2.26	0.34
Earnings per ADS, basic ⁽⁵⁾	2.16	3.40	5.22	4.52	0.68
Earnings per ADS, diluted ⁽⁵⁾	2.16	3.40	5.20	4.52	0.68

	As of December 31,				
	2007	2008	2009	2010	
	RMB	RMB	RMB	(in millions) RMB	US\$(¹)
Consolidated Balance Sheets					
Data:					
Total current assets	904.4	1,582.7	3,297.3	3,394.5	514.3
Total assets	1,857.3	2,444.1	4,327.4	6,779.6	1,027.2
Total current liabilities	606.9	1,178.0	1,261.0	2,142.5	324.6
Total long term liabilities	34.0	30.2	40.9	378.3	57.3
Total liabilities	640.9	1,208.2	1,301.9	2,520.8	381.9
Total Shanda Games Limited shareholders equity	1,001.2	1,097.0	2,819.6	4,020.0	609.1
Non-controlling interests	215.2	138.9	205.9	238.8	36.2
Total equity	1,216.4	1,235.9	3,025.5	4,258.8	645.3
Total liabilities and equity	1,857.3	2,444.1	4,327.4	6,779.6	1,027.2

(1) Translations of RMB into U.S. dollars were made at a rate of RMB6.600 to US\$1.00, the noon buying rate in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2010.

(2) Represents net revenues generated from the operation of MMORPGs in China.

(3) Represents net revenues generated from the operation of advanced casual games in China.

(4) Represents net revenues generated primarily outside of China from game licensing, game operations, and advertising.

(5) Each American Depositary Share, or ADS, represents two Class A ordinary shares.

EXCHANGE RATE INFORMATION

Solely for the convenience of the reader, unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual report were made at a rate of RMB6.600 to US\$1.00, the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2010. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign exchange and through restrictions on foreign trade.

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

Renminbi per U.S. Dollar Noon Buying Rate

	Average⁽¹⁾	Low	High	Period End
2007	7.5806	7.8127	7.2946	7.2946
2008	6.9193	7.2946	6.7800	6.8225
2009	6.8295	6.8176	6.8470	6.6000
2010	6.7696	6.8330	6.6330	6.6000
October 2010	6.6678	6.6912	6.6397	6.6707
November 2010	6.6538	6.6892	6.6330	6.6670
December 2010	6.6497	6.6745	6.6000	6.6000
2011				
January 2011	6.5964	6.6364	6.5809	6.6017
February 2011	6.5761	6.5965	6.5520	6.5713
March 2011	6.5660	6.5743	6.5510	6.5568
April 2011	6.5267	6.5477	6.4900	6.4900
May 2011 (through May 13, 2011)	6.4939	6.4986	6.4915	6.4977

Source: Federal Reserve Statistical Release

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

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B. CAPITALIZATION AND INDEBTEDNESS

Not applicable

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable

D. RISK FACTORS

Risks Relating to Our Business and Our Industry

If we are unable to successfully develop and source new online games, our business prospects, financial condition and results of operations would be materially and adversely affected.

To remain competitive, we must continue to develop and source new online games that appeal to game players. We develop and source new online games through our multi-channel strategy, including in-house development, licensing, investments and acquisitions and co-operation. However, we cannot assure you that we will be successful in executing such strategy. If we fail to do so, our business, financial condition, results of operations and business prospects would be materially and adversely affected. The following summarizes risks relating to our multi-channel strategy.

In-house development of new online games and introduction of expansion packs for our existing online games

We must continue to successfully develop new online games in-house to expand our game portfolio and introduce updates and expansion packs, which are more substantial enhancements than updates, for our existing games to extend the commercial lifespan of our existing games.

Our ability to develop successful new online games in-house will largely depend on our ability to (i) anticipate and effectively respond to changing game player interests and preferences and technological advances in a timely manner, (ii) attract, retain and motivate talented online game development personnel and (iii) execute effectively our online game development plans. In-house development requires a substantial initial investment prior to the launch of a game, as well as a significant commitment of future resources to produce updates and expansion packs.

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

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

We license many of our online games, including some of our most popular games, from third parties. In 2009 and 2010, we derived approximately 69.1% and 60.5% of our net revenues, respectively, from online games that were licensed from third parties. We must maintain good relationships with our licensors to ensure the continued smooth operation of our licensed games. Additionally, we depend upon our licensors to provide technical support necessary for the operation of the licensed games, as well as updates and expansion packs that help to sustain interest in a game. Moreover, certain marketing activities often require the consent of our licensors. Finally, our licenses may be terminated upon the occurrence of certain events, such as a material breach by us. Only some of our license agreements allow us to automatically extend the term of the license without renegotiating with the licensors. We may want to extend a license upon its expiration but may not be able to do so on terms acceptable to us or at all. Our licensors may also demand new royalty terms that are unacceptable to us. Our ability to continue to license our online games and to maintain good relationships with our licensors also affect our ability to license new games developed by the same licensors.

Table of Contents***Investments in and acquisitions of other businesses that we believe may benefit our business***

We intend to continue to invest in or acquire other businesses that complement our business or games that we believe may benefit us in terms of game player base or game portfolio. For example, in 2010, we acquired Eyedentity Games, Inc. or Eyedentity, which is a Korea-based online game developer; Goldcool Holdings Limited, or Goldcool, which is a Shanghai-based online game developer and operator; and Mochi Media, Inc., or Mochi Media, which operates a leading platform for distributing and monetizing browser-based mini-casual games worldwide. Our ability to grow through investments and acquisitions will depend on the availability of suitable candidates at an acceptable cost and our ability to consummate such transactions on commercially reasonable terms, as well as our ability to obtain any required governmental approvals. The identification and completion of these transactions may also require us to expend significant management and other resources. Moreover, the benefits of an investment or acquisition may take considerable time to materialize, and we cannot assure you that any particular transaction will achieve the intended benefits. Future acquisitions could also expose us to potential risks, including those associated with the integration of new operations, technologies and personnel, unforeseen or hidden liabilities, the inability to generate sufficient revenues to offset the costs and expenses of the acquisitions and potential loss of, or harm to, our relationships with employees, customers, licensors and other suppliers as a result of integration of new businesses.

Sourcing of new online games through co-operation

We co-operate certain games in China under nonexclusive licenses granted by third-party Chinese developers who also operate those same games on their own platform. We must maintain good relationships with our co-operators to ensure the continued smooth development or operation of our co-operated games. Our ability to co-operate successful online games also depends on the availability of co-operation partner candidates.

We depend substantially on two massively multi-player online role-playing games, or MMORPGs, which accounted for approximately 78.2% and 66.8% of our net revenues in 2009 and 2010, respectively, and have finite commercial lifespans.

Two of our MMORPGs, namely Legend of Mir II, or Mir II, and The World of Legend, or Wool, including their sequels, contributed approximately 56.4% and 21.8% of our net revenues, respectively, in 2009 and 45.7% and 21.1% of our net revenues, respectively, in 2010. Even though we expect the percentage of our net revenues generated from Mir II and Wool to decrease as net revenues from our other games, such as Dragon Nest, increase, we expect to continue to derive a substantial portion of our net revenues from these games in the near term. Thus, our business prospects, financial condition and results of operations would be materially and adversely affected by any factor that contributes to a decline in revenues from Mir II or Wool, including:

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

For example, in the fourth quarter of 2009, we introduced an expansion pack in Mir II which was not well received by the game's users and led to some of the game's users reducing the amount of virtual items they purchased in the game. Primarily as a result of the introduction of that expansion pack, our net revenues in the first quarter of 2010 decreased by approximately 14% quarter-over-quarter. See also Risks Relating to Our ADSs The price of our ADSs has been volatile historically and may continue to be volatile, which may make it difficult for holders to resell the ADSs when desired or at attractive prices.

As with other online games, Mir II and Wool have finite commercial lifespans. We believe that Mir II and Wool, which we launched in 2001 and 2003, respectively, are in the more mature stages of their commercial lifespan. While we believe we will be able to extend the commercial lifespan of Mir II and Wool by enhancing, expanding and upgrading Mir II and Wool to include new features that appeal to existing players and attract new players, we cannot assure you that revenues from these games will not decline in the future as a result of the games reaching the end of their commercial lifespan. If we are not able to extend the commercial lifespan of Mir II and Wool, our business prospects, financial condition and results of operations may be materially and adversely affected.

Our new games may not be commercially successful, and we may fail to launch new games according to our timetable, or at all.

In order to remain competitive, we must introduce new online games that are attractive to our game players and can generate additional revenues and diversify our revenue sources. We cannot assure you that the new online games we launch will be commercially successful, and you should not use the success of our existing games as an indication of the future commercial success of any of the online games in our pipeline. A number of factors, including technical difficulties, insufficient game development personnel, a lack of marketing or other resources or acceptance of or interest in the new games among game players during the testing phase and adverse developments in our relationship with the licensors of our new licensed games, could result in delays in launching or prevent us from launching our new games. In addition, there are many factors that could adversely affect the popularity of our new games, including our abilities to anticipate and adapt to future technical trends, new business models and changed game player preferences and requirements, to plan and organize marketing and promotional activities, and to differentiate our new games from our existing games and other games offered by other companies. If we fail to launch new games according to our timetable or at all or if our new games are not commercially successful, our business prospects and results of operations would be materially and adversely affected and we may not be able to recover our game sourcing or development costs, which can be significant.

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Our new games may attract game players away from our existing games, which may have a material adverse effect on our business, financial condition and results of operations.

Our new online games may attract game players away from our existing games and shrink our existing games player base, which could in turn make those existing games less attractive to other game players, resulting in decreased revenues from our existing games. Players of our existing games may also spend less money to purchase virtual items in our new games than they would have spent if they had continued playing our existing games. In addition, our game players may migrate from our existing games with a higher profit margin to new games with a lower profit margin. The occurrence of any of the foregoing could have a material and adverse effect on our business, financial condition and results of operations.

Changes or adjustments we make to our existing or new games may not be well received by our game players.

As we develop new online games or introduce updates and expansion packs to our existing games, we closely monitor our game players tastes and preferences and may introduce or change certain game features or game play styles to make our games more attractive. We cannot assure you that these changes or adjustments will be well received by our game players, who may decide not to play the new game or cease playing the existing games. For example, in the fourth quarter of 2009, we introduced an expansion pack in Mir II which was not well received by the game's users and led to some of the game's users reducing the amount of virtual items they purchase in the game. As a result, any changes or adjustments we make to existing or new games may adversely impact our revenues and business prospects.

There are risks that the revenue models we adopt for our online games may not be suitable.

We currently operate substantially all of our online games using the item-based revenue model and have generated, and expect to continue to generate, a substantial majority of our revenues using this revenue model. Although we have adopted the item-based revenue model for substantially all of our online games, it may not be the best revenue model for our games. The item-based revenue model requires us to develop or license online games that not only attract game players to spend more time playing, but also encourage them to purchase virtual items. The sale of virtual items requires us to track closely game players tastes and preferences, especially as to in-game consumption patterns. If we fail to develop or offer virtual items which game players purchase, we may not be able to effectively convert our game player base into paying users. In addition, the item-based revenue model may cause additional concerns from PRC regulators who have been implementing regulations designed to reduce the amount of time that the Chinese youth spend on online games and intended to limit the total amount of virtual currency issued by online game operators and the amount purchased by an individual game player. A revenue model that does not charge for playing time may be viewed by the PRC regulators as inconsistent with this goal. Furthermore, we may change the revenue model for some of our online games if we believe the existing revenue models are not optimal. We cannot assure you that the revenue model that we have adopted for any of our online games will continue to be suitable for that game, or that we will not in the future need to switch our revenue model or introduce new revenue model for that game. A change in revenue model could result in various adverse consequences, including disruptions of our game operations, criticism from game players who have invested time and money in a game and would be adversely affected by such a change, decreases in the number of our game players or decreases in the revenues we generate from our online games.

Our business could suffer if we do not successfully manage our current growth and potential future growth.

To execute our growth strategies, we anticipate that we will need to manage and supervise our current game portfolio, as well as develop and source additional games. We also will need to continue to expand, train, manage and motivate our workforce, and manage our relationships with our game licensors, co-operators, game players and third-party service providers. In addition, we need to implement various new or upgraded operational and financial systems, procedures and controls and to improve our accounting and other internal management systems, all of which will require substantial management efforts and financial resources and may divert our management's attention from running our business or otherwise harm our operations. We cannot assure you that we will be able to efficiently or effectively implement our growth strategies or manage our growth, and any failure to do so may limit our future growth and hamper our business strategy.

Table of Contents***There are risks associated with our pursuit of growth through acquisitions and strategic investments.***

In recent years we have pursued, and in the future we may continue to pursue, growth through acquisitions and strategic investments. In general, these acquired or invested companies either own intellectual property rights relating to online games or operate a network for the distribution of our online games. For example, between 2005 and 2007, Shanda Interactive completed a series of purchases in privately negotiated transactions and open market purchases, pursuant to which Shanda Interactive acquired a majority stake of the outstanding shares of Actoz, the co-owner of the intellectual property rights to Mir II. In addition, we acquired in 2007 Chengdu Aurora, which owns the intellectual property rights to Funygun Online, in 2009 Chengdu Simo, which owns the intellectual property rights to Luvinia Online and in 2010 Goldcool, which owns the intellectual property rights to numerous MMORPGs, including Hades Realm I and II, Zodiac Tales, and Dukes and Lords; Eyedentity, which owns the intellectual property rights to Dragon Nest; and Mochi Media. Our acquisition of these companies entails a number of other risks that could materially and adversely affect our business and results of operations, including an inability to realize the synergies contemplated at the time of executing these transactions, difficulties integrating the acquired company's personnel, operations, technologies or products into our existing business, the need for financial resources above our planned investment levels, unknown and unforeseen assumed liabilities, the diversion of management resources from other strategic and operational issues, the inability to retain the key employees of the acquired companies, and the potential write-offs of acquired assets and goodwill, as well as potential expenses related to the amortization of intangible assets. See also

Risks Relating to Our Business and Our Industry We may need to record impairment charges to earnings if our acquisition goodwill, investments in affiliate companies or acquired intangible assets are determined to be impaired, which would adversely affect our results of operations. If we are unable to generate significant amounts of revenue from the acquired companies, we may suffer financial losses as a result of the acquired company's on-going operating expenses, expenses related to the amortization of intangible assets from the acquisition, and additional share-based compensation expenses related to the acquisition. Our failure to address the risks associated with our acquisition of these companies may have a material adverse effect on our financial condition and results of operations.

We face risks associated with the licensing of our games internationally, and if we are unable to effectively manage these risks, our ability to expand our business internationally could be impaired.

As of March 31, 2011, we had licensed 15 online games to game operators in a number of countries or regions. We plan to further license our existing and new games in more countries and regions.

Licensing our games in the international markets exposes us to a number of risks, including:

- identifying and maintaining good relations with game operators who are knowledgeable in, and can effectively distribute and operate our games in, international markets;
- negotiating licensing agreements with game operators on terms that are commercially acceptable to us and enforcing the provisions of those agreements;
- developing games, updates and expansion packs catering to overseas markets and renewing our license agreements with game operators upon expiration;
- maintaining the reputation of our company and our games, given that our games are operated by game operators in the international markets with different standards;
- protecting our intellectual property rights overseas and managing the related costs;
- receiving and auditing the royalties we are entitled to receive;
- complying with the different commercial and legal requirements of the international markets in which our games are offered, such as game import regulatory procedures, taxes and other restrictions and expenses; and managing our foreign currency risks.

If we are unable to manage these risks effectively, our ability to license our games overseas may be impaired, which may materially and adversely affect our business, financial conditions and results of operations would be materially and adversely affected.

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

We cannot be certain that in-house developed, licensed or co-operated online games or other content posted on our website do not and will not infringe upon patents, copyrights, trademarks or other intellectual property rights held by third parties. As of March 31, 2011, 12 of the games we operated were developed in-house, 11 were licensed from third parties, 10 were invested in or acquired from third parties and three were co-operated with a third party. We or any of our licensors, co-operators or online game developers and operators in which we have invested through 18 Capital may be perceived or alleged to infringe upon patents, copyrights, trademarks or other intellectual property rights held by third parties and become subject to legal proceedings and claims from time to time relating to the intellectual property rights of others. For example, in 2003, Actoz and Wemade Entertainment Co., Ltd. filed a lawsuit against Shanda Interactive in the Beijing First Intermediate People's Court alleging copyright infringement and unfair competition claims with respect to Wool. These claims were settled in February 2007.

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If we, our licensors, co-operators or online game developers and operators in which we have invested through 18 Capital are found to have violated the intellectual property rights of others, we may be subject to monetary damages and be enjoined from using such intellectual property, or we may incur new or additional licensing costs if we wish to continue using the infringing content, be forced to develop or license alternatives or be forced to stop operating a game, any of which may materially and adversely affect our business and results of operations. In addition, we may incur substantial expenses and require significant attention of management in defending against these third-party infringement claims, regardless of their merit.

Some of our employees were previously employed at other companies, including some of our current and potential competitors. To the extent these employees or any employees we may hire in the future are involved in research that is similar to the research that they performed at their former employers, our competitors may file lawsuits or initiate proceedings against us alleging that these employees violated the intellectual property rights, such as trade secret rights, of their former employers. Although we are not aware of any pending or threatened claims alleging these types of violations of intellectual property rights, if any such claim arises in the future, litigation or other dispute resolution proceedings may be necessary to retain our ability to offer our current and future games, which could be costly and divert financial and management resources.

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

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

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

For instance, pirate game servers illegally operate unauthorized copies of our online games and enable players to play those games without purchasing prepaid cards for our online games. Despite our efforts to shut down pirate game servers, we believe that a significant number of pirate game servers continue to operate unauthorized copies of our online games. If pirate game servers continue to operate any of our online games, our business, financial condition and results of operations may be materially and adversely affected.

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

Our business may be materially harmed if our online games are not featured prominently in a sufficient number of Internet cafes in China.

We believe a substantial number of game players access our games through Internet cafes in China. Due to limited hardware capacity, Internet cafes generally feature a limited number of games on their computers. We thus compete with a growing number of online game operators to have our online games featured on these computers. This competition has intensified in China due to a nationwide suspension of approval for the establishment of new Internet cafes in 2007. See [Risks Relating to Regulation of Our Business and to Our Structure](#). The PRC government has tightened its regulation of Internet cafes, which are currently one of the primary venues for our users to play online

games. Intensified government regulation of Internet cafes could restrict our ability to maintain or increase our revenues and expand our game player base. If we fail to feature our games prominently and sufficiently in Internet cafes in China or fail to do so in a cost-effective manner, our business, financial condition and results of operations may be materially and adversely affected.

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We depend on certain VIEs of Shanda Online to provide services that are critical to our business. The termination of either or both of these service agreements or any failure of or significant quality deterioration in these services could have a material adverse effect on our business, financial condition and results of operations.

We have engaged Shanda Networking and Shengfutong to provide certain services that are critical to our business, including, among others, online billing and payment, user authentication, customer service, anti-fatigue compliance, prepaid card marketing and distribution and data support services for a period of five years commencing July 1, 2008. For additional details on our agreements and the fees that we pay to Shanda Networking and Shengfutong, see Item 7,

Major Shareholders and Related Party Transactions Related Party Transactions Transactions and Agreements with Shanda Interactive.

Since we do not control either Shanda Networking or Shengfutong, and because we depend on Shanda Networking and Shengfutong for the provision of services that are critical to the operation of our online game business, we face certain risks with respect to our arrangements with such entities. If Shanda Networking or Shengfutong breaches its respective obligations under the respective agreements, terminates these agreements, or refuses to renew these agreements on terms acceptable to us or at all, we may not be able to find a suitable alternative service provider or be able to establish our own integrated service platform or distribution network in a timely manner. Similarly, if we breach the terms of the agreements, Shanda Networking or Shengfutong could terminate these agreements and halt services that are critical to our business. Termination of either or both of these agreements could have a material adverse effect on our business, financial condition and results of operations.

Any failure of or significant quality deterioration in Shanda Networking's integrated service platform could materially and adversely affect our business. For example, we rely on Shanda Networking's customer service representatives as the first point of contact to serve our game players. Shanda Networking handles customer requests such as providing account settlement-related services, retrieving forgotten passwords and recovering lost user accounts, and liaises with our game management team if the inquiries involve game-related technical problems, such as recovering virtual items and in-game characters. We also rely on Shanda Networking to provide user authentication services for our game players who access our games through Shanda Networking's integrated service platform. If Shanda Networking fails to address customer service requests properly and in a timely manner, our game players may be unable to access our games or attribute any unpleasant experience with Shanda Networking's customer service to us, which could harm our reputation. As a result, we may fail to retain existing and attract new game players and our business, financial condition and results of operations could be materially and adversely affected.

Furthermore, we rely on Shengfutong to provide prepaid card distribution services. Shengfutong relies heavily on a distribution network composed of third-party distributors for its sales of prepaid cards to game players. As Shengfutong does not enter into long-term agreements with any of its distributors, there can be no assurance that Shengfutong will be able to continue to maintain favorable relationships with them. If Shengfutong fails to maintain a stable and efficient distribution network or if there is any failure of or significant quality deterioration in Shengfutong's distribution services, our game players may be unable to purchase prepaid cards for our games, and as a result, we may fail to retain existing and attract new game players, and our business, financial condition and results of operations could be materially and adversely affected.

Shanda Networking provides integrated platform services to some of our competitors, which may have a material adverse effect on our business.

Shanda Networking provides integrated platform services to other online game companies that compete with us, including Giant Interactive Group Inc., or Giant Interactive, Kingsoft Corporation Limited, or Kingsoft, The9 Limited, or The9, Renren Inc., LineKong Entertainment Technology Co. Ltd., and Suzhou Snail Electronics Co. Ltd., and may enter into additional similar commercial relationships with other online game companies. These commercial relationships may strengthen these online game companies' market share and enable them to achieve market acceptance of their game and services, which may have a material adverse effect on our business. In particular, the online games that our competitors offer through Shanda Networking's integrated service platform may attract away players of our games and shrink our games' player base, which could in turn make our games less attractive to other players. Furthermore, if our current game players spend money to play or purchase virtual items in our competitors' games offered through Shanda Networking's integrated service platform that would otherwise have been spent on our

games, our business, financial conditions and results of operations could be materially and adversely affected.

We could be liable for any failure, service interruption or security breach of Shanda Networking's online payment platform, and the reduction in sales made through those channels may have a material adverse impact on our revenues.

Currently, we rely on the online payment system on Shanda Networking's integrated service platform for all of our direct sales of our virtual prepaid cards to our game players. Secured transmission of confidential information, such as game players' credit card numbers and expiration dates, personal information and billing addresses over public networks, is essential to maintaining consumer confidence in such payment channels and to allowing us to collect payments on a timely basis. We expect that an increasing amount of the direct sales of prepaid cards will be conducted over the Internet as a result of the growing use of online payment systems. As a result, associated online crime will likely increase as well and we cannot assure you that Shanda Networking's current security measures and those of the third parties with whom Shanda Networking transacts business are adequate. Security breaches of these online payment systems could result in non-collection of payments, expose us to litigation and possible liability for failing to protect confidential game player information and could harm our reputation and our ability to retain existing and attract new game players and to encourage the consumption of our online games by game players.

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We face the risks of uncertainties in the growth of the online game industry and market acceptance of our online games.

The growth of this industry and the level of demand and market acceptance of our online games are subject to a high degree of uncertainty. Our results of operations will depend on factors beyond our control, including:

- the growth rate in the number of users of personal computers, Internet and broadband in China and other markets in which our online games are offered;
- whether the online game industry, particularly in China and the rest of the Asia-Pacific region, continues to grow and the rate of any such growth;
- changes in consumer demographics, tastes or preferences;
- the popularity and price of new online games and virtual items that we and our competitors launch and distribute;
- our ability to timely upgrade and improve our existing games to extend their commercial lifespan and to maintain or expand their market share in the online game industry;
- the availability and popularity of other forms of entertainment, particularly console system games such as those made by Microsoft, Nintendo and Sony, which are already popular in many other countries and may gain popularity in China and other countries or regions in which we market our online games; and
- general economic conditions, particularly economic conditions that impact the level of discretionary consumer spending.

There is no assurance that online games, such as MMORPGS, will continue to be popular in China or elsewhere. Because we expect to rely on MMORPGs as the primary source of our revenues, a decline in the popularity of online games in general, or the MMORPGs that we operate, would adversely affect our business prospects and results of operations.

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

China's online game industry is evolving rapidly. We need to adapt to new industry trends, including changes in game players' preferences, new revenue models, new game content distribution models, new technologies and new governmental regulations. We evaluate these changes as they emerge and strive to adapt our business and operations in order to maintain and strengthen our leadership in the industry. If we are unable to do so successfully or fall behind in adopting new technologies or standards, our existing online games may lose popularity, and the games in our pipeline may not be well received by our game player base, which may have a material adverse effect on our business, financial condition and results of operations.

We face significant competition which could reduce our market share and materially and adversely affect our business, financial condition and results of operations.

The online game industry in China is highly competitive. In recent years, numerous competitors have entered the online game industry in China. We expect more companies to enter the market and we expect a wider range of online games to be introduced to China. Competition from other online game operators, both based in China as well as overseas, is likely to increase in the future. Other online game operators or developers, such as China-based Changyou.com Limited, Giant Interactive, Kingsoft, KongZhong Corporation, NetDragon Websoft Inc., NetEase.com, Nineyou International Limited, Perfect World Co., Ltd., Tencent Holdings Limited, and The9, as well as international game developers, such as Activision Blizzard, Inc., Electronic Arts Inc., NCSoft Corporation, Nexon Corporation, NHN Corp. and Webzen, Inc., are our current or potential future competitors. As the online game industry in China is constantly evolving, our current or future competitors may compete more successfully as the industry matures. In particular, any of these competitors may offer products and services that provide significant performance, price, creativity or other advantages over those offered by us. These products and services may weaken our brand name and achieve greater market acceptance than ours. In addition, even if we are successful in launching new online games, competitors may launch similar online games which compete for potential game players. Furthermore, any of our current or future competitors may be acquired by, receive investments from or enter into other strategic or commercial relationships with larger, more established and better financed companies and therefore, obtain significantly greater financial, marketing and game licensing and development resources than us. In addition, increased competition in the online game industry in China could make it difficult for us to retain existing players and

attract new players. Moreover, we may face competition from console systems that have achieved significant success in markets other than China but have yet to be permitted to be sold legally in China due to regulatory and other reasons. If these console systems, many of which are strengthening their online game features, are permitted to be sold in China, we may face additional competition. We also compete with other forms of entertainment, such as television and movies. If we are unable to compete effectively, our business, financial condition and results of operations would be materially and adversely affected.

Table of Contents***We depend on our key personnel, and our business and growth prospects may be severely disrupted if we lose their services or are unable to attract new key employees.***

Our future success is heavily dependent upon the continued service of our key executive officers and other key employees. In particular, we rely on the expertise, experience and leadership ability of Mr. Qunzhao Tan, our chairman and chief executive officer, as well as the co-founder of our business, Mr. Tianqiao Chen, our director, the chairman of Shanda Interactive and the co-founder of our business, Mr. Hai Ling, our president, Mr. Richard Wei, our chief financial officer, Mr. Xiangdong Zhang, our chief producer, Mr. Jisheng Zhu, our chief technology officer and acting chief operating officer, and William Chen, our vice president. We also rely on a number of key technology officers and staff for the development and operation of our online games. In addition, as we expect to focus increasingly on the development of our own online games, we will need to continue attracting and retaining skilled and experienced online game development personnel to maintain our competitiveness.

If one or more of our key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all and may incur additional expenses to recruit and train new personnel, our business could be severely disrupted, and our financial condition and results of operations could be materially and adversely affected. We do not maintain key-man life insurance for any of our key personnel. In addition, if any of our executive officers or key employees joins a competitor or forms a competing company, we may lose know-how, trade secrets, suppliers and key professionals and staff. All of our employees, including each of our executive officers and key employees, have entered into an employment agreement with us, which contains customary non-compete provisions. Although non-compete provisions are generally enforceable under PRC laws, PRC legal practice regarding the enforceability of such provisions is not as well-developed as those in countries such as the United States. Thus, if we are required to enforce our rights under the non-compete provisions, we cannot assure you that a PRC court would enforce such provisions. Furthermore, since the demand and competition for talent is intense in our industry, particularly for online game development personnel and related technical personnel, we may need to offer higher compensation and other benefits in order to attract and retain key personnel in the future, which could increase our compensation expenses. We cannot assure you that we will be able to attract or retain the key personnel that we will need to implement our strategies and achieve our business objectives.

The global financial and economic crisis, particularly the slowdown in the Chinese economy, may adversely affect our business, results of operations and financial condition.

The global financial markets have experienced significant disruptions recently, and most of the world's major economies entered into recession. The growth of China's economy experienced a slowdown after the second quarter of 2007, when the quarterly growth rate of China's gross domestic product reached 11.9%, slowing to as low as 6.2% for the first quarter of 2009. Although the growth rate of China's gross domestic product accelerated and reached 11.9% in the first quarter of 2010, the growth rate slowed down to 9.7% in the first quarter of 2011. It is uncertain whether China's recent recovery in economic growth is sustainable and whether the slower growth that China's economy experienced in 2008 and 2009 could return in the near future. Since we currently derive substantially all of our revenues from game players in China, if our game players reduce the amount they spend on our online games due to any prolonged slowdown in the Chinese economy, our business, operating results and financial condition may be adversely affected. In addition, our plan to expand our business internationally may be adversely affected by an economic downturn in the countries or regions where we license or intend to license our online games.

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

The online game industry is subject to rapid technological change. We need to anticipate the emergence of new technologies and assess their market acceptance. In addition, government authorities or industry organizations may adopt new standards that apply to game development. We also need to invest significant financial resources in product development to keep pace with technological advances. However, development activities are inherently uncertain, and our significant expenditures on technologies may not generate corresponding benefits. If we fall behind in adopting new technologies or standards, our existing games may lose popularity, our new games may not be well received by our game players, and we may incur significant cost overrun in product development, any of which would materially and adversely affect our business prospects and results of operations.

Errors or defects in our online games and the proliferation of cheating programs could materially and adversely affect our business prospects and results of operations.

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

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

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

Major risks involved in such network infrastructure include:

any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures which may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware; and

any disruption or failure in the national backbone network, which would prevent our players outside Shanghai from logging on to any of our games, or playing games for which the servers are all located in Shanghai.

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

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

Although there are private sector Internet service providers in China, almost all access to the Internet is maintained through state-owned telecommunications operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or the MIIT. We rely on this infrastructure to provide data communications capacity primarily through local telecommunications lines and wireless telecommunication networks. Although the PRC government has announced plans to develop aggressively the national information infrastructure, we cannot assure you that this infrastructure will be developed as planned or at all. In addition, we have no access to alternative networks and services on a timely basis, if at all, in the event of any infrastructure disruption or failure, which could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

We acquire or invest in companies whose businesses supplement our business and license online games from third parties. We record acquisition goodwill, investments in affiliate companies and acquired intangible assets on our balance sheet in connection with such acquisitions, investments and licensing arrangements, respectively. If the carrying value of our acquisition goodwill, investments in affiliate companies or acquired intangible assets were determined to be impaired, we would be required to write down the carrying value or to record charges to earnings in our financial statements during the period in which our acquisition goodwill, investments in affiliate companies or acquired intangible assets is determined to be impaired, which would adversely affect our results of operations.

Table of Contents***We have limited business insurance coverage in China.***

China's insurance industry is still at an early stage of development. In particular, PRC insurance companies do not offer many business insurance products available in other countries. 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 cause us to incur substantial costs and the diversion of resources.

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

We are subject to the reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required under Section 404 of the Sarbanes-Oxley Act of 2002, has adopted rules requiring public companies to include a report of management on the effectiveness of such companies' internal control over financial reporting in their respective annual reports. In addition, an independent registered public accounting firm for a public company must issue an attestation report on the effectiveness of such company's internal control over financial reporting. Our management conducted an evaluation of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting was effective as of December 31, 2010. In addition, PricewaterhouseCoopers Zhong Tian CPAs Limited Company, our independent registered public accounting firm, reported that our internal control over financial reporting was effective as of December 31, 2010. If we fail to maintain the effectiveness of our internal control over financial reporting, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal control over financial reporting is necessary for us to produce reliable financial reports. As a result, any failure to maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could negatively impact the trading price of our ADSs. Furthermore, we may need to incur additional costs and use additional management and other resources in an effort to comply with Section 404 of the Sarbanes-Oxley Act and other requirements going forward.

You may not be able to rely on our quarterly operating results as an indication of our future performance because our quarterly operating results may be subject to significant fluctuations.

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

- our ability to retain existing users, attract new game players at a steady rate and maintain user satisfaction;
- the announcement or introduction of new games or updates or expansion packs to existing games by us or our competitors;
- the range, number and pricing of virtual items available for sale;
- technical difficulties, system downtime or Internet failures;
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure;
- the adoption of new, or changes to existing, governmental regulations;
- seasonality effect during holidays in the second quarter and the fourth quarter, when generally, fewer game players play our games;
- a shortfall in our revenues relative to our forecasts and a decline in our operating results;
- the introduction and nationwide roll-out of the third-generation wireless telecommunication network in China; and
- economic conditions in general and specific to the online game industry and to China.

For example, in the fourth quarter of 2009, we introduced an expansion pack in Mir II which was not well received by the game's users and led to some of the game's users reducing the amount of virtual items they purchase in the game. Primarily as a result of the introduction of that expansion pack, our net revenues in the first quarter of 2010 decreased by approximately 14% quarter-over-quarter

As a result, you should not rely on the year to year comparisons of our operating results or our quarterly operational metrics such as active paying accounts and monthly average revenues per active paying account, in this annual report

as indicators of our likely future performance. Our operating results may be below our expectations or the expectations of public market analysts and investors in one or more future quarters. If that occurs, the price of our ADSs could decline and you could lose part or all of your investment.

Table of Contents**Risks Relating to the Reorganization and Our Continued Relationship with Shanda Interactive*****We have limited experience operating as a standalone company.***

As a part of the reorganization, Shanda Interactive transferred substantially all of its assets and liabilities relating to its online game business to us and we began to operate as a standalone company. Although we had operated as a business unit of Shanda Interactive prior to the reorganization, we have had limited experience in conducting our operations as a standalone company. As we adjust to operating as a standalone company, we may not be able to react as quickly as our competitors to changes in the industry and markets in which we compete. In addition, since we have become a public company, our management team will need to develop the expertise necessary to comply with the numerous regulatory and other requirements applicable to public companies, including requirements relating to corporate governance, listing standards and investor relations, any of which may divert our management's attention from running our business.

As we have limited experience in operating as a standalone company, we may need to acquire assets in addition to those contributed to us in connection with the reorganization. We may fail to acquire these assets that prove to be important to our operations or may not be able to integrate all of our assets.

Our financial information included in this annual report may not be representative of our results as a standalone company.

For the period from January 1, 2008 to June 30, 2008, our consolidated financial statements were prepared on a combined basis. We made numerous estimates, assumptions and allocations in our financial information because Shanda Interactive did not account for us, and we did not operate, as a standalone company for any period prior to July 1, 2008. Before Shanda Interactive transferred the assets and operations of its online game business to us effective July 1, 2008, the operations of our online game business had been carried out by Shanda Interactive.

For the period from January 1, 2008 to June 30, 2008, our consolidated financial statements were prepared by combining the assets, liabilities, revenues, expenses and cash flows of the entities that were directly engaged in the online game business. With respect to operating expenses, an allocation of certain general corporate expenses of Shanda Interactive which are directly related to the online game business, such as corporate employee compensation costs, professional service fees and other expenses arising from the provisions of certain corporate functions including finance, legal, technology, investment and executive management, was also included. The allocation is based on a variety of factors depending upon the nature of the expenses being allocated, including the number of employees and historical revenue, as well as estimated time incurred by Shanda Interactive's executives for the online game business. Although our management believes that the assumptions underlying our consolidated financial statements for the periods prior to the reorganization and the above allocations are reasonable, our consolidated financial statements for the year ended December 31, 2008 may not be reflective of our result of operations, financial position and cash flows had we been operated as a standalone company during those periods. Therefore, our historical financial information may not be a reliable indicator of what our results of operations, financial position and cash flows will be in the future.

We may not be able to continue to receive the same level of support from Shanda Interactive.

Our online game business has benefited significantly from Shanda Interactive's brand name and strong market position in China. In addition, we have benefited from using Shanda Networking's integrated service platform, which provides Shanda Interactive's large number of registered users with access to our online games, and Shengfutong's prepaid card distribution services. Although we have entered into the Amended and Restated Non-Compete and Non-Solicitation Agreement, Amended and Restated Cooperation Agreement, Amended and Restated Sales Agency Agreement and other related agreements with Shanda Interactive, we cannot assure you that we will be able to continue to receive the same level of support from Shanda Interactive in the future.

Some of the terms of our agreements with Shanda Interactive and its affiliates may be less favorable to us than similar agreements negotiated between unaffiliated third parties.

The various agreements that we entered into with Shanda Interactive and its affiliates in connection with the reorganization when we were a wholly-owned subsidiary of Shanda Interactive may be less favorable to us than would be the case if they were negotiated with unaffiliated third parties. For example, pursuant to the Amended and Restated Cooperation Agreement and the Amended and Restated Sales Agency Agreement, we have engaged certain VIEs of Shanda Online to provide services that are critical to our business, including online billing and payment, user

authentication, customer service, anti-fatigue compliance, prepaid card marketing and distribution and data support services for a five-year period commencing July 1, 2008. While we believe we benefit from these agreements, such agreements were negotiated between a parent company and its wholly-owned subsidiary in connection with the reorganization and therefore may not reflect the terms that would have been reached by two unaffiliated parties negotiating at arm's length. Moreover, pursuant to our Master Separation Agreement with Shanda Interactive, we agreed to indemnify Shanda Interactive for, among other things, liabilities arising from litigation and other contingencies related to our online game business and assumed these liabilities as part of the reorganization. The allocation of assets and liabilities between Shanda Interactive and our company may not reflect the allocation that would have been reached by two unaffiliated parties. Moreover, so long as Shanda Interactive continues to control us, we may not be able to bring a legal claim against Shanda Interactive in the event of a contractual breach, notwithstanding our contractual rights under the agreements described above and any other agreement we may enter into with Shanda Interactive from time to time.

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The Amended and Restated Non-Compete and Non-Solicitation Agreement with Shanda Interactive contains certain exceptions and may not be effective in preventing Shanda Interactive from engaging in certain transactions that directly or indirectly may compete with (or be perceived to be in competition with) our online game business.

In connection with the reorganization, we entered into a Non-Compete and Non-Solicitation Agreement (which was amended and restated on September 10, 2009) with Shanda Interactive, pursuant to which Shanda Interactive has agreed, for a period of five years commencing July 1, 2008, not to engage, and to cause each other member of the Shanda Group (other than Shanda Games) not to engage, directly or indirectly, in the online game business anywhere in the world. This agreement is subject to important exceptions, namely, (1) certain of Shanda Interactive's subsidiaries may continue to engage in their current PC network and e-sports platform businesses, online interactive music community, and online chess and board game platform business, (2) Shanda Interactive may acquire equity interests in a company that does not have more than 25.0% of its gross revenues (based on the latest annual audited financial statements of the investee company) attributable to the online game business and (3) Shanda Interactive may operate virtual communities with certain online game features, provided that such features do not constitute the core business model of such community. In addition, the agreement permits Shanda Interactive to acquire or invest in any third party engaging in the online game business if, after using its reasonable best efforts to make such investment opportunity available to us as required under the agreement, we do not pursue such opportunity; provided that Shanda Interactive's equity interest in such third party shall not exceed 50%. Because of the exceptions to the agreement described above, we cannot assure you that the Amended and Restated Non-Compete and Non-Solicitation Agreement will be effective in preventing Shanda Interactive from engaging in certain conduct or transactions that directly or indirectly may compete with (or be perceived to be in competition with) our online game business. Even if there is no actual direct or indirect competition to our online game business, the perception by investors or securities analysts of possible competition from Shanda Interactive could adversely affect our business prospects and the price of our ADSs. Nor can we assure you that Shanda Interactive will not breach the Amended and Restated Non-Compete and Non-Solicitation Agreement. Although non-compete and non-solicitation agreements are generally enforceable under PRC laws, PRC legal practice regarding the enforceability of such agreements is not as well-developed as those in countries such as the United States. Thus, if we were required to enforce our rights under the Amended and Restated Non-Compete and Non-Solicitation Agreement, we cannot assure you that a PRC court would enforce such agreement. Even if such agreement is enforced, we may not receive adequate remedies from courts in China or elsewhere. In addition, Shanda Interactive may not extend or renew the Amended and Restated Non-Compete and Non-Solicitation Agreement and may decide to compete with us upon expiration of the agreement.

Shanda Interactive will control the outcome of shareholder actions in our company.

Under our amended and restated memorandum and articles of association, our ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares are entitled to one vote per share, while holders of Class B ordinary shares are entitled to 10 votes per share. Shanda Interactive held 409,087,000 Class B ordinary shares, or approximately 72.1% of the combined total outstanding ordinary shares (representing approximately 96.3% of the total voting rights) in our company as of December 31, 2010. Shanda Interactive's shareholding, in particular the greater voting rights of the Class B ordinary shares it holds, gives it the power to control any actions that require shareholder approval under Cayman Islands law, our amended and restated memorandum and articles of association and the NASDAQ requirements, including the election and removal of any member of our board of directors, mergers, consolidations and other business combinations, changes to our amended and restated memorandum and articles of association, the number of shares available for issuance under share incentive plans and the issuance of significant amounts of our ordinary shares in private placements. Due to the disparate voting rights attached to the two classes of our ordinary shares, Shanda Interactive could have sufficient voting rights to determine the outcome of all matters requiring shareholder approval even if it should, at some point in the future, hold considerably less than a majority of the combined total of our outstanding Class A and Class B ordinary shares.

As a result of Shanda Interactive's ownership of Class B ordinary shares, Shanda Interactive's voting power may cause transactions to occur that might not be beneficial to you as a holder of our ADSs and may prevent transactions that would be beneficial to you. For example, Shanda Interactive's voting power may prevent a transaction involving a

change of control of us, including transactions in which you as a holder of our ADSs might otherwise receive a premium for your securities over the then-current market price. Similarly, Shanda Interactive may approve a merger or consolidation of our company which may result in you receiving a stake (either in the form of shares, debt obligations or other securities) in the surviving or new consolidated company which may not operate our current business model and dissenter rights may not be available to you in such an event. In addition, Shanda Interactive is not prohibited from selling a controlling interest in us to a third party and may do so without your approval. If Shanda Interactive sells its controlling interest in us to a third party, is acquired or otherwise undergoes a change of control, any acquiror or successor will be entitled to exercise voting control over the Class B ordinary shares held by Shanda Interactive and may do so in a manner that could vary significantly from that of Shanda Interactive.

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In addition, our director, Mr. Tianqiao Chen, owns a substantial equity interest in Shanda Interactive, serves as its chairman and chief executive officer and controls its corporate actions, and thereby controls the outcome of shareholder actions in our company indirectly through Shanda Interactive. Mr. Chen's voting control could also cause transactions to occur that might not be beneficial to you as a holder of our ADSs and could prevent transactions that would be beneficial to you.

We may have conflicts of interest with Shanda Interactive. Because of Shanda Interactive's controlling ownership interest in our company, we may not be able to resolve such conflicts on terms favorable to us.

Conflicts of interest may arise between Shanda Interactive and us in a number of areas relating to our past and ongoing relationships. Potential conflicts of interest that we have identified include the following:

Indemnification arrangements with Shanda Interactive. In connection with the reorganization, we have agreed to indemnify Shanda Interactive with respect to liabilities relating to our online game business, including operations of that business when it was a business unit of Shanda Interactive prior to the reorganization. These indemnification arrangements could result in our having interests that are adverse to those of Shanda Interactive, such as different interests with respect to settlement arrangements in the event of litigation.

Non-compete agreement with Shanda Interactive. Shanda Interactive has agreed not to compete with us in the online game business anywhere in the world for a five-year period commencing July 1, 2008, subject to certain exceptions that may present conflicts of interests. See [Risks Relating to the Reorganization and Our Continued Relationship with Shanda Interactive](#). The Amended and Restated Non-Compete and Non-Solicitation Agreement with Shanda Interactive contains certain exceptions and may not be effective in preventing Shanda Interactive from engaging in certain transactions that directly or indirectly may compete with (or be perceived to be in competition with) our online game business.

Employee recruitment and retention. Because both Shanda Interactive and we operate primarily in Shanghai and are engaged in the interactive entertainment business, we may compete with Shanda Interactive in the hiring of new employees, in particular with respect to those involved in interactive entertainment content development and operation. While the Amended and Restated Non-Compete and Non-Solicitation Agreement restricts Shanda Interactive from inducing any of our employees to terminate his or her employment with us, we cannot assure you that Shanda Interactive will not breach this agreement.

Our board members or executive officers may have conflicts of interest. Mr. Qunzhao Tan, our chairman and chief executive officer, currently also serves as a member of the board of directors of Shanda Interactive. In addition, Mr. Tianqiao Chen, Mr. Danian Chen, and Ms. Grace Wu, all of whom are our directors, currently also serve as Shanda Interactive's chairman and chief executive officer, chief operating officer, and chief financial officer, respectively, and as a member of the board of directors of Shanda Interactive. A majority of our directors and executive officers also own shares and/or options to purchase shares in Shanda Interactive. Shanda Interactive may continue to grant incentive share compensation to our board members and executive officers from time to time. These relationships could create perceived or actual conflicts of interest when these persons are faced with decisions with potentially different implications for Shanda Interactive and us.

Transfer of assets. In connection with the reorganization, Shanda Interactive transferred substantially all of its assets and liabilities related to its online game business to us. However, there may be assets (such as intellectual property rights) that are required for our business but were not part of the assets transferred to us pursuant to the Master Separation Agreement or otherwise have not been transferred to us. If Shanda Interactive refuses to transfer such assets to us or if we are not able to secure similar assets on terms acceptable to us or at all, our business, financial condition and results of operations may be materially and adversely affected.

Sale of shares in our company. Shanda Interactive may decide to sell all or a portion of the Class B ordinary shares that it holds to a third party, including to one of our competitors, thereby giving that third party substantial influence over our business and our affairs. Such a sale could be contrary to the interests of certain of our shareholders, including our employees and our public shareholders, and affect the implementation of our business strategy.

Allocation of business opportunities. Business opportunities may arise that both we and Shanda Interactive find attractive, and which would complement our respective businesses. Although Shanda Interactive has agreed in the Amended and Restated Non-Compete and Non-Solicitation Agreement with us not to acquire equity interests in third-party online game businesses without first using its reasonable best efforts to make such investment opportunities available to us, subject to certain limited exceptions, we may not be able to pursue the business opportunities effectively if Shanda Interactive decides to take advantage of such opportunities itself notwithstanding such agreement.

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Services provided by Shanda Networking to our competitors. Shanda Networking provides integrated services to other online game companies that compete with us. These commercial relationships are beyond our control and may negatively affect our business. See **Risks Relating to Our Business and Our Industry**. Shanda Networking provides integrated platform services to some of our competitors, which may have a material adverse effect on our business.

Developing business relationships with Shanda Interactive's competitors. So long as Shanda Interactive remains our controlling shareholder, we may be limited in our ability to do business with its competitors, such as other interactive entertainment media companies in China.

Although our company is a standalone entity, we expect to operate, for as long as Shanda Interactive is our controlling shareholder, as a part of the Shanda Group. Shanda Interactive may from time to time make strategic decisions that it believes are in the best interests of the Shanda Group as a whole. These decisions may be different from the decisions that we would have made on our own. Shanda Interactive's decisions with respect to us or our business may be resolved in ways that favor Shanda Interactive and therefore Shanda Interactive's own shareholders, which may not coincide with the interests of our other shareholders. We may not be able to resolve any potential conflicts, and even if we do so, the resolution may be less favorable to us than if we were dealing with an unaffiliated shareholder. Even if both parties seek to transact business on terms intended to approximate those that could have been achieved among unaffiliated parties, this may not succeed in practice.

Risks Relating to Regulation of Our Business and to Our Structure

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

Various regulations in China currently restrict or prevent foreign and foreign-invested entities from engaging in telecommunication services in China, including operating online games. Since we are a Cayman Islands exempted company and therefore are a foreign or foreign-invested enterprise under PRC law, neither we nor our PRC subsidiaries are eligible to hold a license to operate online games in China. In order to comply with the foreign ownership restrictions, we operate our online game business in China through our PRC operating companies, all of which are wholly owned by either PRC citizens or PRC companies. Our PRC subsidiaries have entered into a series of contractual arrangements with our PRC operating companies and/or their shareholders. As a result of these contractual arrangements, we are considered the primary beneficiary of our PRC operating companies and consolidate the results of operations of our PRC operating companies in our financial statements. In the opinion of our PRC legal counsel, Jade & Fountain PRC Lawyers, in all material aspects, the ownership structure and the contractual arrangements between our PRC subsidiaries, on the one hand, and our PRC operating companies and/or their shareholders, on the other hand, comply with current PRC laws and regulations. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, PRC governmental authorities may ultimately take a view that is inconsistent with the opinion of Jade & Fountain PRC Lawyers.

On July 13, 2006, the MIIT issued the Circular on Strengthening the Administration of Foreign Investment in Value-added Telecommunication Services, or the MIIT Circular 2006. According to the MIIT Circular 2006, since the Regulation for the Administration of Foreign Invested Telecommunication Enterprises, or the FITE Regulations, went into effect, some foreign investors had engaged in value-added telecom services illegally by conspiring with domestic value-added telecom enterprises to circumvent the requirements of the FITE Regulations by delegating domain names and licensing trademarks. In order to further strengthen the administration of foreign invested telecommunications enterprises, the MIIT Circular 2006 provides that any domain name or trademark used by a value-added telecom carrier shall be legally owned by such carrier or its shareholders. The MIIT Circular 2006 also provides that the operation site and facilities of a value-added telecom carrier shall be installed within the scope as prescribed by operating licenses obtained by the carrier and shall correspond to the value-added telecom services that the carrier has been approved to provide. In addition, value-added telecom carriers are required to establish or improve the measures to ensure network security. Due to a lack of interpretative materials from the authorities, it is uncertain whether the MIIT would consider our corporate structure and the contractual arrangements between our PRC subsidiaries and our PRC operating companies as a kind of foreign investment in telecommunication services. Therefore, it is unclear what impact the MIIT circular might have on us or the other Chinese Internet companies that have adopted the same or

similar corporate structures and contractual arrangements as ours.

On September 28, 2009, the General Administration of Press and Publications, or the GAPP, the State Copyright Bureau, and National Office of Combating Pornography and Illegal Publications jointly issued the Circular Regarding the Consistent Implementation of the Stipulations on Three Provisions of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games, or the GAPP Circular 2009, which restates the general principle espoused in recently promulgated regulations that foreign investment is not permitted in online game operating businesses in China. Article IV of the GAPP Circular 2009 prohibits foreign investors from participating in online game operating businesses via wholly-owned, equity joint venture or cooperative joint venture investments in China, and from controlling and

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participating in such businesses directly or indirectly through contractual or technical support arrangements. In the event of a violation of these provisions, the GAPP shall, in conjunction with the relevant governmental departments of the PRC, investigate and handle the same in accordance with the law. In serious cases, the relevant licenses and registrations shall be terminated. However, as a detailed interpretation of the GAPP Circular 2009 has not been issued, it is not yet clear how this circular will be implemented. Furthermore, as certain other government authorities such as the Ministry of Commerce, or MOFCOM, the Ministry of Culture, or the MOC, and the MIIT did not join the GAPP in issuing the GAPP Circular 2009, the views of these authorities are uncertain in clarifying the scope of implementation and enforcement of the GAPP Circular 2009.

We cannot be sure that the PRC government would view our operating arrangements to be in compliance with PRC licensing, registration or other regulatory requirements, including without limitation the requirements described in the MIIT Circular 2006 and the GAPP Circular 2009, with existing policies or with requirements or policies that may be adopted in the future. For example, as some of the domain names and trademarks that we use in our operations are not owned by our PRC operating companies or their respective shareholders, we may be in violation of the provisions of the MIIT Circular 2006 or the GAPP Circular 2009. If any of our businesses is determined not to be in compliance with the MIIT Circular 2006 or the GAPP Circular 2009, the PRC government could take a number of regulatory or enforcement actions that could be harmful to our business, including but not limited to: levying fines, revoking its business and operating licenses, requiring it to discontinue or restrict its operations, blocking its website, requiring us to restructure our business or imposing additional conditions or requirements with which it may not be able to comply. We may also encounter difficulties in obtaining performance under or enforcement of related contracts. Any of these actions could cause our business, financial condition and results of operations to suffer and the market price of our ADSs to decline.

The contractual arrangements related to critical aspects of our operations with our PRC operating companies and their shareholders may not be as effective in providing operational control as direct ownership.

We rely on contractual arrangements with our PRC operating companies and their shareholders to operate our business. These contractual arrangements are intended to provide us with effective control over, but may not be as effective as direct ownership in providing us with control over, our PRC operating companies. See **Related Party Transactions** in Item 7 of this annual report for a description of these contractual arrangements. Direct ownership would allow us, for example, to directly or indirectly exercise our rights as a shareholder to effect changes in the boards of directors of our PRC operating companies, which, in turn, could effect changes, subject to any applicable fiduciary obligations, at the management level. Because we rely on these contractual arrangements to effect control and management of our PRC operating companies, we are exposed to the risk that the shareholders of our PRC operating companies may fail to perform his or her respective obligations under these contractual arrangements. In addition, the shareholders of our PRC operating companies may potentially have a conflict of interest with us, and they may breach their contracts with us or cause such contracts to be amended in a manner contrary to the interest of our company, if they believe such action furthers their own interest, or if they otherwise act in bad faith. If any of the foregoing were to occur, we may have to incur substantial costs and expend significant resources to enforce these contractual arrangements.

In addition, as all of these contractual arrangements are governed by PRC law and provide for the resolution of disputes through either arbitration or litigation in the PRC, they would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. The legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could further limit our ability to enforce these contractual arrangements. Furthermore, these contracts may not be enforceable in China if PRC government authorities or courts take a view that such contracts contravene PRC laws and regulations or are otherwise not enforceable for public policy reasons. In the event we are unable to enforce these contractual arrangements, we may not be able to exert effective control over our PRC operating companies, and our ability to conduct our business may be materially and adversely affected.

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

We could face material adverse tax consequences if the PRC tax authorities determine that the contractual arrangements between our PRC subsidiaries and our PRC operating companies were not entered into based on arm's length negotiations. Although we based our contractual arrangements on those of similar businesses, if the PRC tax authorities determine that these contracts were not entered into on an arm's length basis, they may adjust our income and expenses for PRC tax purposes in the form of a transfer pricing adjustment. A transfer pricing adjustment could adversely affect us by increasing our PRC operating companies' tax liabilities without reducing our PRC subsidiaries' tax liabilities, which could further result in late payment fees and other penalties to our PRC operating companies for under-paid taxes. As a result, any transfer pricing adjustment could have a material adverse effect on our financial condition and results of operations.

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Our holding company structure may restrict our ability to receive dividends from, or transfer funds to, our PRC subsidiaries and our PRC operating companies, which could restrict our ability to act in response to changing market conditions and reallocate funds among our Chinese entities timely.

We are a Cayman Islands holding company and conduct substantially all of our operations through our PRC operating companies. We may rely on dividends and other distributions on equity by our PRC subsidiaries for our cash requirements, including the funds to pay dividends on the Class A ordinary shares underlying our ADSs and to service any debt we may incur or financing we may need for our operations. If any of our PRC subsidiaries incurs its own debt in the future, the instruments governing the debt may restrict such PRC subsidiary's ability to pay dividends or make other distributions to our HK subsidiaries and to us. Furthermore, under PRC laws and regulations, each PRC subsidiary is only permitted to pay dividends out of its retained earnings, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, each PRC subsidiary is also required to set aside at least 10% of its after-tax profit based on PRC accounting standards each year to its general reserves until the cumulative amount of such reserves reaches 50% of its registered capital. These reserves are not distributable as cash dividends, loans or advances. Each PRC subsidiary may also allocate a portion of its after-tax profits, as determined by its board of directors, to its staff welfare and bonus funds, which may not be distributed to us. As a result of these and other restrictions under PRC laws and regulations, each PRC subsidiary is restricted from transferring a portion of its assets to us as dividends, loans or advances, which restricted portion amounted to approximately RMB856.9 million (US\$129.8 million), or 21.3% of our total consolidated net assets as of December 31, 2010. Any limitation on the ability of our PRC subsidiaries to transfer funds to us as dividends, loans or advances could materially and adversely limit our ability to grow, make investments or acquisitions that could benefit our businesses, pay debt or dividends, and otherwise fund and conduct our business.

In addition, any funds we transfer to our PRC subsidiaries, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval of PRC governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. Our PRC companies are prohibited by PRC law to directly lend money to each other. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our PRC subsidiaries. These limitations on the free flow of funds between us and our PRC companies could restrict our ability to act in response to changing market conditions and reallocate funds among our PRC companies on a timely basis. Moreover, according to a circular jointly issued by the Ministry of Finance and the State Administration of Taxation on September 19, 2008, the debt-to-equity ratio of a non-financial institution may not exceed 2:1 unless the shareholder loan in question can meet certain conditions. Although there is uncertainty at this time as to how the circular will be interpreted and implemented, such circular may have a negative impact on our PRC subsidiaries' abilities to obtain loans from its shareholders.

We are one of China's leading online game providers and cooperate closely with Shanda Online, which through its VIEs operates a leading online service platform in China. Some of our competitors and our users may institute claims against us and Shanda Online under the new Anti-Monopoly Law and as a result we may have to terminate our relationship with Shanda Online, which may have a material adverse effect on our business, financial conditions and results of operations.

The new Anti-Monopoly Law, or the AML, was approved by the National People's Congress on August 30, 2007, which became effective on August 1, 2008. While certain aspects of the AML are unclear and are subject to subsequent interpretation by the State Council and the Anti-Monopoly Commission and the Anti-Monopoly Enforcement Agency, the AML prohibits certain conduct, referred to as monopolistic acts, which include monopoly agreements, abuse of a dominant market position, and certain concentrations, which result or could result in the elimination or restriction of competition. The law also requires the State Council to establish an Anti-Monopoly Commission with authority to make competition policy, publish guidelines, coordinate anti-monopoly enforcement work and conduct investigations and impose penalties on business operators that commit certain monopolistic acts within or outside of China that have the effect of eliminating or restricting competition in the China market.

It remains to be seen how the AML will be implemented in practice and what effects it will have on us and other companies in China. Given our leading position in the online game industry in China and our close cooperation with Shanda Online, which through its VIEs, operates a leading online service platform in China, some of our competitors

and our users may institute claims against us and Shanda Online under the AML and as a result, we may have to terminate our relationship with Shanda Online if such claims are determined adversely to us or Shanda Online, which may have a material adverse effect on our business, financial conditions and results of operation.

Our operations may be adversely affected by implementation of anti-fatigue-related regulations.

The PRC government may decide to adopt more stringent policies to monitor the online game industry as a result of adverse public reaction to perceived addiction to online games, particularly by minors. On April 15, 2007, eight PRC government authorities, including the GAPP, the Ministry of Education and the MIIT jointly issued a notice requiring all Chinese online game operators to adopt an anti-fatigue system in an effort to curb addiction to online games by minors. Under the anti-fatigue system, three hours or less of continuous play is defined to be healthy, three to five hours is defined to be fatiguing, and five hours or more is defined to be unhealthy. Game operators are required to reduce the value of game benefits for minor game players by half when those game players reach the fatigue level, and to zero when they reach the unhealthy level. In addition, online game players in China are now required to register their identity card numbers before they can play an online game. This system allows game operators to identify which game players are minors. These restrictions could limit our ability to increase our business among minors. Furthermore, if these restrictions were expanded to apply to adult game players in the future, our business could be materially and adversely affected.

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

Internet cafes are one of the primary places where our games are played. In March 2001, the PRC government began tightening its regulation and supervision of Internet cafes. In particular, a large number of unlicensed Internet cafes have been closed. The PRC government has also imposed higher capital and facility requirements for the establishment of Internet cafes. Furthermore, the PRC government's policy, which encourages the development of a limited number of national and regional Internet cafe chains and discourages the establishment of independent Internet cafes, may slow down the growth of Internet cafes. In February 2007, several governmental authorities jointly issued a circular suspending the issuance of new Internet cafe licenses. Since this ban was imposed in 2007, to our knowledge, local authorities have not issued new Internet cafe licenses and it is unclear when local authorities will start issuing new licenses again. In March 2010, the MOC issued a circular to increase the punishment on Internet cafes which allow minors to enter and use Internet in their cafes. According to this circular, among other things, the authorities may revoke an Internet cafe's Internet culture operation license if that Internet cafe allows three or more minors to enter and use Internet at one time. Governmental authorities may from time to time impose stricter requirements, such as the customers' age limit and hours of operation, among others, as a result of the occurrence and perception of, and the media attention on, gang fights, arson and other incidents in or related to Internet cafes. Since a substantial portion of our users play our games in Internet cafes, any reduction in the number, or slowdown in the growth, of Internet cafes in China, or any new regulatory restrictions on their operations, could limit our ability to maintain or increase our revenues and expand our game player base, thereby adversely affecting our business and results of operations, as well as growth prospects.

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

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

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

We may also be subject to potential liability for unlawful actions of our users or for content we distribute that is deemed inappropriate. Furthermore, we may be required to delete content that violates PRC law and report content that we suspect may violate PRC law. It may be difficult to determine the type of content that may result in liability for us, and if we are wrong, we may be prevented from operating our games or offering other services in China.

We may be required to reapply for approvals for online games licensed from overseas licensors.

The MOC issued a Circular Concerning the Examination and Declaration of Imported Online Game Products on April 24, 2009. Imported online games refers to online games that are licensed from licensors outside of China. According to this circular, in the event of a change of the operator of an imported online game, the game's existing import approval will be automatically revoked and the new operator must apply to the MOC for a new approval for the same game. As this circular is newly issued, it remains unclear how and to what extent this circular will be implemented or enforced. On September 28, 2009, the GAPP, together with two other government authorities, issued a circular (*Xin Chu Lian* [2009] No. 13) which contains a similar provision to the MOC circular mentioned above. The GAPP circular also requires that, in the event of a change of the operator of an imported online game, the new operator must apply to the GAPP for a new approval for the same game, and the operation of the online game should

be suspended until the GAPP approves the change in operator.

We currently operate substantially all of our imported online games under import approvals granted by the GAPP and the MOC to Shanda Networking. Under the above referenced circulars, we are required to reapply to the GAPP and the MOC for approvals for our imported online games. We are committed to complying with the requirements of these circulars. However, we cannot assure you that we will succeed in obtaining all the approvals as required by these circulars in time or at all. If we fail to comply with the requirements of these circulars or fail to obtain all the approvals for our imported online games, we may be subject to fines, revocation of the relevant operating licenses, the discontinuation or restrictions on our operations or other sanctions. As a result, our business, financial condition and results of operations could be materially and adversely affected.

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

In the course of playing online games, some virtual assets, such as special equipment, player experience grades and other features of our users' game characters, are acquired and accumulated. Such virtual assets can be important to online game players and have monetary value and in some cases are sold among players for actual money. In practice, virtual assets can be lost for various reasons, often through unauthorized use of the game account of one user by other users and occasionally through data loss caused by a delay of network service, a network crash or hacking activities. Currently, there is no PRC law or regulation specifically governing virtual asset property rights. As a result, there is uncertainty as to who is the legal owner of virtual assets, whether and how the ownership of virtual assets is protected by law, and whether an operator of online games such as us would have any liability to game players or other interested parties (whether in contract, tort or otherwise) for loss of such virtual assets. In case of a loss of virtual assets, we may be sued by our game players and held liable for damages, which may negatively affect our reputation and business, financial condition and results of operation.

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

Our online game revenues are collected through the sale of our prepaid cards or online sale of game points. The Notice on the Reinforcement of the Administration of Internet Cafés and Online Games, or the Internet Cafés Notice, issued by MOC on February 15, 2007, directs the People's Bank of China, or PBOC, to strengthen the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. The Internet Cafés Notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. In addition, the Internet Cafés Notice provides that virtual currency should only be used to purchase virtual items.

On June 4, 2009, the MOC and MOFCOM jointly issued the Notice on Strengthening the Administration of Online Game Virtual Currency, or the Virtual Currency Notice. In the Virtual Currency Notice, the authorities for the first time define Virtual Currency as a type of virtual exchange instrument issued by online game operators, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the online game operators in electronic record format and represented by specific numeric units. In addition, the Virtual Currency Notice categorizes companies involved with virtual currency as either issuers or trading platforms and prohibits companies from simultaneously engaging both as issuers and as trading platforms. Most importantly, the Virtual Currency Notice desires to limit the circulation of virtual currency and thereby reduce concerns that it may impact real world inflation. Specifically, the Virtual Currency Notice provides that online game operators are required to report the total amount of their issued virtual currencies on a quarterly basis and game operators are prohibited from issuing disproportionate amounts of virtual currencies in order to generate revenues.

We issue online game virtual currency to game players for them to purchase various virtual items or time units to be used in our online games. We intend to comply with the Virtual Currency Notice. Shanghai Shulong, Chengdu Simo, Chengdu Aurora and Shanghai Hongli have obtained approval from the MOC to issue online game virtual currency, as required under the Virtual Currency Notice. However, we cannot assure you that all of our PRC operating companies will be able to obtain the approval in a timely manner or at all. If we are not able to obtain the approval, we may be prohibited from issuing virtual currency and thus may have to change our business model. We are in the process of adjusting the content of our online games, as well as the form of payment settlement between Shanda Online and us, but we cannot assure you that our adjustments will be sufficient to comply with the Virtual Currency Notice. Moreover, although we believe we do not offer online game virtual currency transaction services, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours. For example, certain virtual items we issue (such as coupons) are transferable and exchangeable in the games. If the PRC regulatory authorities deem such transfer or exchange to be a virtual currency transaction, aside from being engaged in the issuance of virtual currency, we may also be deemed to be providing transaction platform services that enable the trading of such virtual currency. Simultaneously engaging in both of these activities is prohibited under the Virtual Currency Notice. In that event, we may be required to cease either our virtual currency issuance activities or such deemed transaction service

activities and may be subject to certain penalties, including but not limited to mandatory corrective measures and fines. The occurrence of any of the foregoing could have a material adverse effect on our business and results of operations.

In addition, the Virtual Currency Notice also prohibits online game operators from setting game features that involve the direct payment of cash or virtual currency by players for the chance to win virtual items or virtual currency based on random selection through a lucky draw, wager or lottery. The notice also prohibits game operators from issuing currency to game players through means other than purchases with legal currency. It is unclear whether these restrictions would apply to certain aspects of our online games. For example, certain of our games contain features known as treasure boxes. Players may use yuanbao, a type of virtual item they obtain in the games, to acquire keys to open treasure boxes that, if opened, award the player with rewards, such as game points or virtual items. As no cash or virtual currency is directly paid by the players in opening treasure boxes, we believe this feature is distinct

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from those prohibited by the Virtual Currency Notice. However, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours and deem such feature as prohibited by the Virtual Currency Notice, thereby subjecting us to penalties, including mandatory corrective measures and fines. In addition, since we believe many of our game players find treasure boxes to be an enjoyable feature of our games, if we are required to eliminate this from our games, our games could be less attractive to players. The occurrence of any of the foregoing could materially and adversely affect our business and results of operations.

The Virtual Currency Notice also places potentially burdensome obligations on online game operators, including a requirement that operators keep transaction data records for no less than 180 days and a prohibition on operators providing virtual currency trading services to minors. In order to comply with the requirements of the Virtual Currency Notice, it may be necessary for us to change our virtual currency distribution channel, and our business model may be affected accordingly and we may put more efforts in consummating our database so as to keep users information longer. These restrictions may result in higher costs of our online game operation and lower sales of our prepaid cards or game points, which may have an adverse effect on our games revenue.

Our business may be adversely affected by public opinion and governmental policies in China as well as in other jurisdictions where we license our games to third parties.

Due to a relatively high degree of game player loyalty, easy access to personal computers and Internet cafés, and the lack of other appealing forms of entertainment in China, many teenagers in China frequently play online games. This may result in these teenagers spending less time on or refraining from other activities, including education, vocational training, sports, and taking rest, which could result in adverse public reaction and stricter government regulation. For example, the PRC government has promulgated anti-fatigue-related regulations to limit the amount of time minors can play online games. See Our operations may be adversely affected by implementation of new anti-fatigue-related regulations. The PRC government has also begun to tighten its regulations on Internet cafés, currently one of the primary places where online games are played, including limiting the issuance of Internet café operating licenses and imposing higher capital and facility requirements for the establishment of Internet cafés. See The PRC government has tightened its regulation of Internet cafes, which are currently one of the primary venues for our users to play online games. Intensified government regulation of Internet cafes could restrict our ability to maintain or increase our revenues and expand our game player base.

Adverse public opinion could discourage game players from playing our games, and could result in government regulations that impose additional limitations on the operations of online games as well as the game players' access to online games. For example, in January 2011, the MIIT and seven other central government authorities jointly issued a circular under which online game operators are required to adopt various measures to maintain a system to communicate with the parents or other guardians of minors playing online games and are required to monitor the activities of the minors and suspend the accounts of minors if so requested by their parents or guardians. We believe stricter government regulations, such as regulations imposing stricter age and hour limits on Internet cafés, limiting the issuance of virtual currency by online game operators or the amount of virtual currency that can be purchased by an individual game player, or extending anti-fatigue-related regulations to adults, could be implemented in the future. Such adverse public opinion and tightened government regulations could materially and adversely affect our business prospects and our ability to maintain or increase revenues.

In addition, the PRC State Administration of Taxation previously announced that it will tax game players on the income derived from the trading of virtual currencies at the rate of 20%. However, it is currently unclear how the tax will be collected or if there will be any effect on our game players or our business.

Our plan to continue to license our games in international markets may also be adversely affected by public opinion or government policies in markets in which we license our games. For example, South Korea requires online game operators, such as Actoz, to obtain ratings classifications for online games and implement procedures to restrict minors from accessing online games. More recently, the Ministry of Culture, Sports and Tourism in South Korea has enacted rules which require certain online game operators to automatically log off underage users of certain online games and to slow down the Internet speed for underage users who have been logged on continuously for too many hours.

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

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

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Our PRC operating companies are required to obtain applicable permits or approvals from different regulatory authorities in order to provide their services. For example, an Internet content provider, or ICP, must obtain a value-added telecommunications business operation license, or ICP license, from the MIIT or its local offices in order to engage in any commercial ICP operations within China. An online game operator must also obtain an Internet culture operation license from the MOC, an Internet publishing license from the GAPP in order to operate and distribute games through the Internet. Shanghai Shulong currently holds an inter-regional ICP license, an Internet culture operation license, and an Internet publishing license. Each of Chengdu Simo and Shanghai Hongli currently holds a regional ICP license, an Internet culture operation license and an Internet publishing license. Chengdu Aurora currently holds a regional ICP license as well as an Internet culture operation license. Each of Tianjin Youji and Chengdu Youji currently holds a regional ICP license. While we believe that we comply 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.

Further strengthened supervision of the online game industry may adversely affect our online game operation.

In the GAPP Notice, the GAPP stated that it is the only governmental department with authority for examination and pre-approval of online games, and that all online game operators must obtain an internet publishing license to provide online game services. Under the GAPP Notice, additional approvals from the GAPP are required when game operators release new versions or expansion packs, or make any changes to the originally approved online game. In addition, on July 1, 2009, the GAPP issued the Notice on Strengthening the Approval and Administration of Imported Online Games, in which the GAPP stated that it is the only governmental department authorized by the State Council to approve the importation of online games from offshore copyright owners. In the event of any failure to meet the above-mentioned requirements, an operator may face heavy penalties, such as being ordered to stop operation, or having its business license revoked. Our online game business may be adversely affected by these two GAPP notices. The launch of expansion packs and imported games might be delayed because of the extra approval required. Such delay in releasing expansion packs or imported games may result in higher costs for our online game operation and have an adverse effect on our game revenue.

On June 3, 2010, the MOC issued Interim Measures for Online Games Administration, or the Online Game Measures, which became effective on August 1, 2010, aiming to further strengthen the MOC's supervision of the online game industry. Specifically, the Online Game Measures reiterate that the MOC has the power to review the content of all online games except online game publications that have been pre-approved by the GAPP. However, the Online Game Measures do not clearly specify what constitutes online game publication. Furthermore, the Online Game Measures provide that all domestic online games must be filed with the MOC, while all imported online games are subject to a content review prior to their launch. If a substantial change (for example, any significant modification to a game's storyline, language, tasks, or trading system) is made to an existing imported or domestic online game, it will be subject to a new content review.

Our online game business may be adversely affected by the Online Game Measures. The Online Game Measures do not set forth any specific procedure for the required filing and content review procedures for online games and therefore may cause delay when we try to file or apply for content review with the MOC. In addition, for our imported licensed games, the requirement for prior approval of any substantial change may cause delay in releasing expansion packs, which may result in higher costs of our online game operation and have an adverse effect on our game revenue. In addition, the Online Game Measures do not resolve certain inconsistencies and ambiguities resulting from pronouncements included in previous notices issued by the GAPP and the MOC. Because there is ambiguity in the scope of the authority and the roles and responsibilities of 22 governmental departments, such as the MOC and the GAPP, with oversight of the online game industry, we may face stricter scrutiny of the day-to-day operations of our online game business. If any of our online game operating entities cannot comply with any of the stipulations of any PRC governmental department regarding the online game industry, we may be subject to various penalties and our online game business may be adversely affected.

Our business may be adversely affected if Shanda Networking cannot obtain a payment service license.

On June 14, 2010, the PBOC issued the Administrative Measure on the Payment Services of Non-Financial Institutions, or the Payment Measures, which became effective on September 1, 2010. Under the Payment Measures,

payment services are defined as the provision of capital transfer services by non-financial institutions acting as intermediaries, including services rendered in connection with network-based payments, issuance and settlement services for pre-paid cards and acquiring services for bank cards. The Payment Measures require all non-financial institutions engaging in payment services to obtain a payment service license from the PBOC. The Payment Measures provide a one-year grace period starting September 1, 2010. Failure to obtain a payment service license will lead to the termination of the right to provide payment services. Given that the definition of network-based payments in the Payment Measures is vague, we are not sure whether or not Shanda Networking's fee collection activity to support our online game operations would constitute a kind of payment service under the Payment Measures. If Shanda Networking is required to apply for a payment service license under the Payment Measures, we cannot assure you that Shanda Networking will be able to obtain the required license in a timely manner or at all. If Shanda Networking cannot obtain such license and is unable to provide us with payment services, our business would be materially and adversely affected.

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

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

Risks Relating to the People's Republic of China

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.

Most of our business operations are conducted in China and most of our revenues are generated in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The Chinese economy differs from the economies of most developed countries in many respects, including the amount of government involvement, the level of development, the growth rate, the control of foreign exchange, and the allocation of resources.

While the Chinese economy has grown significantly in the past 30 years, the growth has been uneven geographically among various sectors of the economy, and during different periods. 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 if the measures reduce the consumable income of our game players.

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

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing general economic and business matters. The overall effect of legislation since 1979 has been a significant enhancement of the protections afforded to various forms of foreign-invested enterprises in China. Each of our PRC subsidiaries is a wholly foreign owned enterprise, or WFOE, which is an enterprise incorporated in China and wholly owned by foreign investors. Our PRC subsidiaries are subject to laws and regulations applicable to foreign investment in China in general and laws and regulations applicable to WFOEs in particular. However, these laws, regulations and legal requirements are constantly changing and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. Furthermore, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

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

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

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

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

Table of Contents***Restrictions on currency exchange may limit our ability to utilize our capital effectively.***

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

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

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

Foreign exchange transactions under the capital account are subject to limitations and require registration with or approval by the relevant PRC governmental authorities. In particular, if we finance our PRC subsidiaries by foreign currency loans, those loans cannot exceed certain statutory limits and must be registered with the SAFE, and if we finance our PRC subsidiaries by capital contributions, those capital contributions must be approved by the MOFCOM. In addition, because of the regulatory issues related to foreign currency loans to, and foreign investment in, domestic PRC enterprises, we may not be able to finance our PRC operating companies' operations by loans or capital contributions. We cannot assure you that we can obtain these governmental registrations or approvals on a timely basis, if at all. These limitations could affect the ability of these entities to obtain foreign exchange through debt or equity financing, and could adversely affect our business and financial conditions.

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

Substantially all of our revenues are denominated in Renminbi, while a portion of our expenditures are denominated in foreign currencies, primarily the U.S. dollar. Fluctuations in exchange rates, particularly those involving the U.S. dollar, may affect our costs and operating margins. Where our operations conducted in Renminbi are reported in U.S. dollars, such fluctuations could result in changes in reported results which do not reflect changes in the underlying operations. On July 21, 2005, the PRC government changed its policy of pegging the value of the Renminbi to the U.S. dollar. Under the policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. Provisions on Administration of Foreign Exchange, as amended in August 2008, further changed China's exchange regime to a managed floating exchange rate regime based on market supply and demand. While the international reaction to the Renminbi revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the U.S. dollar. As substantially all of our revenues are denominated in Renminbi, any potential future devaluation of the Renminbi against the U.S. dollar could adversely affect our results of operations. The fluctuation of foreign exchange rate affects the value of these monetary assets and liabilities denominated in U.S. dollars. Generally, an appreciation of the Renminbi against the U.S. dollar results in a foreign exchange loss for monetary assets denominated in U.S. dollars, and a foreign exchange gain for monetary liabilities denominated in U.S. dollars. On the contrary, a devaluation of the Renminbi against the U.S. dollar results in a foreign exchange gain for monetary assets denominated in U.S. dollars and a foreign exchange loss for monetary liabilities denominated in U.S. dollars. With very limited hedging transactions available in China, we have not entered into any hedging transactions to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge all or part of our exposure or at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into U.S. dollars. Conversely, an increase in the value of the Renminbi could increase our reported earnings in U.S. dollar terms without a fundamental change in our business or operating performance.

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

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

Under the new enterprise income tax law which became effective January 1, 2008, or the New EIT Law, both foreign-invested enterprises and domestic enterprises are subject to a unified 25% income tax rate. Under the New EIT Law, preferential tax treatments will be granted to enterprises that conduct business in certain encouraged sectors and to enterprises that qualify as high and new technology enterprises, a status reassessed every three years. Shengqu, Shanghai Shulong and Chengdu Aurora were recognized as high and new technology enterprises in 2008 and are entitled to a 15.0% preferential income tax rate for the three-year period ending December 31, 2010. Lansha was also recognized as a high and new technology enterprise in 2010. In addition, an enterprise is entitled to a 10.0% income tax rate for the year in which it is recognized as a national key software enterprise, a status reassessed every year. Shengqu was recognized as a national key software enterprise for 2008 and 2009. We cannot assure you that our PRC companies will be able to continue to qualify for preferential tax treatments. For example, Shengqu was not recognized as a national key software enterprise in 2010 and therefore will be taxed at a 15.0% income tax rate in 2010. If any of our PRC companies, such as Shengqu, that qualified for certain preferential tax treatments fails to continue to qualify in a subsequent year, our income tax expenses would increase, which would have a material adverse effect on our net income and results of operations. For additional details on the preferential tax status, see Item 5, Operating and Financial Review and Prospects Taxation PRC Enterprise Income Tax.

Furthermore, pursuant to the New EIT Law, certain enterprises established prior to March 16, 2007 that are entitled to the lower tax rates in accordance with the then prevailing tax laws and regulations shall be eligible for a five-year transition period beginning from January 1, 2008. On December 26, 2007, the State Council issued a notice on the implementation of the grandfathering preferential policies under the New EIT Law, under which it is uncertain whether the transitional tax rates would apply to the companies that enjoyed preferential tax rates of 15.0% under a local preferential tax policy. If our PRC companies cannot enjoy the grandfathering treatment, our income tax expenses would increase, which would have a material adverse effect on our financial condition and results of operations.

In 2008, 2009 and 2010, our PRC companies received financial incentives from the government in the aggregate amount of RMB18.4 million, RMB177.0 million and RMB232.3 million (US\$35.2 million), respectively, which were calculated with reference to taxable revenues and taxable income. To be eligible for the government financial incentives, we are required to continue to meet a number of financial and non-financial criteria and, even if we meet these criteria, the grant of any incentive is still subject to the discretion of the municipal government. Moreover, the central government or municipal government could determine at any time to eliminate or reduce these government financial incentives. Since the government has discretion in the timing of payment and the amount of the financial incentive, we cannot assure you that we will be able to continue to enjoy these government financial incentives or receive such incentives promptly. The discontinuation, reduction or delay of these government financial incentives could have a material adverse effect on our business, financial condition and results of operations.

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

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

Although we are a Cayman Islands company and our HK subsidiaries own 100% of the equity interests of all of our PRC subsidiaries, the PRC tax authorities may regard the main purpose of our HK subsidiaries as obtaining a lower withholding tax rate of 5.0%. As a result, the PRC tax authorities could impose a higher withholding tax rate on

dividends received by our HK subsidiaries from our PRC subsidiaries. In addition, a substantial majority of the members of our management team, as well as the management team of our HK subsidiaries, are located in China. Under current PRC laws and regulations, it is uncertain whether we and/or our HK subsidiaries would be deemed to be PRC tax resident enterprises under the New EIT Law. If we or our HK subsidiaries are deemed to be a PRC tax resident enterprise, our global income would be subject to PRC enterprise income tax at the rate of 25.0%, which would have a material adverse effect on our financial condition and results of operations.

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

Our business could be adversely affected by avian flu, SARS, H1N1 flu, also known as swine flu, or other epidemics or outbreaks. There have been recent reports of outbreaks of a highly pathogenic avian flu caused by the H5N1 virus, in certain regions of Asia and Europe. In 2005 and 2006, there were reports on the occurrences of avian flu in various parts of China, including a few confirmed human cases. Since April 2009, there have been reports on the occurrences of H1N1 flu in Mexico, the United States, China and certain other countries and regions around the world. An outbreak of avian flu or H1N1 flu in the human population could result in a widespread health crisis that could adversely affect the economies and financial markets of many countries, particularly in Asia. Additionally, any recurrence of SARS, a highly contagious form of atypical pneumonia, similar to the occurrence in 2003 that affected China, Hong Kong, Taiwan, Singapore, Vietnam and certain other countries and regions, would also have similar adverse effects.

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Our business could also be adversely affected by natural disasters, such as the earthquakes in Sichuan Province, China on May 12, 2008 and in Qinghai Province, China on April 14, 2010. In connection with each of the earthquakes, we observed a three-day period of national mourning for the victims, during which period we suspended our online games, in accordance with a public notice issued by the PRC government. These natural disasters, outbreaks of contagious diseases, and other adverse public health developments in China could severely disrupt our business operations and adversely affect our financial condition and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future natural disasters or outbreaks of avian flu, H1N1 flu, SARS or any other epidemic.

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

On December 25, 2006, the PBOC issued the Administration Measures on Individual Foreign Exchange Control, and its Implementation Rules were issued by the SAFE on January 5, 2007. Both took effect on February 1, 2007. Under these regulations, all foreign exchange matters involved in an employee stock holding plan, stock option plan or similar plan in which a PRC citizen participates, requires approval from the SAFE or its authorized branch. On March 28, 2007, the SAFE issued the Application Procedure for Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plans or Stock Option Plans of Overseas Listed Companies, or Notice 78. Under Notice 78, PRC individuals who participate in an employee stock option holding plan or a stock option plan of an overseas listed company are required, through a PRC domestic agent or PRC subsidiary of the overseas listed company, to register with the SAFE and complete certain other procedures. We and our Chinese employees who have been granted restricted shares or stock options pursuant to our share incentive plan are subject to Notice 78. However, in practice, there are significant uncertainties with regard to the interpretation and implementation of Notice 78. As of December 31, 2010, we had registered our employee stock holding plans and stock option plans with the SAFE in accordance with the requirements of Notice 78. However, we cannot provide any assurance that we or our Chinese employees will continue to be able to qualify for or obtain any registration required by Notice 78. In particular, if we and/or our Chinese employees fail to comply with the provisions of Notice 78 in the future, we and/or our Chinese employees may be subject to fines and legal sanctions imposed by the SAFE or other PRC government authorities, as a result of which our business operations and employee option plans could be materially and adversely affected.

Risks Relating to Our ADSs

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

The trading price of our ADSs has been and may continue to be subject to wide fluctuations. Since we completed our initial public offering on September 30, 2009, the closing price of our ADSs on the NASDAQ Global Select Market has ranged from US\$5.00 to US\$11.70 per ADS and the last reported closing price on May 23, 2011 was US\$6.86.

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

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

For example, we introduced an expansion pack in Mir II which was not well received by the game's users and led to some of the game's users reducing the amount of virtual items they purchase in the game. Primarily as a result of the introduction of that expansion pack, on March 1, 2010, we announced that we expected our net revenues in the first quarter of 2010 to decrease by 10-15% quarter-over-quarter. On that day, the market price of our ADSs decreased by approximately 18%, and on the following night, further decreased by approximately 6%.

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

We may need additional capital and may sell additional ADSs or other equity securities or incur indebtedness, which could result in additional dilution to our shareholders or increase our debt service obligations.

We may require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

We may be required to withhold PRC income tax on the dividends we pay you (if any), and any gain you realize on the transfer of our ordinary shares and/or ADSs may also be subject to PRC withholding tax.

Pursuant to the New EIT Law, we may be treated as a PRC resident enterprise for PRC tax purposes. See Risks Relating to the People's Republic of China. There are significant uncertainties under the New EIT Law relating to our PRC enterprise income tax liabilities. If we are so treated by the PRC tax authorities, we would be obligated to withhold PRC income tax on payments of dividends on our ordinary shares and/or ADSs to investors that are non-resident enterprises of the PRC because the dividends payable on our ordinary shares and/or ADSs would be regarded as being derived from sources within the PRC. The withholding tax rate depends on the provisions of the bilateral tax treaty, if any, between the PRC and the jurisdiction where the non-resident enterprise is incorporated. For example, for non-resident enterprises located in Hong Kong which own more than 25% of the shares or equity interest in a PRC company, the rate would be 5%, and for non-resident enterprises located in the United States, the rate would be 10%. If the jurisdiction where the non-resident enterprise is incorporated does not have a bilateral tax treaty with the PRC, such as the Cayman Islands, a uniform rate of 10% will apply. In addition, any gain realized by any investors who are non-resident enterprises of the PRC from the transfer of our ordinary shares and/or ADSs could be regarded as being derived from sources within the PRC and be subject to a 10.0% PRC withholding tax.

Moreover, under the PRC Individual Income Tax Law, or IITL, non-resident individual investors are required to pay PRC individual income tax on interests or dividends payable to such investors or any capital gains realized from the transfer of our ordinary shares and/or ADSs if such gains are deemed income derived from sources within the PRC. A non-resident individual refers to an individual who has no domicile in the PRC and does not stay within the PRC or who has no domicile in the PRC and has stayed within the PRC for less than one year. Pursuant to the IITL and its implementation rules, for purposes of the PRC capital gains tax, the taxable income will be based on the total income obtained from the transfer of our ordinary shares and/or ADSs minus all the costs and expenses that are permitted under PRC tax laws to be deducted from the income. Therefore, if we are considered a PRC resident enterprise and dividends we pay with respect to our ordinary shares and/or ADSs and the gains realized from the transfer of our ordinary shares and/or ADSs are considered income derived from sources within the PRC by relevant PRC tax authorities, such gains earned by non-resident individuals may also be subject to PRC withholding tax. The foregoing PRC withholding tax would reduce your investment return on our ordinary shares and/or ADSs and may also materially and adversely affect the price of our ordinary shares and/or ADSs.

Your right as a holder of ADSs to participate in any future rights offerings may be limited, which may cause dilution to your holdings and they may not receive cash dividends if it is impractical to make them available to such holders.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. However, we cannot make rights available to our ADS holders in the United States unless we register the rights and the securities to which the rights relate under the Securities Act or an exemption from the registration requirements is available. In addition, the deposit agreement provides that the depositary 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 exempted 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. Accordingly, ADS holders may be unable to participate in our rights offerings and may experience dilution in their holdings. In addition, if the depositary is unable to sell rights that are not exercised or not distributed or if the sale is not lawful or reasonably practicable, it will allow the rights to lapse, in which case you will receive no value for these rights.

In addition, the depositary of our ADSs has agreed to pay to ADS holders the cash dividends or other distributions it or the custodian receives on our ordinary shares or other deposited securities after deducting its fees and expenses. ADS holders will receive these distributions in proportion to the number of ordinary shares their ADSs represent. However, the depositary may, at its discretion, decide that it is inequitable or impractical to make a distribution available to any holders of ADSs. As a result, the depositary may decide not to make the distribution and ADS holders will not receive such distribution.

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

Your ADSs represented by the ADRs 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 necessary 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.

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

Our corporate affairs are governed by our amended and restated memorandum and articles of association, the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) and common law of the Cayman Islands. The rights of our shareholders to take action against the directors, actions by minority shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as that from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities law as compared to the United States, and provides significantly less protection to investors. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action in the federal court of the United States.

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

The Cayman Islands courts are also unlikely:

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

- to impose liabilities against us, in original actions brought in the Cayman Islands, based on certain civil liability provisions of U.S. securities laws that are penal in nature.

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

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

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

You may have difficulties in enforcing judgments obtained against us.

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

PRC providing statutory recognition of judgments obtained in the United States. Furthermore, it is uncertain whether such Cayman Islands or PRC courts would be competent to hear original actions brought in the Cayman Islands or the PRC against us or such persons who reside outside the United States predicated upon the securities laws of the United States or any state.

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We are a controlled company within the meaning of the NASDAQ Listing Rules and, as a result, rely on exemptions from certain corporate governance requirements that provide protection to shareholders of other companies, and we may also rely on the foreign private issuer exemption from most of the corporate governance requirements under the NASDAQ Listing Rules.

Because Shanda Interactive owns more than 50% of the total voting rights in our company, we are a controlled company under the NASDAQ Listing Rules. We are relying on the controlled company exemption under the NASDAQ Listing Rules and are not obligated to comply with certain NASDAQ corporate governance requirements, including the requirements:

- that a majority of our board of directors consist of independent directors;
 - that we have a corporate governance and nominating committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities;
 - that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities; and
 - for an annual performance evaluation of the nominating and governance committee and the compensation committee.
- We are not required to and will not voluntarily meet these requirements. As a result of our reliance on the controlled company exemption, you will not have the same protection afforded to shareholders of companies that are subject to all of NASDAQ's corporate governance requirements.

In the event that we no longer qualify as a controlled company under the NASDAQ Listing Rules, we intend to rely on the foreign private issuer exemption from most of the corporate governance requirements under the NASDAQ Listing Rules.

We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. holders of our ADSs or Class A ordinary shares.

Based upon the composition of our income and valuation of our assets, including goodwill, we do not believe that we were a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for the taxable year ended December 31, 2010. That determination is subject to uncertainty, however, both because it is not clear how the contractual arrangements between our PRC subsidiaries and our PRC operating companies will be treated for purposes of the PFIC rules, and because of the uncertain characterization of certain components of our revenue. We must make a separate determination each year as to whether we are a PFIC after the close of each taxable year. A non-U.S. corporation will be considered a PFIC for any taxable year if either (i) at least 75% of its gross income is passive income or (ii) 50% or more of the value of its assets (determined on the basis of a quarterly average) during such year is attributable to assets that produce passive income or are held for the production of passive income. Because the determination of whether we are a PFIC will depend on the character of our income and assets and the value of our assets from time to time, which may be based in part on the market price of our ADSs, which is likely to fluctuate (and may fluctuate considerably given that market prices of Internet and online game companies historically have been especially volatile), we cannot assure you that we were not a PFIC for the taxable year ending December 31, 2010 and or that we will not be a PFIC for any future taxable year. If we were treated as a PFIC for any taxable year during which a U.S. person held an ADS or a Class A ordinary share, certain adverse U.S. federal income tax consequences could apply to such U.S. person. See Item 5, Operating and Financial Review and Prospects Taxation United States Federal Income Tax Considerations Passive Foreign Investment Company Rules.

Our dual-class ordinary share structure with different voting rights could discourage others from pursuing any change of control transactions that holders of our Class A ordinary shares and ADSs may view as beneficial.

Our amended and restated memorandum and articles of association provide for a dual-class ordinary share structure. Our ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares are entitled to one vote per share, while the holder of Class B ordinary shares, which is Shanda Interactive, is entitled to 10 votes per share. We issued Class A ordinary shares represented by our ADSs in our initial public offering. Shanda Interactive holds Class B ordinary shares, each of which is convertible into one Class A ordinary share at any time by Shanda Interactive. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances.

Due to the disparate voting rights attached to these two classes, the holder of our Class B ordinary shares has significant voting rights over matters requiring shareholder approval, including the election and removal of directors and certain corporate transactions, such as mergers, consolidations and other business combinations. This concentrated control could discourage others from pursuing any potential merger, takeover or other change of control transactions that holders of Class A ordinary shares and ADSs may view as beneficial.

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Our amended and restated articles of association contain anti-takeover provisions that could adversely affect the rights of holders of our ordinary shares and ADSs.

Our amended and restated articles of association include certain provisions that could limit the ability of others to acquire control of our company. Such provisions could deprive our shareholders of the opportunity to sell their shares at a premium over the prevailing market price by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transactions.

The following provisions in our amended and restated memorandum and articles of association may have the effect of delaying or preventing a change of control of our company:

our amended and restated memorandum and articles of association provides for a dual-class ordinary share structure with disparate voting rights attached to the two classes of ordinary shares;

our board of directors has the authority, without approval by the shareholders, to issue any unissued shares and determine the terms and conditions of such shares, including preferred, deferred or other special rights or restrictions with respect to dividend, voting and return of capital;

the shareholders may by ordinary resolution appoint a candidate as director of the board to fill a casual vacancy or as an addition to the existing board;

the chairman, a majority of our board of directors or shareholder(s) who hold(s) more than 25% of the voting rights of our company having requisitioned for an extraordinary shareholders meeting at least 21 days previously, have the right to convene an extraordinary shareholders meeting, and the agenda of such meeting will be set by a majority of the directors or the shareholder(s) who hold more than 25% of the voting rights of our company who request such meeting; and

the amended and restated articles of association may be amended only by a resolution passed at a shareholders meeting by a majority of not less than two-thirds of the vote cast.

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

A holder of our ADSs may only exercise the voting rights with respect to the underlying Class A ordinary shares in accordance with the provisions of the deposit agreement. Upon receipt of voting instructions of a holder of ADSs in the manner set forth in the deposit agreement, the depositary will endeavor to vote the underlying Class A ordinary shares in accordance with these instructions. Under our amended and restated memorandum and articles of association and Cayman Islands law, the minimum notice period required for convening a general meeting is five days. When a general meeting is convened, you may not receive sufficient notice of a shareholders meeting to permit you to withdraw your ordinary shares to allow you to cast your vote with respect to any specific matter. In addition, the depositary and its agents may not be able to send voting instructions to you or carry out your voting instructions in a timely manner. We will make all reasonable efforts to cause the depositary to extend voting rights to you in a timely manner, but we cannot assure you that you will receive the voting materials in time to ensure that you can instruct the depositary to vote your shares. Furthermore, the depositary and its agents will not be responsible for any failure to carry out any instructions to vote, for the manner in which any vote is cast, or for the effect of any such vote. As a result, you may not be able to exercise your right to vote and you may lack recourse if your ordinary shares are not voted as you requested.

Item 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our online game business was founded by Shanda Interactive in 2001 and was operated by Shanda Interactive through various subsidiaries and VIEs until the reorganization effective July 1, 2008. In November 2001, Shanda Interactive launched its first MMORPG, Mir II, which it had licensed from Actoz. In October 2003, Shanda Interactive launched Wool, its first in-house developed online game.

Effective July 1, 2008, Shanda Interactive reorganized its businesses. See Item 7, Major Shareholders and Related Party Transactions, Related Party Transactions, Transactions and Agreements with Shanda Interactive for a description of the Master Separation Agreement and other agreements relating to the reorganization. As a part of the reorganization, our company, Shanda Games Limited, was incorporated in the Cayman Islands on June 12, 2008 as an exempted company with limited liability and a direct wholly-owned subsidiary of Shanda Interactive to be the holding company for the online game business. Pursuant to a share exchange, Shanda Games (HK) became our direct

wholly-owned subsidiary, and we became a direct wholly-owned subsidiary of Shanda Interactive. Furthermore, pursuant to a Master Separation Agreement, Shanda Interactive transferred substantially all of its assets and liabilities related to its online game business (including applicable intellectual property rights) to us. Concurrently, we transferred to Shanda Interactive all of our assets and liabilities unrelated to the online game business, such as real estate properties which we owned.

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In the second quarter of 2009, Shanda Interactive transferred to us its entire equity interest in Actoz for a cash consideration of US\$70.2 million.

We completed our initial public offering of our ADSs on the Nasdaq Global Select Market on September 30, 2009. In connection with our initial public offering, we sold 13,043,500 ADSs representing 26,087,000 Class A ordinary shares and Shanda Interactive, through its subsidiary, sold an additional 70,456,500 ADSs, representing 140,913,000 Class A ordinary shares.

There were an aggregate of 567,389,254 ordinary shares outstanding as of December 31, 2010.

Our principal executive offices are located at No. 1 Office Building, 690 Bibo Road, Pudong New Area, Shanghai 201203, China. Our telephone number is (86-21) 5050- 4740. Our registered address in the Cayman Islands is located at Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman, KY1-1111, 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 are China's leading online game company in terms of the size and diversity of our game portfolio. Our online game revenues and game player base are also among the largest in China. Through our extensive experience in the online game industry in China, we have created a scalable approach to develop, source and operate online games, as well as license our games to third parties. We use multiple channels to assemble a large and diversified game portfolio of various genres. We operate a nationwide, secure network to host hundreds of thousands of users playing simultaneously, and monitor and adjust the game environment to optimize our game players' experience.

We develop and source a broad array of game content through multiple channels, including in-house development, licensing, investment and acquisition and co-operation. Through these channels, we have built a large, diversified game portfolio and a robust game pipeline. As of March 31, 2011, we operated 28 MMORPGs and six advanced casual games. Some of our online games are also web games which we categorize as either MMORPGs or advanced casual games, rather than as a separate category of online games. As of March 31, 2011, our in-house development capabilities consist of over 2,000 game development personnel and our proprietary game development platform. We license games from international and domestic developers. In 2009 and 2010, we derived approximately 69.1% and 60.5%, respectively, of our net revenues from online games that were licensed from third parties. In 2009 and 2010, we derived approximately 56.4% and 45.7%, respectively, of our net revenues from Mir II, including its sequels, which we license from Actoz. As of March 31, 2011, 11 of our 34 online games were licensed from third-party developers on an exclusive basis and an additional three games were being co-operated with the developer.

Our game player base, which consisted of over 10.2 million active paying accounts for the three-month period ended December 31, 2010, is one of the largest in China. We seek to strengthen our game players' loyalty by, among other things, closely monitoring our players' preferences and introducing updates, expansion packs and other game improvements in a timely manner. We believe the size of our game player base is a key factor in attracting and retaining both game players and additional game content.

We are a leader in the development and innovation of China's online game industry. In 2003, we launched Wool, which is our in-house developed and one of China's first domestically developed MMORPGs. We were among the first in China to adopt the item-based revenue model for advanced casual games and were the first to adopt this revenue model for MMORPGs on a large scale. This revenue model has since become the prevailing revenue model in China. In 2006, we established 18 Capital, which is one of the first investment initiatives in China focused exclusively on investing in independent online game development and operating studios.

Our online game business was founded by Shanda Interactive in 2001 and was operated by Shanda Interactive until the reorganization. We have benefited from and intend to continue leveraging our relationship with Shanda Interactive. By offering our games through Shanda Networking's integrated service platform on which diverse multi-media content is offered, including online games, literature and music, we can access Shanda Interactive's large user base and broaden our marketing reach. In addition, we have successfully established a separate brand identity,

Shanda Games, building on Shanda Interactive's established brand name as one of China's leading interactive entertainment media companies. We believe our powerful brand in China helps us to attract and retain large communities of game players and further strengthen our leading industry position.

Our net revenues were RMB4,504.7 million (US\$682.5 million) in 2010, compared to RMB4,806.7 million in 2009. Our net income attributable to our company was RMB1,288.8 million (US\$195.3 million) in 2010, compared to RMB1,453.0 million in 2009.

Table of Contents**Our Games****MMORPGs**

Our MMORPGs are action adventure-based and draw upon themes including martial arts adventure, fantasy, strategy and historical events. Each of our MMORPGs creates an evolving virtual world within which game players can play and interact with each other simultaneously over the Internet. Because our MMORPGs require a significant amount of players' time and commitment to develop the skills and character attributes required to progress to the next level, our MMORPGs tend to develop game player loyalty.

As of March 31, 2011, we operated 28 MMORPGs. The following table sets forth certain information relating to the MMORPGs that we operated as of March 31, 2011.

Game	Genre	Visual Dimensions	Game Source	Launch Date
Mir II	Martial arts adventure	2D	License ⁽¹⁾	November 2001
Wool ⁽²⁾	Martial arts adventure	2D	In-house	October 2003
The Sign	Martial arts adventure	3D	In-house	May 2004
The Age	Martial arts adventure	2D	In-house	June 2004
Magical Land	Fantasy	2D	In-house	July 2005
R.O.	Fantasy	2D	License	September 2005
Archlord	Fantasy	3D	License	July 2006
Latale	Side-scrolling combat	2D	In-house	April 2007
Fengyun Online	Martial arts adventure	3D	Acquisition	July 2007
World Hegemony	Strategy web game	2D	In-house	November 2007
Might & Hero	Strategy web game	2D	Investment	May 2008
Lineage	Fantasy	2D	License	June 2008
Lineage II	Fantasy	3D	License	June 2008
Tales of Dragons	Fantasy	2D	In-house	July 2008
A Thousand Years III	Martial arts adventure	2D	In-house	November 2008
AION	Fantasy	3D	License	April 2009
JX Online World	Martial arts adventure	2D	Co-operation	June 2009
Ghost Fighter Online	Side-scrolling action	3D	Investment	August 2009
Luvinia Online	Fantasy	3D	Acquisition	August 2009
ZU Online	Martial arts adventure	3D	Investment	August 2009
Yuyan Online	Martial arts adventure	2.5D ⁽³⁾	Co-operation	September 2009
TS2 Online	Turn-based	2D	License	December 2009
Hades Realm	Martial arts adventure	2D	Acquisition	January 2010
Zodiac Tales	Turn-based	2D	Acquisition	January 2010
Dukes and Lords	Martial arts adventure	2D	Acquisition	January 2010
Dragon Nest	Action	3D	Acquisition	July 2010
JX3 Online	Martial arts adventure	3D	Co-operation	August 2010
Hades Realm II	Martial arts adventure	3D	Acquisition	November 2010

(1) We license Mir II from Actoz, which is our majority-owned subsidiary. While Actoz controls the licensing of Mir II in China, we continue to classify Mir II as a licensed game because Actoz shares a portion of the ongoing licensing fees we pay to Actoz with a third party that co-owns the intellectual property rights relating to the game.

(2) Including Wool: Legend of Heroes and Wool: Raider of Gems, which are the sequels to Wool.

(3) 2.5D refers to a game with 3D-rendered characters but a 2D game environment.

The following table sets forth, for the periods indicated, certain operating statistics for our MMORPGs.

	For the Three Months Ended,			
	March 31,	June 30,	September	December
	2010	2010	30,	31,
			2010	2010
Quarterly active paying accounts (in thousands) ⁽¹⁾	9,578	9,608	9,191	9,464
Average monthly revenues per active paying account (in RMB) ⁽²⁾	35.0	34.7	35.2	36.7

(1) Quarterly active paying accounts refers to the aggregate number of active paying accounts for our MMORPGs operated in China during a given quarter.

(2) Average monthly revenues per active paying account refers to our revenues from the operation of MMORPGs in China during a given quarter divided by quarterly active paying accounts, further divided by three.

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Advanced casual games, which is a sub-category of casual games, are generally less time-consuming and require less focus and attention than MMORPGs but are similar to MMORPGs in that they typically have a story line, elaborate graphics, virtual items available for purchase, and frequent interactions among game players. Advanced casual games are an important component of our overall growth strategy as such games generally attract a broader range of demographic groups, as well as more home users, than MMORPGs.

The following table sets forth certain information relating to the advanced casual games that we operated as of March 31, 2011.

Game	Genre	Visual Dimensions	Game Source	Launch Date
BNB	Battle	2D	License	August 2003
GetAmped	Fighting	3D	License	May 2004
Maple Story	Side-scrolling combat	2D	License	August 2004
Crazy Kart	Racing	3D	In-house	March 2006
Kongfu Kids	Fighting	3D	In-house	June 2007
Tales Runner	Racing	3D	License	July 2007

The following table sets forth, for the periods indicated, certain operating statistics for our advanced casual games.

	For the Three Months Ended			
	March 31, 2010	June 30, 2010	September 30, 2010	December 31, 2010
Quarterly active paying accounts (in thousands) ⁽¹⁾	1,075	923	834	746
Average monthly revenues per active paying account (in RMB) ⁽²⁾	28.6	25.3	30.5	27.7

(1) Quarterly active paying accounts refers to the aggregate number of active paying accounts for our advanced casual games operated in China during a given quarter.

(2) Average monthly revenues per active paying account refers to our online game revenues from the operation of advanced casual games in China during a given quarter divided by quarterly active paying accounts, further divided by three.

Some of our online games are web games. Web games are played on a web browser and typically do not require any client-side software to be installed apart from the web browser. We categorize web games as either MMORPGs or advanced casual games, rather than as a separate category of online games. Mini casual games without user-end software offered by Mochi Media are not included in the above tables.

Access to Our Games

All of the MMORPGs and advanced casual games we operate in China are accessible through Shanda Networking, which hosts a website dedicated to each game. Each game's website provides detailed information and updates on that game and on the products and services that we offer in connection with that game. Game players typically access our games at Internet cafes or through the Internet by using personal computers. A game player can download the end-user software, if necessary, for a game from the website for free and set up a user account and password to access and play the game.

Our Online Game Development and Sourcing Model

The sources of our online game content include the games that we develop in-house and license from, acquire from or co-operate with third parties.

In-House Development

We develop new online games and related updates and expansion packs. As of March 31, 2011, we operated eight MMORPGs and two advanced casual games that we developed in-house, including Wool, the first large-scale MMORPG developed in China and one of our most popular games. In 2009 and 2010, we introduced approximately 270 and 290 updates and expansion packs, respectively, for our existing online games.

We have strong in-house game development capabilities supported by our research and development center and our proprietary game development platform which is designed with modularized functions and provides a stable, efficient and scalable online game development platform for developing both server-end and client-end online game software. We have used this platform to successfully develop in-house online games, such as The Age and Wool. Furthermore, we have significantly strengthened our in-house game development capabilities by acquiring game developers such as Actoz. Because Actoz is a majority-owned subsidiary, we classify all online games developed by Actoz as in-house developed, except for Mir II, which we categorize as a licensed game because Actoz shares the ongoing licensing fees we pay to Actoz with a third party that co-owns the intellectual property rights relating to the game.

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Our game development process generally includes the following key steps:

- formulate a new game proposal based on a preliminary market study;
- conduct an in-depth feasibility study;
- establish a project team to draft a new game development plan;
- develop the game story and overall game design;
- design the game style, characters and environments;
- develop the server-end and user-end software;
- conduct intermediate management review after the fundamental game structure has been developed; and
- conduct final management review upon completing the development of the new game.

The development of MMORPGs and advanced casual games, from management approval of a new game proposal to commencement of closed beta testing, generally takes two years and one year, respectively, but could take longer depending on certain circumstances.

As of March 31, 2011, we had over 2,000 game development personnel, including approximately 280 from Actoz, 250 from Goldcool and 110 from Eyedentity. Most of our software programmers and testing engineers have university or graduate degrees. We plan to continue to expand our research and development center by recruiting from top universities in China.

Game Licensing

We license games from international and domestic developers. We monitor certain key markets such as South Korea, Japan, the United States and Europe to identify and source game content.

As of March 31, 2011, 11 of our 34 online games were licensed from third-party developers, including Mir II, which is our top game in terms of revenues in 2010 and for which Actoz shares the ongoing licensing fees we pay to Actoz with a third party that co-owns the intellectual property rights relating to the game.

The cost of licensing games from game content owners generally consists of an upfront licensing fee, which we typically pay in installments, and royalties which are equal to a percentage of revenues we generate from operating the games. Under the license agreements, we have the exclusive right to operate the games in China. Generally, the license agreements have a term of three to six years. Most game content owners agree to provide us with updates and expansion packs developed for the games licensed to us timely without additional charge. Most of our license agreements require the game content owners to provide us with technical support.

Investment and Acquisition

We have expanded our online game portfolio through acquisitions and strategic investments and acquisitions. In June 2007, we acquired Chengdu Aurora, which operates Fengyun Online, a martial arts 3D MMORPG. In July 2009, we acquired Chengdu Simo, which operates Luvinia Online, a fantasy 3D MMORPG. In 2010, we acquired Goldcool, which operates numerous MMORPGs, including Hades Realm I and II, Zodiac Tales, and Dukes and Lords; Eyedentity, which operates Dragon Nest; and Mochi Media, which operates a leading platform for distributing and monetizing browser-based mini-casual games worldwide. Our investments and acquisitions have in turn enhanced the influence of our game development and operation platforms and strengthened our brand recognition within the online game industry in China.

We invest in independent game development and operating studios that have superior development or operation capabilities or potential to develop successful online games through 18 Capital which we established in 2006. In connections with our investments through 18 Capital, we typically acquire (i) intellectual property rights to online games, (ii) equity rights in online game development and operating studios or (iii) an option to acquire equity interests in online game development and operating studios in the future. Through our investments, we help entrepreneurial game developers and operators grow their businesses by leveraging our industry experience and game development and operation expertise. As a result of our investments thus far, we have sourced numerous talented game development personnel and currently operate three games that are developed by investee companies.

Co-Operation

We co-operate certain games in China under nonexclusive licenses granted by third-party Chinese developers who also operate the same games on their own platform. For example, we have entered into agreements with Shanghai Storm Information Technology Co., Ltd., or Shanghai Storm, in connection with the operation of Yuyan Online, and

Kingsoft in connection with the operation of JX Online World and JX3 Online. Under these agreements, we pay royalties to the game developers but no upfront licensing fee. We do not own any of the related game intellectual property rights, and Shanghai Storm and Kingsoft will continue to operate these games on their platforms as well.

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Our Game Performance Evaluation and Testing Systems

Our Game Performance Evaluation System for Game Sourcing

To better identify games with potential for commercial success, we have developed a game performance evaluation system to evaluate a potential game's attractiveness to game players and its expected performance before we source such games. The main characteristics of the system are as follows:

Stage 1. We evaluate a game based upon a number of criteria, including game and artistic design, technology and infrastructure requirements and operational metrics, if any. Of the thousands of games evaluated over our years of operation, only a small number have been submitted to our steering committee, which is comprised of personnel from our game development and operations, quality management, finance, marketing and other departments, for further evaluation.

Stage 2. The steering committee assesses these games and approves a select number of games, which are then passed on to the game management, business development and quality management divisions for testing and final evaluation.

Stage 3. These divisions evaluate the games to identify those with the highest potential for commercial success and allocate our marketing and other resources to such games.

Our Pre-Launch Game Testing System

Before the launch of a new game, we generally conduct internal beta testing to detect and resolve technical problems and improve the quality and features of the game. Thereafter, we conduct a closed beta testing to minimize technical problems, followed by open beta testing in which our registered users play the game to ensure consistency of performance and stability of operation systems. Open beta testing generally creates an initial game player base, builds awareness and generates publicity for the game. Based on information and feedback collected in pre-launch game testing, we adjust the game accordingly.

Our Game Operation Model

Game Management

Each game is managed by a designated game management team. Our game management teams:

- conduct cost/benefit analyses and form operational plans;
- coordinate internal resources and interact with our other departments such as game design, artistic design, quality management, marketing, and technological services to ensure a smooth daily operation of the online game;
- control the timing of the release of updates and expansion packs; and
- manage the game's virtual community on an ongoing basis by, for example, organizing in-game events.

A centralized game management center monitors the performance of each team. Our operational expertise and best practices are shared with all of our game management teams and departments.

Network and Technology Infrastructure

We have developed an extensive technology infrastructure to support our game operations, including a nationwide server network. As of March 31, 2011, the server network consisted of approximately 19,200 servers and 3,600 server annex equipment units with the capacity to accommodate up to 14 million concurrent online game players.

Due to the real-time interaction among hundreds of thousands of users, the stable operation of our games requires a large number of servers and a significant amount of Internet connectivity bandwidth. Due to China's large geographical area and limited Internet connectivity bandwidth, we have located game servers in numerous regions throughout China. As a result, our users can play our games using servers located in their region without exchanging data across long distances, thereby increasing the speed at which our games operate and enhancing our users experience.

The servers for each of our games are organized into a number of independent operating networks. Each operating network consists of a set of login system servers and a number of game server groups. Each operating network for our MMORPGs operates one game environment and our game players interact in a single virtual environment. Accordingly, with the expansion of our game player base for these games, we continue to increase the number of game server groups running separate game environments. We have introduced server virtualization technologies that allow a single hardware unit to host multiple virtual machines or game environments, to increase network efficiency.

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Each operating network is linked to Shanda Networking's centralized billing system, which processes access codes and passwords provided by users from their prepaid cards to add virtual currency into users' accounts and to deduct virtual currency consumed by users from their accounts as they play our games. Each operating network is also linked to our central data backup system, which backs up data from all login system servers and game servers on a daily basis. Most of our login servers for each operating network, as well as the servers for Shanda Networking's central billing system and our central data backup system, are located in Shanghai.

We continuously monitor the operation of our server network. Our remote control system allows us to track our online game players on an ongoing basis, and to discover and fix problems in the operation of hardware and software in our server network on a timely basis.

As of March 31, 2011, we owned approximately 90% of the servers in the server network for our game operations and leased the remainder from telecommunications operators. All of the servers in the server network for our game operations are located on the premises of our hosting telecommunications operators. Our server lease arrangements reduce our initial expenditures on servers, provide flexibility in network deployment and include incentives for network operators to maximize our network performance. We plan to add additional servers in order to introduce new games into our portfolio, service additional game players in more locations and accommodate a larger game player base.

Anti-Cheating and Anti-Hacking

We are committed to quickly disabling cheating programs developed by unauthorized third parties for use in connection with our games. We have developed our Game Protection Kit, which disables cheating programs developed by unauthorized third parties to help ensure the fairness of our game environments and significantly enhances our game players' experience. Game Protection Kit is used currently in most of the games that we operate. Upon the detection of a cheating program, our technology support team cooperates with our game development team to analyze the cheating program and develop and deploy software to disable it. With respect to cheating programs for games that we license, the licensors generally develop the disablement software.

Marketing

We employ various traditional and online marketing programs and promotional activities, including in-game events and announcements, online and traditional advertising, and offline promotions.

In-game events and announcements. We frequently organize in-game events for our game players to strengthen our communities of game players and generate more interest in our games. Examples of in-game events include special challenges or features introduced to the game environments for a scheduled period. In addition, we use in-game events to introduce new game features. Furthermore, we post in-game announcements to promote new features and other improvements of the game and in-game events. We also use in-game announcements for cross-game promotions.

Online and traditional advertising. We regularly advertise on a wide range of Internet portals and online game websites in China. We target a broad base of Internet users through three key initiatives: (i) the launch of large-scale coordinated advertising campaigns on major Internet portals, (ii) an affiliate marketing campaign attracting hundreds of regional websites in China through an incentive scheme to jointly promote our new games and direct traffic to our games' websites and (iii) a multi-segment targeted advertising campaign promoting our online games to different demographic groups of game players. We also advertise in national and regional newspapers and magazines as well as on billboards and city buses.

Offline promotions. We also market new games through posters at Internet cafes where a large number of game players play our games. We also organize promotional events at Internet cafes, distribution points, school campuses and other locations frequented by game players. In addition, we have also established sales offices in a number of provinces in China to assist Shengfutong's local distributors in organizing promotional activities for our games. Furthermore, we selectively sponsor media events to promote our games and have entered into arrangements with home personal computer manufacturers, consumer product manufacturers and telecommunications service providers in China to cross-market our games.

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Our Revenue Models

Revenue Models for the Games that We Operate

We adopt one of two different revenue models for each of the online games that we operate: item-based and time-based. We have adopted the item-based model for substantially all of our MMORPGs and all of our advanced casual games.

Under the item-based model, players are able to play the basic features of the game for free. We generate revenues when players purchase virtual items that enhance their playing experience, such as weapons, clothing, accessories and pets. The item-based revenue model allows us to introduce new virtual items or change the features or properties of virtual items to enhance game player interaction and create a better game community. The item-based revenue model also allows us to generate additional revenues by offering additional virtual items through new updates and expansion packs that meet the changing demands of game players. We determine the price of each virtual item before it is introduced, generally based on an analysis of certain benchmarks, such as the extent of the advantage to the player's character that the virtual item brings, the demand for the virtual item and the price of similar virtual items offered in other online games. We track the number and price of each virtual item sold as well as user behavior in response to the launch of a virtual item. We adjust the pricing of certain virtual items based on their consumption pattern and other factors.

Under the time-based model, players pay for game-playing time. The pricing is typically determined near the end of the open beta testing period based on several factors, including the game's development and operation costs, the pricing of competing games operated using a time-based model in the market, the playing and payment patterns of game players, the technological and other features of the game and the targeted market.

As one of the first online game companies in China to adopt the item-based revenue model on a large scale, we have accumulated significant experience in successfully operating online games through both revenue models. We adopt one of the two revenue models for a particular game based on a number of factors, including the quality and features of the game, the preference and playing habits of game players and the revenue models adopted for similar games. We also consider the revenue model adopted by the licensor or by other licensees.

Licensing of Our Games to Third Parties

We license certain of our online games in which we own the related game intellectual property rights to third parties. Under these license agreements, we typically license the right to exclusively operate, promote, distribute and service our online games in specified territories. In return, the licensee pays us an upfront licensing fee, which is typically paid in installments, and a royalty fee, which is equal to a percentage of revenues generated by the licensee from operating the game in the specific country or region. Generally, the licensees are responsible for the sales and marketing of the licensed games, including setting the price of virtual items, as well as the maintenance of the network infrastructure and customer service, and we are responsible for providing the localized versions of our games and the technical support for the operation of our games. We generally provide our licensees with updates to the licensed games. We also usually assist the licensee in preventing, detecting and resolving cheating and hacking activities. As of March 31, 2011, we licensed 14 MMORPGs and one advanced casual game to third parties in international markets, including Hong Kong, Macau, Taiwan, Vietnam, India, Malaysia, Indonesia, the Philippines, Singapore, Thailand, Korea, Japan, U.S.A., Canada, and Russia, as well as countries in the Middle East and Europe.

In-Game Advertising

We also generate revenues by selling advertising space within the browser-based mini-casual games offered by Mochi Media.

Online Billing and Payment, Distribution and Customer Service

Pursuant to the Amended and Restated Cooperation Agreement, we have engaged Shanda Networking to be our provider of certain services, including, among others, online billing and payment, user authentication, customer service, anti-fatigue compliance, prepaid card marketing and data support services, for a five-year period commencing July 1, 2008. Pursuant to the Amended and Restated Sales Agency Agreement, we have engaged Shengfutong as our sales agent for the distribution of prepaid cards, which are required to purchase virtual items or time units in our online games for a five-year period commencing July 1, 2008. For additional details on our agreements and the fees that we pay to Shanda Online, see Item 7, Major Shareholders and Related Party Transactions - Related Party

Transactions Transactions and Agreements with Shanda Interactive. The following services and functions described below are provided to our game players by Shanda Networking and Shengfutong pursuant to the agreements discussed above.

Online Billing and Payment and Distribution

Our game players can purchase virtual or physical prepaid cards to access our online games and to purchase virtual items. These cards are sold through Shengfutong's distribution network. Each prepaid card contains a unique access code and password that enables the user to purchase virtual currency. Such virtual currency can be used to purchase virtual items or time units in our online games. Fees incurred for purchases of these virtual items are deducted from the user's account.

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Our game players can purchase prepaid cards primarily through the following channels operated by Shengfutong:

Direct online sales. Game players can purchase prepaid cards directly online and payment can be made using certain commercial bank cards and other online payment service providers.

Indirect e-sales. Distributors order prepaid cards through a central e-sales computer system and resell the cards to game players through Internet cafes or other retail points of sale.

Indirect offline distribution. Game players can purchase physical prepaid cards from retail points of sale, which primarily consist of news stands, convenience stores, software stores and book stores.

Customer Service

We provide high-quality customer service and are responsive to our game players' needs. When our game players make customer service inquiries, a customer service representative of Shanda Networking will be the initial point of contact, and if the inquiry involves game-related technical problems, will liaise with a member of our game management team responsible for such game. We investigate and address irregularities in game operation reported by users, including eliminating cheating programs that are used by players to enable their game characters to acquire superior in-game capabilities. Typical requests handled by Shanda Networking include addressing problems in adding value to user accounts, retrieving forgotten passwords, and recovering lost user accounts. Typical requests handled by us include recovering virtual items or in-game characters, and other game-related questions. Customer service by Shanda Networking is provided through call centers, walk-in customer service centers and online customer service, including online forums and in-game customer service.

VIP game players (i.e., those who achieve a certain amount of spending on our games) also have access to more personalized customer service, including more user-friendly account management services. For certain VIP game players whose playing habits may have dropped significantly over a period of time, a customer service representative may contact them to persuade them to become a more active player.

Our game management teams, through Shanda Networking's customer relationship management system, monitor our game players' activities on a real-time basis and effectively manage and promote our games according to the user data. Game players can use the bulletin board services operated by Shanda Networking to post questions to, and receive responses from, other users, which helps us to monitor our users' common interests and concerns and provides us with important feedback on our online games. Furthermore, game player comments are collected and weekly reports are generated summarizing important issues and problems raised by game players as well as how such issues have been addressed.

Competition

We compete primarily with other online game developers and operators in China, including Changyou.com Limited, Giant Interactive Group, Inc., Kingsoft Corporation Limited, KongZhong Corporation, NetDragon Websoft Inc., NetEase.com, Nineyou International Limited, Perfect World Co., Ltd., Tencent Holdings Limited, and The9 Limited. We also compete with other private companies in China devoted to game development or operation, many of which are backed by venture capital funds and international competitors. Competition may also come from international game developers and operators, such as Activision Blizzard, Inc., Electronic Arts Inc., NCSoft Corporation, Nexon Corporation and Webzen, Inc.

We compete primarily on the basis of the quality or features of our online games, our operational infrastructure and expertise, the strength of our product management approach, and the services we offer that enhance our game players' experience.

We believe that domestic game developers and operators, including us, are likely to have a competitive advantage over international competitors entering the China market, as these companies are likely to lack operational infrastructure in China and content localization experience for the China market. We cannot assure you, however, that this competitive advantage will continue to exist, particularly if international competitors establish joint ventures, form alliances with or acquire domestic game developers and operators. In addition, we also compete for users against various offline games, such as console games, arcade games and handheld games, as well as various other forms of traditional or online entertainment. For a discussion of risks relating to competition, see Item 3, Key Information Risk Factors Risks Relating to Our Business and Our Industry. We face significant competition which could reduce our market share and materially and adversely affect our business, financial condition and results of operations.

Intellectual Property and Proprietary Rights

Intellectual property is essential to our business. We rely on copyright, trademark, patent, trade secret and other intellectual property law, as well as noncompetition, confidentiality and license agreements with our employees, suppliers, business partners and others to protect our intellectual property rights. We generally require our employees to sign agreements acknowledging that all inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf are our property, and assigning to us any ownership rights that they may claim in those works. Despite these measures, we cannot assure you that we will be able to prevent unauthorized use of our intellectual property, which would adversely affect our business.

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As of December 31, 2010, we owned 134 software copyrights, each of which we have registered with the State Copyright Bureau of the PRC.

As part of the reorganization, we entered into a Domain Names and Trademarks License Agreement with Shanda Online pursuant to which Shanda Online licensed to us nine trademarks and 252 domain names on a nonexclusive, nontransferable and royalty-free basis.

As of December 31, 2010, we owned or licensed 53 trademarks, each in various categories, each of which we have registered with the China Trademark Office, and had 102 trademark applications, each in various categories, pending with the China Trademark Office. We have also filed applications to register certain trademarks in a number of other jurisdictions, including Hong Kong and Vietnam.

As of December 31, 2010, we owned or licensed 687 registered domain names, including our official website and domain names registered in connection with each of the games we offer. All of our domain names are either held by, or licensed by our PRC companies.

As of December 31, 2010, we had 8 patent applications pending with the State Intellectual Property Office of China.

Government Regulations

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

- the Bureau of State Secrecy;
- the General Administration of Press and Publication, or the GAPP (formerly the State Press and Publications Administration);
- the Ministry of Commerce, or the MOFCOM;
- the Ministry of Culture, or the MOC;
- the Ministry of Industry and Information Technology, or the MIIT (formerly the Ministry of Information Industry);
- the Ministry of Public Security;
- the State Administration of Foreign Exchange, or the SAFE;
- the State Administration of Industry and Commerce, or the SAIC;
- the State Administration for Radio, Film and Television;
- the State Copyright Bureau, or the SCB; and
- the State Council Information Office.

Foreign Ownership Restrictions

Foreign direct investment in telecommunications companies in China is regulated by the Regulations for the Administration of Foreign-Invested Telecommunications Enterprises, or the FITE Regulations, which was issued by the State Council on December 11, 2001 and subsequently amended on September 10, 2008. The FITE Regulations limit foreign ownership of companies that provide value-added telecommunications services, including Internet content provision, to 50%. In addition, foreign and foreign-invested enterprises are currently not able to apply for the required licenses for operating online games in China.

On July 13, 2006, the MIIT issued the Circular on Strengthening the Administration of Foreign Investment in Value-added Telecommunication Services, or the MIIT Circular 2006. The MIIT Circular 2006 requires that (i) foreign investors can only operate a telecommunications business in China by establishing a telecommunications enterprise with a valid ICP license; (ii) domestic ICP license holders are prohibited from leasing, transferring or selling an ICP license to foreign investors in any form, or providing any resource, sites or facilities to foreign investors to facilitate the illegal operation of telecommunications business in China; (iii) ICP license holders (including their shareholders) must directly own the domain names and registered trademarks they use in their daily operations; (iv) each ICP license holder must have the necessary facilities for its approved business operations and maintain such facilities in the regions covered by its license and (v) all value-added telecommunication service providers must improve the network and information security, draft relevant information safety administration regulations and set up networks and information safety emergency plans.

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In order to comply with such foreign ownership restrictions, we operate our online game business in China through our PRC operating companies, and controlled by our PRC subsidiaries through a series of contractual arrangements. In the opinion of our PRC legal counsel, Jade & Fountain PRC Lawyers, except as otherwise disclosed in this annual report, in all material respects, our ownership structure, business and operation model comply with existing PRC laws and regulations.

Licenses

A number of aspects of our business require us to obtain licenses from a variety of PRC regulatory authorities.

ICP License. According to the Administrative Measures on Internet Information Services, commercial Internet information service operators must obtain an ICP license or be sublicensed by qualified ICP license holders. Moreover, ICP operators providing ICP services in multiple provinces, autonomous regions and centrally administered municipalities may be required to obtain an inter-regional ICP license. Shanghai Shulong has obtained an inter-regional ICP license which covers online game services. Chengdu Youji, Chengdu Aurora and Chengdu Simo have obtained a regional ICP license which only allows them to provide ICP services within Sichuan Province and Shanghai Hongli and Tianjin Youji have obtained regional licenses which allow them to provide ICP services in Shanghai and Tianjin, respectively.

According to the Administrative Measures for Telecommunications Business Operating Licenses, a value-added telecommunications service provider that has obtained an inter-regional ICP license shall commence its business operations in the geographic areas as covered by its license within one year after acquiring the license. The ICP license will be valid for five years. A value-added telecommunications service provider may authorize its subsidiaries or branches to conduct a value-added telecommunications service business in licensed regions and have greater than 51% of the equity ownership in the subsidiaries in order to do so. Moreover, a value-added telecommunications service provider shall not authorize two or more subsidiaries or branches to conduct the same value-added telecommunications service business in the same region. Shanghai Shulong has authorized Shulong Computer and Nanjing Shulong to conduct a value-added telecommunications service business in separate regions.

Internet Culture Operation License. According to the Provisional Regulations for the Administration of Online Culture, a commercial operator of online cultural products, including online games, must obtain, in addition to the ICP license, an Internet culture operation license from the MOC. In addition, the Interim Measures for Online Games Administration issued by the MOC, effective on August 1, 2010, reiterate that online game operators shall obtain an Internet culture operation license for operating online games. Each of Shanghai Shulong, Chengdu Aurora, Chengdu Simo, and Shanghai Hongli currently holds the license.

Internet Publishing License. The Interim Administration Measures on Internet Publication impose a license requirement for any company that engages in online publishing, defined as any act by an Internet information service provider to select, edit and process content or programs and to make such content or programs publicly available on the Internet. Under current PRC laws and regulations, the provision of online games is deemed an Internet publication activity. Therefore, an online game operator must obtain an Internet publishing license in order to directly make its online games publicly available in China. Shanghai Shulong, Shanghai Hongli and Chengdu Simo currently hold such a license. All of our online games in commercial operation have been filed with the GAPP as electronic publications.

Regulation of Internet Content

The PRC government has promulgated measures relating to Internet content through a number of governmental agencies. These measures specifically prohibit Internet activities, which include 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. When an Internet content provider or an Internet publisher finds that information falling within the above scope is transmitted on its website, it shall terminate the transmission of such information or delete such information immediately and keep records and report to relevant authorities. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

In addition, according to the Notice on the Work of Purification of Online Games jointly issued by several governmental authorities in June 2005, online games are required to be registered and filed as software products in accordance with the Administrative Measures on Software Products (2000) for the purpose of being operated in

China. Furthermore, in accordance with the Notice on Enhancing the Content Review Work of Online Game Products (2004) promulgated by the MOC, imported online games are subject to a content review by the MOC prior to their operation in China. In addition, imported and domestic online games are required to be filed with the MOC before the operation of each game. Our online games in commercial operation were all filed with the MOC.

Table of Contents***Regulation of Information Security***

Internet content in China is 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: (i) gain improper entry into a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak state secrets; (iv) spread false commercial information; or (v) infringe intellectual property rights.

The Ministry of Public Security has promulgated measures that prohibit using the Internet in ways which, among other things, result 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. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

Technology Import and Export

Our ability to license online games from abroad and import them into China is regulated in several ways. We are required to register with the MOFCOM, any license agreement with a foreign licensor that involves an import of technologies, including online game software into China. Without that registration, we cannot remit licensing fees out of China to any foreign game licensor. Furthermore, the SCB requires us to register copyright license agreements relating to imported software. Without the SCB registration, we are not allowed to publish or reproduce the imported game software in China. In addition, imported online game software is also required to pass a content examination by the MOC. Any imported online game software which has not been examined and approved by the MOC is not allowed to be put into operation in China. If we import into China and operate online games without obtaining game content approval, the MOC may impose certain penalties on us, including the revocation of our Internet culture operation license that we require to operate online games in China. In 2009, the MOC and the GAPP issued separate circulars to further tighten the review procedure for importing online games into China. See also Item 3, Key Information Risks Relating to Our Business and Our Industry We may be required to reapply for approvals for online games licensed from overseas licensors. The MIIT also requires us to register online games that we want to import and operate in China. We have registered all online games that we currently operate.

Intellectual Property Rights

China has enacted various laws and regulations relating to protection of intellectual property rights, including copyrights, software, trademarks, patents, domain names and other forms of intellectual property.

Software Copyright. Software copyrights are under the protection of various laws, regulations, and rules promulgated by the State Council and the SCB, including the Regulations on Computer Software Protection, or the Software Regulations, promulgated on December 20, 2001 by the State Council, and the Measures on the Registration of Computer Software Copyright, promulgated on February, 20, 2002 by the SCB. In addition, On March 5, 2009, the MIIT issued the Administrative Measures on Software Products, which became effective on April 10, 2009, to strengthen the regulation of software products and to encourage the development of the PRC software industry. Under these rules and regulations, software owners, licensees and transferees may register their rights in software with the SCB or its local branches and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process and registered software rights may be entitled to better protections. We have registered all of our in-house developed online games that have been commercially launched with the SCB.

Copyright. According to the PRC Copyright Law, adopted in 1990 and amended in 2001 and 2010, and its implementing rules, publications and products disseminated over the Internet and software products are protected by the PRC laws and regulations. In addition, according to the Trial Measures of Voluntary Registration of Works, which became effective on January 1, 1995, copyright owners are encouraged, although not required, to register their copyrights with the SCB or its local branches and receive written registration certificates.

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

Patent. The PRC Patent Law, promulgated on March 12, 1984, as amended on September 4, 1992, August 25, 2000 and December 27, 2008, with its implementing rules, protects the patents. The State Intellectual Property Office is responsible for administering patents in the PRC. Under the PRC Patent Law, patents are grouped into three categories: inventions, utility models and designs. Patents for inventions remain valid for twenty years, and patents for utility models and designs remain valid for ten years, in each case from the filing date of the patent application.

Table of Contents***Internet Cafe Regulation***

Internet cafes are required to obtain a license from the MOC and the SAIC and are subject to requirements and regulations with respect to location, size, number of computers, age limit of customers and business hours. Although we do not own or operate any Internet cafes, many Internet cafes distribute virtual prepaid cards. The PRC government has intensified its regulation of Internet cafes, which are currently one of the primary venues for our users to play our games. In 2004, the MOC, the SAIC and several other government authorities jointly issued a notice to suspend issuance of new Internet cafe licenses. Though this nationwide suspension has been generally lifted in 2005, the local authorities have the authority of controlling the volume and recipients of new licenses at their discretion. In addition, local and higher-level governmental authorities may from time to time strictly enforce customer age limits and other requirements relating to Internet cafes, as a result of the occurrence of, and media attention on, gang fights, arsons or other incidents in or related to Internet cafes. As many of our game players access our games from Internet cafes, any reduction in the number, or any slowdown in the growth, of Internet cafes in China as a result of any intensified Internet cafe regulation will limit our ability to maintain or increase our revenues and expand our game player base, which will in turn materially and adversely affect our business and results of operations. A notice jointly issued by several central governmental authorities in February 2007 suspended nationwide the approval for the establishment of new Internet cafes in 2007 and enhanced the punishment for Internet cafes admitting minors. In March 2010, the MOC issued a circular to increase the punishment on Internet cafes which allow minors to enter and use Internet in their cafes.

Privacy Protection

Chinese law does not prohibit Internet content providers from collecting and analyzing personal information of their users. We require our users to accept a user agreement whereby they agree to provide certain personal information to us. Chinese law prohibits Internet content providers from disclosing any information transmitted by users through their networks to any third parties unless otherwise permitted by law. If an Internet content provider violates these regulations, the MIIT or its local bureaus may impose penalties and the Internet content provider may be liable for damages caused to its users.

Anti-fatigue Compliance System and Real-name Registration System

In April 2007, the GAPP and several other governmental authorities issued a circular requiring the implementation of an anti-fatigue compliance system and a real-name registration system by all PRC online game operators to curb addictive online game playing by minors. Under the anti-fatigue compliance system, three hours or less of continuous playing by minors, defined as game players under 18 years of age, is considered to be healthy, three to five hours to be fatiguing, and five hours or more to be unhealthy. Game operators are required to reduce the value of in-game benefits to a game player by half if the game player has reached the fatiguing level, and to zero in the case of the unhealthy level.

To identify whether a game player is a minor and thus subject to the anti-fatigue compliance system, a real-name registration system must be adopted to require online game players to register their real identity information before playing online games. The online game operators are also required to submit the identity information of game players to the public security authority for verification.

Shanda Online has implemented an anti-fatigue compliance system and real-name registration system and provides anti-fatigue compliance services for us. Under this system, game players must use real identities to create accounts to enable us to identify which of our game players are minors and thus are subject to these regulations. For game players who do not register, we assume that they are minors.

Payment and Clearance By Non-financial Institutions

On April 16, 2009, the PBOC issued a notice regarding the payment and clearance business carried out by non-financial institutions, or the PBOC Notice. The PBOC Notice requires non-financial institutions which engage in payment and clearance business to register with the PBOC before July 31, 2009.

In order to collect payment from our online game players, we rely on certain services provided by certain VIEs of Shanda Online, which may be subject to the requirements of the PBOC Notice. Shanda Online has registered with the PBOC. However, if the PBOC requires Shanda Online to obtain additional licenses or approvals for its services, there is no assurance that Shanda Online will be able to obtain such licenses or approvals. In the event that Shanda Online

fails to obtain any or all of the licenses or approvals as mentioned above, we may not be able to collect payment from our game players on a timely basis or at all and may have to change our current billing model and system.

Virtual Currency

In January 2007, the Ministry of Public Security, the MOC, the MIIT and the GAPP jointly issued a circular regarding online gambling which has implications for the issuance and use of virtual currency. To curtail online games that involve online gambling as well as address concerns that virtual currency could be used for money laundering or illicit trade, the circular (i) prohibits online game operators from charging commissions in the form of virtual currency in relation to winning or losing of games; (ii) requires online game operators to impose limits on use of virtual currency in guessing and betting games; (iii) bans the conversion of virtual currency into real currency or property and (iv) prohibits services that enable game players to transfer virtual currency to other players. In February 2007, 14 PRC regulatory authorities jointly promulgated a circular to further strengthen the oversight of Internet cafes and online games. Under the circular, the PBOC has authority to regulate virtual currency, including: (i) setting limits on the aggregate amount of virtual currency that can be issued by online game operators and the amount of virtual currency that can be purchased by an individual; (ii) stipulating that virtual currency issued by online game operators can only be used for purchasing virtual products and services within the online games and not for purchasing tangible or physical products; (iii) requiring that the price for redemption of virtual currency shall not exceed the respective original purchase price and (iv) banning the trading of virtual currency.

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On June 4, 2009, the MOC and the MOFCOM jointly issued a notice regarding strengthening the administration of online game virtual currency, or the Virtual Currency Notice. The Virtual Currency Notice requires businesses that (i) issue online game virtual currency (in the form of prepaid cards and/or pre-payment or prepaid card points) or (ii) offer online game virtual currency transaction services to apply for approval from the MOC through its provincial branches within three months following the date of such notice. The Virtual Currency Notice also prohibits businesses that issue online game virtual currency from providing services that would enable the trading of such virtual currency. Any business that fails to submit the requisite application will be subject to sanctions, including but not limited to warnings, mandatory corrective measures and fines.

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

In addition, the Virtual Currency Notice regulates, among other things, the amount of virtual currency a business can issue, the retention period of user records, the function of virtual currency, and the return of unused virtual currency upon termination of online services. It also prohibits online game operators from allocating virtual items or virtual currency to players based on random selection through lucky draw, wager or lottery which involves cash or virtual currency directly paid by the players. The Virtual Currency Notice also provides that game operators may not issue virtual currency to game players through means other than purchases with legal currency. Moreover, any businesses that do not provide online game virtual currency transaction services are required to adopt technical measures to restrict the transfer of online game virtual currency among accounts of different game players.

We issue online game virtual currency to game players for them to purchase various virtual items to be used in our online games. We intend to comply with the Virtual Currency Notice. Shanghai Shulong, Chengdu Aurora, Chengdu Simo and Shanghai Hongli have obtained approval from the MOC for issuing online game virtual currency, as required under the Virtual Currency Notice. However, we cannot assure you that all of our PRC operating companies can obtain the approval in a timely manner or at all. Certain of our games contain features known as treasure boxes. Players may use yuanbao, a virtual item they obtain in the games, to acquire keys to open treasure boxes that, if opened, award the players with rewards, such as game points or virtual items. As no cash or virtual currency is directly paid by the players in opening treasure boxes, we believe such feature is distinct from those prohibited by the Virtual Currency Notice. However, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours. See Item 3, Key Information Risk Factors Risks Relating to Regulation of Our Business and to Our Structure Compliance with the laws or regulations governing virtual currency may result in us having to obtain additional approvals or licenses or change our current business model.

C. ORGANIZATIONAL STRUCTURE

As of December 31, 2010, we operated our businesses through the following significant direct and indirect subsidiaries and investee companies:

Shanda Games Holdings (HK) Limited, or Shanda Games (HK), which is our direct wholly-owned subsidiary incorporated in Hong Kong;

Shengqu Information Technology (Shanghai) Co., Ltd., or Shengqu, which is a wholly foreign-owned operating entity incorporated in the PRC and a direct wholly-owned subsidiary of Shanda Games (HK);

Shengji Information Technology (Shanghai) Co., Ltd., or Shengji, which is a wholly foreign-owned operating entity incorporated in the PRC and a direct wholly-owned subsidiary of Shanda Games Technology (HK) Limited;

Lansha Information Technology (Shanghai) Co., Ltd., or Lansha, which is a wholly foreign-owned operating entity incorporated in the PRC and a direct wholly-owned subsidiary of Shanda Games Technology (HK) Limited;

Shanda Games International (Pte) Ltd., which is our direct wholly-owned subsidiary incorporated in Singapore;

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Kuyin Software (Shanghai) Co., Ltd., which is a wholly foreign-owned operating entity incorporated in the PRC and a direct wholly-owned subsidiary of Goldcool Holdings Limited;

Mochi Media, Inc., which is our direct wholly-owned subsidiary incorporated in California;

Eyedentity Games, Inc., which is our direct wholly-owned subsidiary incorporated in Korea; and

Actoz Soft Co., Ltd., or Actoz, which is our majority-owned subsidiary incorporated in South Korea and publicly listed on the Korea Exchange.

In order to comply with PRC laws restricting foreign ownership in the online game business in China, we operate our online game business in China through our PRC operating companies. We control our PRC operating companies through a series of contractual arrangements, including agreements between our PRC subsidiaries, on the one hand, and our PRC operating companies and/or their shareholders, on the other hand. The VIE agreements are a series of contractual arrangements relating to business operations, consulting services, and certain shareholder rights and corporate governance matters. As a result of these contractual arrangements, we are considered the primary beneficiary of our PRC operating companies and accordingly, consolidate the results of operations of our PRC operating companies in our financial statements.

In the opinion of our PRC legal counsel, Jade & Fountain PRC Lawyers, in all material aspects, the ownership structure and the contractual arrangements between our PRC subsidiaries, on the one hand, and our PRC operating companies and/or their shareholders, on the other hand, comply with current PRC laws and regulations. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, PRC governmental authorities may ultimately take a view that is inconsistent with the opinion of Jade & Fountain PRC Lawyers. See Item 3, Key Information Risk Factors Risks Relating to Regulation of Our Business and to Our Structure.

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The following diagram illustrates our direct and indirect subsidiaries and VIEs as of December 31, 2010.

D. PROPERTY, PLANTS AND EQUIPMENT

We lease our office space of approximately 12,000 square meters at No. 1 Office Building, No. 690 Bibo Road, Pudong New Area, Shanghai 201203, from Shanda Interactive. In addition, we occupy an aggregate of approximately 24,000 square meters of leased office space in Beijing, Shenzhen, Chengdu, Hangzhou, Wuhan and various other cities in China and Hong Kong, Singapore, U.S.A. and South Korea. As our workforce expands, we may need to lease or purchase additional office space.

Item 4A. UNRESOLVED STAFF COMMENTS

None.

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Item 3. Key Information D. Risk Factors or in other parts of this annual report on Form 20-F.

Overview

We are China's leading online game company in terms of the size and diversity of our game portfolio. Our online game revenues and game player base are also among the largest in China. Through our extensive experience in the online game industry in China, we have created a scalable approach to develop, source and operate online games, as well as license our games to third parties. We develop and source a broad array of game content through multiple channels, including in-house development, licensing, investment and acquisition, and co-operation. Through these channels, we have built a large, diversified game portfolio and a robust game pipeline. In addition, we operate a nationwide, secure network to host hundreds of thousands of users playing simultaneously, and monitor and adjust the game environment to optimize our game players' experience.

As of March 31, 2011, we operated 28 MMORPGs and six advanced casual games. Our in-house development capabilities consist of over 2,000 game development personnel and our proprietary game development platform.

We use either the item-based or time-based revenue model for the games we operate. Compared with the time-based model, under which players pay for game-playing time, the item-based model allows game players to play the basic features of the game for free. Game players may then choose to purchase virtual items that enhance their playing experience, such as weapons, clothing, accessories and pets. Our game players purchase electronic or physical prepaid cards to purchase virtual items and to access our time-based online games. We have adopted the item-based model for substantially all of our MMORPGs and all of our advanced casual games.

Our net revenues were RMB4,504.7 million (US\$680.2 million) in 2010, compared to RMB4,806.7 million in 2009. Our net income attributable to our company was RMB1,288.8 million (US\$194.6 million) in 2010, compared to RMB1,453.0 million in 2009.

We depend substantially on two online games, which accounted in the aggregate for approximately 78.2% and 66.8% of our net revenues in 2009 and 2010, respectively. These games have finite commercial lifespan. While we may be able to extend the commercial lifespans of these games by adding new features that appeal to existing players and attract new players, we need to develop and source new online games that appeal to game players and that will be commercially successful in order to remain competitive. Furthermore, the online game industry in China may not continue to grow at current levels, and we face uncertainties regarding the continuing market acceptance of our online games in China and elsewhere. We need to adapt to new industry trends, including changes in game players preferences, new revenue models, new game content distribution models, new technologies and new governmental regulations. We evaluate these changes as they emerge and strive to adapt our business and operations in order to maintain and strengthen our leadership in the industry.

Table of Contents**The Reorganization and the Basis of Preparation**

Our online game business was founded by Shanda Interactive in 2001 and was operated by Shanda Interactive through various subsidiaries and VIEs, until the reorganization on July 1, 2008. As part of the reorganization, Shanda Interactive transferred substantially all of its assets and liabilities related to the online game business to us. In connection with the reorganization, we entered into agreements with Shanda Interactive and certain of its affiliates with respect to various ongoing relationships between us. See Item 7, Major Shareholders and Related Party Transactions Related Party Transactions Transactions and Agreements with Shanda Interactive.

As the reorganization was accounted for as a common control transaction, our consolidated financial statements have been prepared as if our current corporate structure had been in existence throughout the periods presented and as if the online game business, including Actoz that Shanda Interactive subsequently transferred to us in the second quarter of 2009, was transferred to us from Shanda Interactive as of the earliest period presented. Accordingly, for the period from January 1, 2008 to June 30, 2008, our consolidated financial statements were prepared by combining the assets, liabilities, revenues, expenses and cash flows of entities that were directly engaged in the online game business.

Our statements of operations and comprehensive income for the periods from January 1, 2008 to June 30, 2008 include all the historical costs related to the online game business, including payments for certain services performed by Shanda Interactive's various subsidiaries and VIEs, which became Shanda Online after the reorganization, and an allocation of certain general corporate expenses of Shanda Interactive. These general corporate expenses primarily relate to employee compensation costs, professional service fees and other expenses arising from the provisions of certain corporate functions, including finance, legal, technology, investment and executive management. We allocated these expenses based on estimates that our management believes are a reasonable reflection of the utilization of services provided to, or benefits received by, us. See Note 2(1) to our consolidated financial statements included elsewhere in this annual report for further information related to these costs. Shanda Interactive allocated an aggregate of RMB14.4 million and RMB8.2 million (US\$1.2 million) of corporate expenses to us for the years ended December 31, 2009 and 2010, respectively. While the expenses allocated to us are not necessarily indicative of the expenses that we would have incurred if we had been a separate, independent entity during the periods presented, our management believes that the foregoing presents a reasonable basis of estimating what our expenses would have been on a historical basis.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could materially differ from those estimates.

For the period from July 1, 2008 to December 31, 2010, our consolidated financial statements consist of the financial statements of Shanda Games, including its subsidiaries and VIEs, as a standalone entity subsequent to the reorganization.

Our Agreements with Shanda Online

Effective as of the reorganization, we have engaged certain VIEs of Shanda Online to provide certain services that are critical to our business. Pursuant to the Amended and Restated Cooperation Agreement with Shanda Networking and Nanjing Shanda, we have engaged Shanda Networking as our provider of certain services, including, among others, online billing and payment, user authentication, customer service, anti-fatigue compliance, prepaid card marketing and data support services for a period of five years commencing July 1, 2008. We pay Shanda Networking a service fee, which we record as a portion of platform fees in our cost of revenues. Pursuant to the Amended and Restated Sales Agency Agreement with Shengfutong, we have engaged Shengfutong, for a period of five years commencing July 1, 2008, as the sales agent for the distribution of prepaid cards which are required to purchase virtual items or time units in our online games. For each prepaid card sold, we pay Shengfutong a service fee, which we record as a portion of sales and marketing expenses in our operating expenses. See Item 7, Major Shareholders and Related Party Transactions Related Party Transactions Transactions and Agreements with Shanda Interactive for more details on the terms of these agreements, including the fixed discount to the face value of prepaid cards used to calculate the service fees we pay under these agreements. Prior to the reorganization, the services currently provided by Shanda Networking were performed by Shanda Interactive's various subsidiaries and VIEs and the service fees were based on

certain agreements in existence at that time. Prior to the reorganization, the services currently provided by Shengfutong were performed by our own sales and marketing personnel and the costs relating to such services were recorded as a portion of sales and marketing expenses.

Due to the differences in the agreements in place prior to and after the reorganization, our results of operations for the periods prior to and after the reorganization are not entirely comparable. Specifically, the agreements pursuant to which we recognize platform fees and sales and marketing expenses following the reorganization differ from the methods prior to the reorganization. Therefore, with respect to periods prior to and after July 1, 2008, cost of revenues (namely, platform fees) and operating expenses (namely, sales and marketing expense) are not entirely comparable, which also impact other line items such as gross profit, income from operations and net income. As a result, the results of operations for the years ended December 31, 2008 and 2009 may not be entirely comparable.

Table of Contents**Factors Affecting Results of Operations**

Significant factors affecting our financial condition and results of operations include:

Our ability to continue to successfully introduce new online games and expansion packs for existing games. We have built the largest and the most diversified portfolio of online games in China through our multi-channel game content development and sourcing strategy. We must continue to generate and acquire attractive online games by developing in-house, licensing, acquiring through investment, or co-operating with third parties, new online games and to maintain the popularity of our existing online games by introducing updates, expansion packs and other game improvements. Our results of operations may also be significantly affected by the timing of our new game launches;

Our ability to maintain and expand our community of loyal game players. The size and loyalty of our community of game players are critical to our business. Players of online games, especially MMORPGs, are typically attracted to online games in which they can interact with many players. We have built a large community of game players and have maintained and expanded this community by enhancing our game players' loyalty to our online games. Our loyal game players tend to remain active paying game players and in addition, such game players are likely to spend more on our virtual items or consume more playing time on our games. Our ability to retain and attract game players will depend significantly on our ability to continually strengthen our community of loyal game players and enhance their experience;

Game content sourcing costs. Significant resources are required to develop, acquire and market new online games and maintain their popularity in the market, including game development, game licensing and other online game generation and acquisition costs. We typically incur significant costs and expenses before such online games generate any revenues. If such games are not popular and do not generate substantial revenues, we may not be able to recover such game content sourcing costs;

The reliability and quality of Shanda Networking's integrated service platform and Shengfutong's distribution services. We have engaged Shanda Networking and Shengfutong to provide certain services that are critical to the operation of our online game business, including online billing and payment, customer service, user authentication, anti-fatigue compliance, prepaid card marketing and distributions and data support services, for a period of five years commencing July 1, 2008. The reliability and quality of Shanda Networking's integrated service platform and Shengfutong's distribution services directly affect the availability of our online games to our game players and the quality of the game-playing experience, which would have a material effect on our revenues;

Competition in China's online game industry. The online game industry in China is highly competitive. Numerous competitors have entered the online game industry in China, including Changyou.com Limited, Giant Interactive Group, Inc., Kingsoft, KongZhong Corporation, NetDragon Websoft Inc., NetEase.com, Nineyou International Limited, Perfect World Co., Ltd., Tencent Holdings Limited and The9 Limited. The proliferation of the number of online game companies has placed significant pressure on the cost of sourcing and marketing online games, attracting new and retaining existing game players, and recruiting and retaining game development and management talent; and

The growth of our international business. We have licensed the publishing rights to 15 of our online games to game operators in a number of countries and regions, and intend to operate our games in overseas markets through our overseas subsidiaries. To operate our games in overseas markets, we will need to localize our online games to meet the preferences of game players in overseas markets. In addition, we will need to operate our online games across various platforms, including social networking platforms, and various devices, such as mobile phones.

Revenues

We currently derive a substantial portion of our revenues from purchases of virtual items by game players of our MMORPGs and advanced casual games.

The following table sets forth, for the periods indicated, a breakdown of our net revenues into MMORPGs, advanced casual games and other revenues.

For the Year Ended December 31,					
2008		2009		2010	
RMB	% of Net Revenues	RMB	% of Net Revenues	RMB	% of Net Revenues

(audited)
(in millions, except percentages)

Net revenues:						
MMORPG revenues ⁽¹⁾	2,948.5	87.3%	4,422.1	92.0%	4,018.3	89.2%
Advanced casual game revenues ⁽²⁾	355.8	10.5	305.6	6.4	300.6	6.7
Other revenues ⁽³⁾	72.5	2.2	79.0	1.6	185.8	4.1
Total net revenues	3,376.8	100.0%	4,806.7	100.0%	4,504.7	100.0%

(1) Represents net revenues generated from the operation of MMORPGs in China.

(2) Represents net revenues generated from the operation of advanced casual games in China.

(3) Represents net revenues generated primarily outside of China from game licensing, game operations, and advertising.

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Our revenues from MMORPGs and advanced casual games are net of a sales discount. For the period prior to the reorganization, the sales discount represented the difference between the face value of the prepaid card and the price at which we sold the prepaid card to our distributors or to our game players. For the periods subsequent to the reorganization, pursuant to the Amended and Restated Sales Agency Agreement, the sales discount represents the difference between the face value of the prepaid cards and the price at which Shengfutong sells the prepaid cards to third-party distributors and retailers or directly to our game players. Therefore, with respect to each prepaid card sold, the amount of revenues we record and service fee we pay to Shengfutong, which we record under sales and marketing expenses in our operating expenses, depend on the sales discount at which Shengfutong sells the prepaid card. A smaller discount applied by Shengfutong will result in higher net revenues to us, as well as corresponding higher service fee paid to Shengfutong, and vice versa. Notwithstanding the foregoing, with respect to each prepaid card sold, we are guaranteed a fixed percentage of the face value of a prepaid card in revenues.

Our revenues are also net of the PRC business tax that our PRC operating companies pay on their gross revenues. The PRC business tax ranges from 3% to 5%.

We operate our games using one of two revenue models. For games operated using the item-based revenue model, which constitute the majority of our games, the most significant factors that affect our revenues are (i) the number of active paying accounts and (ii) the range, number and pricing of virtual items available for sale. The number of active paying accounts for any given period is equal to the number of game player accounts that spend virtual currency at least once during a given period and includes accounts of game players who spend virtual currency in beta testing of our online games. Our quarterly active paying accounts is equal to the aggregate number of active paying accounts for our online games during a given quarter.

For games operated using the time-based revenue model, the most significant factors that affect our revenues are (i) the number of users playing the game and (ii) the length of time that users play the game, or total user-hours. We calculate our total user-hours based on our average concurrent users. In a given period, the number of total user-hours equals the average concurrent users for that period multiplied by the number of hours in that period. In measuring average concurrent users, we determine the number of users logged on to our games that adopt the time-based revenue model at one minute intervals, and then average that number over the course of a day to derive daily averages. Average daily information is further averaged over a particular period to determine average concurrent users for that period.

Our online game business is subject to seasonality factors. Generally, our game players spend more time playing our games in the first and third quarters of each year, which typically have more holidays, allowing for more time for leisure activities, whereas the second and fourth quarters are generally slower for our business as there are fewer holidays during those quarters.

Our other revenues consist of net revenues generated primarily outside of China from game licensing, game operations, and advertising. We enter into licensing arrangements with overseas licensees to operate our MMORPGs and advanced casual games in other countries or territories. In connection with these license agreements, we generally receive an initial license fee and a monthly revenue-based royalty fee. The initial license fee is based on a fixed amount and recognized ratably over the term of the license. The royalty fee is generally calculated as a fixed percentage of the revenues generated by the licensee from operating the MMORPG or advanced casual game. Game operation revenues as a portion of our other revenues are derived from our operation of online games outside of China. Advertising revenues are derived from online advertising associated with the online games on our platform.

Cost of Revenues

Our cost of revenues primarily consists of platform fees, upfront and ongoing licensing fees for online games we operate and other miscellaneous expenses. The following table sets forth, for the periods indicated, a breakdown of our cost of revenues by amount and percentage of our net revenues.

For the Year Ended December 31,					
2008		2009		2010	
RMB	% of Net Revenues	RMB	% of Net Revenues	RMB	% of Net Revenues

	(audited)					
	(in millions, except percentages)					
Net revenues	3,376.8	100.0%	4,806.7	100.0%	4,504.7	100.0%
Cost of revenues:						
Platform fees	864.9	25.6	1,018.5	21.2	909.8	20.2
Upfront and ongoing licensing fees	520.9	15.4	797.1	16.6	730.3	16.2
Others	103.6	3.1	117.9	2.4	197.1	4.4
Total cost of revenues	1,489.4	44.1	1,933.5	40.2	1,837.2	40.8
Gross profit/margin	1,887.4	55.9%	2,873.2	59.8%	2,667.5	59.2%

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Platform fees. Platform fees consist of (1) costs related to various support services, including online billing and payment, user authentication, customer service, anti-fatigue compliance, prepaid card marketing and data support services, and (2) other expenses related to server leasing expense, depreciation of purchased servers and equipment, server and equipment maintenance fees, and software rental fees. Platform fees constituted approximately 25.6%, 21.2% and 20.2% of our net revenues in 2008, 2009 and 2010, respectively. We expect our platform fees as a percentage of our net revenues to remain generally stable going forward because a substantial portion of platform fees is based on a fixed percentage of the portion of the face value of prepaid cards used in our games. Our platform fees as a percentage of our net revenues may increase if we operate our online games on additional platforms.

Upfront and ongoing licensing fees. The cost of licensing games from third-party game content providers consists of upfront licensing fees, which are generally paid in several installments, and ongoing licensing fees, the majority of which is equal to a percentage of the revenues we generate from the relevant licensed game and, in some circumstances, includes a minimum guarantee. Upfront licensing fees are amortized on a straight-line basis over the shorter of the licensed period and the useful economic life of the relevant licensed game. Amortization of upfront licensing fees and ongoing licensing fees for games constituted approximately 15.4%, 16.6% and 16.2% of our net revenues in 2008, 2009 and 2010, respectively. We expect our upfront and ongoing licensing fees as a percentage of our net revenues to decrease slightly in 2011 as we expect revenues generated from games whose intellectual property rights we own to increase in 2011.

Others. Other expenses include employee salary and welfare benefits, such as medical insurance, statutory housing contributions, unemployment insurance and pension benefits, for employees involved in the operation of our online games, stock-based compensation for employees who operate our games, revenue sharing with Mochi's third party game developers, and office expenses. Other expenses were approximately 3.1%, 2.4% and 4.4% of our net revenues in 2008, 2009 and 2010, respectively.

Gross profit/margin. Gross profit as a percentage of our net revenues was 55.9%, 59.8% and 59.2% in 2008, 2009 and 2010, respectively.

Operating Expenses

Our operating expenses consist of product development expenses, sales and marketing expenses and general and administrative expenses. The following table sets forth, for the periods indicated, a breakdown of our operating expenses by amount and percentage of our net revenues.

	For the Year Ended December 31,					
	2008		2009		2010	
	RMB	% of Net Revenues	RMB	% of Net Revenues	RMB	% of Net Revenues
	(in millions, except percentages)					
Net revenues:	3,376.8	100.0%	4,806.7	100.0%	4,504.7	100.0%
Operating expenses:						
Product development	238.8	7.1	339.8	7.1	465.8	10.3
Sales and marketing	204.5	6.1	432.9	9.0	501.8	11.1
General and administrative	287.2	8.4	366.1	7.6	367.0	8.2
Total operating expenses	730.5	21.6	1,138.8	23.7	1,334.6	29.6
Operating profit/margin	1,156.9	34.3%	1,734.4	36.1%	1,332.9	29.6%

Product development expenses. Our product development expenses primarily consist of salary and benefits expenses of personnel engaged in the product development of our online games, outsourced game development expenses as a result of our investments through 18 Capital, share-based compensation and other expenses incurred by our product

development personnel. Product development expenses were 7.1%, 7.1% and 10.3% of our net revenues in 2008, 2009 and 2010, respectively. We expect our product development expenses to increase in 2011 as we develop new online games, updates or expansion packs for our existing online games, customize games licensed from third parties and continue to invest through 18 Capital.

Sales and marketing expenses. Our sales and marketing expenses primarily consist of advertising and promotion expenses for our online games in different media outlets, costs related to distribution of prepaid cards, salary and benefits for our sales and marketing personnel, share-based compensation and other expenses incurred by our sales and marketing personnel. Beginning on July 1, 2008, service fees paid to Shengfutong for the distribution of prepaid cards pursuant to the Amended and Restated Sales Agency Agreement are dependent upon the sales discount at which Shengfutong sells the prepaid cards and are recorded as sales and marketing expenses. A smaller discount applied by Shengfutong will result in a higher service fee paid to Shengfutong, as well as higher net revenues to us, and vice versa. Sales and marketing expenses were 6.1%, 9.0% and 11.1% of our net revenues in 2008, 2009 and 2010, respectively. We expect our sales and marketing expenses to increase in 2011 as we expect our service fee paid to Shengfutong to increase as more prepaid cards are sold and our advertising and promotion expenses to increase as we launch additional new games and expand our sales and marketing efforts in our existing markets and in new markets.

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General and administrative expenses. Our general and administrative expenses primarily consist of salary and benefits for general management, finance and administrative personnel, professional services fees, business tax expenses, share-based compensation and other expenses. General and administrative expenses were 8.4%, 7.6% and 8.2% of our net revenues in 2008, 2009 and 2010, respectively. Our business tax expense relates to services and licensing fees paid by our PRC operating companies to our PRC subsidiaries. We expect the general and administrative expenses to increase in 2011 due to the increased amount of business tax to be paid by our PRC operating companies, as a result of the increasing volume of services to be performed by our PRC subsidiaries for our PRC operating companies and increased salary and share-based compensation expenses as a result of the increased headcount.

Operating profit/margin. Operating profit as a percentage of our net revenues was 34.3%, 36.1% and 29.6% in 2008, 2009 and 2010, respectively.

Non-Operating Income

Our non-operating income consists of interest income and other non-operating income.

Interest Income. We earn interest income from the deposit of our cash balance with banks.

Other Non-Operating Income. Other non-operating income primarily consists of government incentives. Due to the preferential treatments for qualified high technology companies in China and incentives from local governments to encourage regional business development, certain of our PRC companies receive financial incentives from local governments that are calculated with reference to taxable income and revenues, as the case may be. The amount and timing of the financial incentives are determined by government authorities. Upon receipt, these incentives are recognized as other income in our statements of operations and comprehensive income. Please see note 5 to our consolidated financial statements included elsewhere in this annual report.

In 2008, 2009 and 2010, we received an aggregate of RMB18.4 million, RMB177.0 million and RMB232.3 million (US\$35.2 million) in cash, respectively, as financial incentives from municipal governments. Going forward, eligibility for the government financial incentives we may receive requires that we continue to meet a number of government-mandated financial and non-financial criteria, which generally include:

- generating more than a minimum level of revenues from high-tech related sales or services, determined as a percentage of total revenues;
- employing more than a minimum number of employees in product development; and
- expending more than a minimum amount on product development, determined as a percentage of total revenues.

The continued qualification is further subject to the discretion of the municipal government. Moreover, the central government or municipal government could determine at any time to immediately eliminate or reduce these financial incentives. Upon expiration of these government financial incentives, we will consider available options, in accordance with applicable law, that would enable us to qualify for additional government financial incentives to the extent they are then available to us.

Taxation

Under the current laws of the Cayman Islands, we are not subject to tax on income or capital gains. In addition, payment of dividends by us is not subject to withholding tax in the Cayman Islands.

Under the Hong Kong Inland Revenue Ordinance, our HK subsidiaries were subject to a 16.5% tax rate for the years ended December 31, 2008, 2009 and 2010 on taxable income generated from operations in Hong Kong. Additionally, payments of dividends by our HK subsidiaries are not subject to any Hong Kong withholding tax.

PRC Enterprise Income Tax

In March 2007, the PRC government enacted the PRC Enterprise Income Tax Law, or the New EIT Law, and promulgated related regulations, Implementing Regulations for the PRC Enterprise Income Tax Law. The law and regulations went into effect on January 1, 2008. The New EIT Law, among other things, imposes a unified income tax rate of 25% for both domestic and foreign invested enterprises. The PRC Enterprise Income Tax Law provides a five-year transitional period for those entities established before March 16, 2007, which enjoyed a favorable income tax rate of less than 25% under the previous income tax laws and rules, to gradually change their rates to 25%.

On April 14, 2008, relevant governmental regulatory authorities released qualification criteria, application procedures and assessment processes for high and new technology enterprises, which will be entitled to a favorable statutory tax

rate of 15%. On July 8, 2008, relevant governmental authorities further clarified that high and new technology enterprises previously qualified under the previous income tax laws and rules as of December 31, 2007 were allowed to enjoy grandfather treatment for the unexpired tax holidays, on condition that they were re-approved for high and new technology enterprise status under the regulations released on April 14, 2008. An enterprise's qualification as a high and new technology enterprise is re-assessed by the relevant PRC governmental authorities every three years.

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In December 2008, the local governments recognized Shengqu, Shanghai Shulong and Chengdu Aurora as high and new technology enterprises. Accordingly, these entities are entitled to a 15% preferential income tax rate for the three-year period ending December 31, 2010. Lansha qualified as a high and new technology enterprise in 2010. In addition, Shengqu also qualified as a key national software enterprise for 2008 and 2009 and was entitled to a 10% income tax rate for these years. Shengqu did not qualify as a key national software enterprise in 2010 and was subject to a 15% income tax rate in 2010. Chengdu Aurora also qualified as software development enterprise and was granted a three year 50% EIT reduction on its taxable income, commencing the year ended December 31, 2009.

As required by the New EIT Law, the profits of a foreign invested enterprise arising in 2008 and onwards which are distributed to its immediate holding company outside the PRC are subject to a withholding tax rate of 10%. A lower withholding tax rate will be applied if there is a tax treaty or arrangement between the PRC and the jurisdiction of the foreign holding company. Holding companies in Hong Kong which own more than 25% of the shares or equity interest in a PRC company, for example, are subject to a 5% withholding tax rate. We accrued a withholding tax of RMB37.0 million and RMB69.6 million as of December 31, 2008 and 2009, respectively, based on the 5% withholding tax rate of the profits of Shengqu that we distributed to Shanda Games (HK). The withholding tax accrued in 2008 was paid in 2009.

Korean Corporate Income Tax

Actoz and Eyedentity are subject to income tax on the taxable income as reported in its statutory financial statements adjusted in accordance with the Corporate Income Tax Law of the Republic of Korea, or the Korea Income Tax Laws. Under the Korean Income Tax Laws, corporations were subject to a tax rate of 14.3% for the year ended December 31, 2008 (or 27.5% if the corporation's taxable income was greater than KRW100 million for such year); 12.1% for the year ended December 31, 2009 (or 24.2% if the corporation's taxable income was greater than KRW200 million for such year); and 11.1% for the year ended December 31, 2010 (or 24.2% if the corporation's taxable income was greater than KRW200 million for such year). The foregoing tax rates include resident tax surcharges in accordance with the Korea Income Tax Laws and local tax laws. Actoz was subject to a tax rate of 27.5% in 2008, 24.2% in 2009 and 24.2% in 2010.

Under the Special Tax Treatment Control Law of Korea, Eyedentity, as a small and medium-sized venture company, was entitled to a 50% reduction in corporate income tax on its taxable income. However, after our acquisition of Eyedentity, Eyedentity no longer qualified as a small and medium-sized venture company and was subject to the standard statutory corporate income tax rate. Eyedentity was subject to a tax rate of 24.2% in 2010.

Equity in Earning (Loss) of Affiliated Companies

We record our investment in affiliates using the equity method of accounting, and the profit or loss of the affiliates is presented as Equity in earning (loss) of affiliated companies on the statements of operations and comprehensive income.

Non-Controlling Interest

In the second quarter of 2009, Shanda Interactive transferred to us its entire equity interest in Actoz, whose financial results were consolidated into our financial statements beginning from January 1, 2008. As a result, we recognized non-controlling interest in our statements of operations and comprehensive income for the shares of Actoz that we did not own for the years ended December 31, 2008, 2009 and 2010. See Critical Accounting Policies Basis of Preparation.

Critical Accounting Policies

We prepare our financial statements in conformity with 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 revenues 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 we believe to be reasonable under the circumstances. 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 places the most significant demands in our management's judgment.

Basis of Preparation

The reorganization is accounted for as a common control transaction, and accordingly, we have prepared the consolidated financial statements as if the current corporate structure had been in existence throughout the periods presented and as if the online game business, including Actoz that Shanda Interactive transferred to us in the second quarter of 2009, was transferred to us from Shanda Interactive as of the earliest period presented.

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Before the reorganization, the online game business was conducted by various subsidiaries and VIEs of Shanda Interactive. Therefore, for the period from January 1, 2008 to June 30, 2008, our consolidated financial statements were prepared by combining the assets, liabilities, revenues, expenses and cash flows of the entities that were directly engaged in the online game business.

Our statement of operations and comprehensive income for the periods prior to the reorganization include all the historical costs related to the online game business including payments for certain services performed by various subsidiaries and VIEs of Shanda Interactive, which became Shanda Online after the reorganization, and an allocation of certain general corporate expenses of Shanda Interactive. These general corporate expenses primarily relate to corporate employee compensation costs, professional service fees and other expenses arising from the provisions of certain corporate functions, including finance, legal, technology, investment and executive management. We allocated these expenses based on estimates that our management believes to be a reasonable reflection of the utilization of services provided to, or benefits received by, us.

For the period from July 1, 2008 to December 31, 2010, our consolidated financial statements consist of the financial statements of Shanda Games, including its subsidiaries and VIEs, as a standalone company subsequent to the reorganization.

Our management believes that the assumptions underlying our consolidated financial statements and the above allocations are reasonable. Our consolidated financial statements, however, may not be reflective of our result of operations, financial position and cash flows had we been operated as a standalone company during those periods. Our historical results for any prior period are not necessarily indicative of results to be expected for any future period.

Revenue Recognition

Prior to the reorganization, Shanda Interactive sold prepaid cards, in both virtual and physical forms, to third party distributors and retailers, including Internet cafes, as well as through direct online payment systems. The prepaid cards entitle end users to purchase virtual items or time units in our online games. All proceeds received from distributors or retailers are deferred when received.

In connection with the reorganization, we entered into various agreements with subsidiaries that are under the common control of Shanda Interactive. Pursuant to the Amended and Restated Cooperation Agreement, we have engaged Shanda Networking to provide customer and other game support services, and pursuant to the Amended and Restated Sales Agency Agreement, we have engaged Shengfutong to provide agency services in selling prepaid cards to third party distributors and retailers, in each case for a period of five years beginning from the date of the reorganization. We have assessed the relationship and arrangements with Shanda Networking and Shengfutong under Accounting Standards Codification 605-45 (formerly referred to as the Emerging Issues Task Force, or EITF, Issue No. 99-19, Reporting revenue gross as a principal versus net as an agent), and have concluded that reporting the gross amount equal to the amount that Shengfutong receives from the sale of prepaid game cards to distributors or retailers and subsequently was activated and charged to the respective game accounts by players as deferred revenue is appropriate as we are the primary obligor and we provide the online game services desired by the customers.

Both before and after reorganization, under the item-based revenue model, revenues are recognized over the life of the virtual items that game players purchase or as the virtual items are consumed. Under the time-based revenue model, revenues are recognized based on the time units consumed by our game players. Revenues are also recognized when game players who had previously purchased playing time or virtual currency are no longer entitled to access the online games in accordance with our published expiration policy. Deferred revenue is reduced as revenues are recognized.

For revenues that are recognized over the life of the virtual item, we have considered the average period that game players typically play our games to arrive at our best estimates for the lives of these virtual items. We have also considered that the estimated lives of these virtual items may be affected by various factors, including the acceptance and popularity of expansion packs, promotional events launched and market conditions. While we believe our estimates to be reasonable based on available game player information, we may revise such estimates in the future as our games operation period changes. Any adjustments arising from changes in the estimates of the lives of these virtual items would be applied prospectively on the basis that such changes are caused by new information indicating a change in the game player behavior patterns. Any changes in our estimates of useful lives of these virtual items may

result in our revenues being recognized on a basis different from prior periods and may cause our operating results to fluctuate.

Revenues are net of the PRC business tax that our PRC operating companies pay on their gross revenues.

Other revenues consist of net revenues generated primarily outside of China from game licensing, game operations, and advertising. We enter into licensing arrangements with overseas licensees to operate our MMORPGs and advanced casual games in other countries or territories. In connection with these license agreements, we generally receive an initial license fee and a monthly revenue-based royalty fee. The initial license fee is based on a fixed amount and recognized ratably over the term of the license. The royalty fee is generally calculated as a fixed percentage of the revenues generated by the licensee from operating the MMORPG or advanced casual game. Game operation revenues as a portion of our other revenues are derived from our operation of online games outside of China. Advertising revenues from online advertising arrangements are recognized ratably over the contract period of display when the collectability is reasonably assured. In case of advertising arrangements involving multiple deliverables where there is lack of objective and reliable evidence of fair value for each deliverable included in the arrangements, revenues are recognized ratably over the performance period of the last deliverable in the arrangement.

Table of Contents***Consolidation of Variable Interest Entities***

PRC regulations currently limit foreign ownership of companies that provide value-added telecommunications services, including Internet content services, to 50%. In addition, foreign and foreign-invested enterprises are currently not able to apply for the licenses required to operate online games in China. We are a Cayman Islands exempted company, and therefore, as foreign or foreign-invested enterprises under PRC law, we and our PRC subsidiaries are ineligible to hold a license to operate online games in China. In order to comply with the foreign ownership restrictions, we operate our online game business in China through our PRC operating companies. Our PRC operating companies hold the licenses and approvals that are material to the operation of our online game business. Our PRC subsidiaries have entered into a series of contractual arrangements with our PRC operating companies and/or their shareholders. As a result of these contractual arrangements, we are considered the primary beneficiary of our PRC operating companies and consolidate their results of operations, assets and liabilities in our financial statements. In the opinion of our PRC legal counsel, Jade & Fountain PRC Lawyers, in all material aspects, the ownership structure and the contractual arrangements between our PRC subsidiaries, on the one hand, and our PRC operating companies and/or their shareholders, on the other hand, comply with current PRC laws and regulations. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, PRC governmental authorities may ultimately take a view that is inconsistent with the opinion of Jade & Fountain PRC Lawyers.

Property and Equipment, Intangible Assets, and Other Long-lived Assets

Our accounting for long-lived assets, including property and equipment, intangible assets, and other long-lived assets is described in notes 2(12), 2(13), 2(15) and 2(16) to our consolidated financial statements included elsewhere in this annual report. The recorded values of long-lived assets, including property and equipment, intangible assets, and other long-lived assets, are affected by a number of management estimates, including the estimated useful lives, residual values and impairment charges. Significant judgment is required in the assessment of the estimated useful lives of these assets, especially for game licenses. Changes in these estimates and assumptions could materially impact our financial position and results of operations.

We assess the impairment for long-lived assets and intangible assets whenever events or changes in circumstances indicate that the applicable carrying amount may not be recoverable. During the year ended December 31, 2010, we recognized an impairment loss of RMB10.2 million related to trademark licensing fees. During the years ended December 31, 2008 and 2009, we did not recognize any impairment loss relating to our long-lived assets or intangible assets.

Impairment of Investment in Affiliated Companies

We continually review our investments in affiliated companies to determine whether a decline in fair value below the carrying value is other than temporary. The primary factors we consider in our determination are the length of time that the fair value of the investment is below its carrying value and the financial condition, operating performance and near term prospects of the investee. In addition, we consider the reasons for the decline in fair value, including general market conditions, industry specific or investee specific reasons, changes in valuation subsequent to the balance sheet date, and our intent and ability to hold the investment for a period of time sufficient to allow for a recovery in fair value. The determination of whether a decline in value is other than temporary requires significant judgment. If the decline in fair value is deemed to be other than temporary, the carrying value of the investment is written down to fair value. Write-downs for equity method investments are included in equity in earning (loss) of affiliated companies.

Impairment of Goodwill

We review our goodwill on an annual basis or more frequently if events or changes in circumstances indicate that the goodwill might be impaired as required by Accounting Standard Codification 350 (formerly referred to as Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets). In performing this review, we are required to make an assessment of fair value for our goodwill under each reporting unit. When determining fair value, we utilize various assumptions, including projection of future cash flows. A change in these underlying assumptions will cause a change in the results of the test and, as such, could cause the fair value to be less than the respective carrying amount. In such event, we would be required to record a charge, which would significantly impact our earnings. We did not recognize any impairment of goodwill during the periods presented.

Table of Contents***Share-Based Compensation***

Certain of our officers (including directors) and employees have received (i) options to purchase ordinary shares of Shanda Interactive granted by Shanda Interactive to officers (including directors) and employees who were engaged in the online game business prior to the reorganization and who subsequently became our employees following the reorganization; (ii) options to purchase ordinary shares of Actoz granted by Actoz to its officers and employees and (iii) options to purchase our Class A ordinary shares granted to officers (including directors) and employees under our Amended and Restated 2008 Equity Compensation Plan, or the 2008 Equity Compensation Plan.

We account for any stock option grants made pursuant to the respective stock option plan in accordance with Accounting Standards Codification 718 (formerly referred to as Statement of Financial Accounting Standard 123(R) *Accounting for stock-based compensation*), or ASC 718. Under the fair value recognition provision of ASC 718, share-based compensation expense is measured at the grant date based on the fair value of the stock options and is recognized as an expense either on a straight-line basis or a graded-vesting basis, net of estimated forfeitures, over the requisite service period, which is generally the vesting period. We use the Black-Scholes option pricing model to determine the fair value of stock options where the exercisability is conditional only upon completion of the service condition through the vesting date. With respect to options for which the exercisability is conditional upon completion of both the service and performance conditions through the vesting date, we use the binomial option pricing model.

For our option awards granted to our employees under the 2008 Equity Compensation Plan, we are required to determine the fair value of our ordinary shares at the respective grant dates. Determining the fair value of our ordinary shares with respect to option awards made prior to the consummation of our initial public offering requires us to make complex and subjective judgments regarding our projected financial and operating results, our unique business risks, the liquidity of our ordinary shares and our operating history and prospects at the time the grants were made, and therefore, we used the binomial option pricing model.

In determining the fair value of our ordinary shares in each of the grant dates prior to our initial public offering, we relied in part on a valuation report prepared by an independent valuer based on data we provided. The valuation report provided us with guidelines in determining the fair value, but the determination was made by our management. We used the income approach/discounted cash flow method as the primary approach and market approach as a cross-check to derive the fair value of our ordinary shares. We applied the discounted cash flow analysis based on our projected cash flow using management's best estimate as of the valuation date. The projected cash flow estimate included, among other things, an analysis of projected revenue growth, gross margins, effective tax rates, capital expenditures and working capital requirements. The income approach involves applying appropriate discount rates, based on earnings forecasts, to estimated cash flows. The assumptions we used in deriving the fair value of our ordinary shares include no significant contingent liabilities, unusual contractual obligations or substantial commitments; no significant pending or threatened litigation involving us as of the valuation date; no violations of any regulations or laws by us; no redundant assets as of the valuation date other than those identified by the valuer and disclosed; no significant change in our business model; management information is on a consolidated basis; and the book values of non-operating assets and total debt approximate their fair values. These assumptions are inherently uncertain and subjective. The discount rates reflect the risks the management perceived as being associated with achieving the forecasts and are based on our estimated cost of capital, which was derived by using the capital asset pricing model, after taking into account systemic risks and company-specific risks. The capital asset pricing model is a model for pricing securities that adds an assumed risk premium rate of return to an assumed risk-free rate of return. Using this method, we determined the appropriate discount rates to be 26% as of November 14, 2008 and 25% as of April 30, 2009.

We also applied a discount for lack of marketability, or DLOM, to reflect the fact that, at the time of the grants, we were a closely-held company and there was no public market for our ordinary shares. To determine the discount for lack of marketability, we and the independent valuer used the Black-Scholes option pricing model and assumed a liquidity event in the first quarter of 2010. Pursuant to the Black-Scholes option pricing model, we used the cost of a put option, which can be used to hedge the price change before a privately held share can be sold, as the basis to determine the discount for lack of marketability. Based on the foregoing analysis, we used a DLOM of 23% to discount the value of our ordinary shares as of November 14, 2008 and April 30, 2009. It was concluded that our fair

value as a going concern was RMB11,751 million (equivalent to US\$1,720.4 million) as of November 14, 2008 and RMB15,000 million (equivalent to US\$2,196.1 million) as of April 30, 2009. The fair value per ordinary share and restricted share was RMB21.37 per share (equivalent to US\$3.13) as of November 14, 2008 and RMB26.60 per share (equivalent to US\$3.90) as of April 30, 2009.

The intrinsic value of the options outstanding as of December 31, 2010 was US\$0.3 million, which is calculated based on the difference between the fair value of US\$3.22 of our ordinary shares as of December 31, 2010 and the exercise price of the shares.

The determination of the fair value of share options on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including our expected stock price volatility over the vesting period, risk-free interest rate, expected dividend yield, expected term, and actual and projected employee stock option exercise behaviors. Furthermore, we are required to estimate forfeitures at the time of grant and recognize share-based compensation expenses only for those awards that are expected to vest. If actual forfeitures differ from those estimates, we may need to revise those estimates used in subsequent periods.

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Certain of our and Shanda Interactive's employees were awarded restricted shares under the 2008 Equity Compensation Plan. The restricted shares will vest in equal installments over four calendar years, subject to the employee's continued employment with his employer. Share-based compensation expense related to the restricted share award granted by the Company to its employees under the 2008 Equity Compensation Plan amounted to RMB0.1 million, RMB3.0 million and RMB55.9 million (US\$8.5 million) for the years ended December 31, 2008, 2009 and 2010, respectively. Restricted shares granted to Shanda Interactive's employees are measured at fair value at the grant date and were recognized as a dividend distributed to Shanda Interactive.

Our share-based compensation expenses totaled RMB20.8 million, RMB125.8 million and RMB105.9 million (US\$16.0 million) in 2008, 2009 and 2010, respectively.

Income Taxes and Valuation Allowance

We account for income taxes under the provisions of Accounting Standards Codification 740 (formerly referred to as SFAS No. 109, *Accounting for Income Taxes*), with the required disclosures as described in note 6 to our consolidated financial statements included elsewhere in this annual report. Accordingly, we record valuation allowances to reduce our deferred tax assets when we believe it is more likely than not that we will not be able to utilize the deferred tax asset amounts based on our estimates of future taxable income and prudent and feasible tax planning strategies. As of December 31, 2008, 2009 and 2010, valuation allowances recognized were RMB41.6 million, RMB123.9 million and RMB180.2 million (US\$27.3 million), respectively. Valuation allowances were provided for because it was more likely than not that we would not be able to utilize certain foreign tax credit carry forwards generated by one of our subsidiaries. As of December 31, 2008, 2009 and 2010, we recorded deferred tax assets, net of valuation allowances, of RMB105.1 million, RMB95.7 million and RMB86.5 million (US\$13.1 million), respectively. We do not believe any further valuation allowances to reduce our net deferred tax assets are necessary as we currently anticipate future taxable profits which will allow us to fully utilize our net deferred tax assets in the foreseeable future. If, however, events were to occur in the future which are not currently contemplated, that would not allow us to realize all or part of our net deferred tax assets in the future, an adjustment would result by way of a charge to income tax expense in the period in which such determination was made.

Accounting Standards Codification 740-10-25 (formerly referred to as FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An interpretation of FASB Statement No. 109*) or ASC 740-10-25, prescribes a recognition threshold and a measurement attribute for the financial statements recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by tax authorities. The amount recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Our adoption of ASC 740-10-25 did not result in any adjustments to the opening balance of our retained earnings as of January 1, 2008. We did not have any interest and penalties associated with uncertain tax positions and did not have any significant unrecognized uncertain tax positions for the years ended December 31, 2008, 2009 and 2010.

Results of Operations***Year Ended December 31, 2010 Compared to Year Ended December 31, 2009***

Net revenues. Our net revenues decreased 6% from RMB4,806.7 million in 2009 to RMB4,504.7 million (US\$682.5 million) in 2010. Net revenues from MMORPGs decreased 9% from RMB4,422.1 million in 2009 to RMB4,018.3 million (US\$608.8 million) in 2010. Net revenues from advanced casual games decreased 2% from RMB305.6 million in 2009 to RMB300.6 million (US\$45.5 million) in 2010. Other revenues increased 135% from RMB79.0 million in 2009 to RMB185.8 million (US\$28.2 million) in 2010.

Our net revenues from MMORPGs decreased primarily due to a decrease in net revenues from our existing MMORPGs, partially offset by an increase in net revenues from the introduction of new MMORPGs. The decrease in net revenues from our existing MMORPGs is primarily due to our strategy to scale back monetization activities in our existing MMORPGs and focus on activities that enhance interaction between users, as well as the introduction in the fourth quarter of 2009 of an expansion pack for Mir II which was not well received by the game's users. Net revenues from new MMORPGs that we introduced in 2010 totaled RMB333.1 million (US\$50.5 million) for the year ended December 31, 2010, primarily due to the commercialization of Dragon Nest and Hades Realm II.

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The decrease in our net revenue from MMORPGs was primarily due to a decrease in average monthly revenues per active paying account. The number of active paying accounts for MMORPGs increased on a quarterly basis in 2010, compared with 2009, as a result of the release of new games, updates and expansion packs and the introduction of new virtual items in our MMORPGs, as well as numerous promotions that we offered to our game players. Average monthly revenues per active paying account for each quarter in 2010 were lower than that of the corresponding quarter of 2009 primarily due to (i) the scaling back of monetization activities and the expansion pack in Mir II as discussed in the preceding paragraph and (ii) an increase in the number of new game players who generally have a lower average monthly revenues per active paying account as they begin purchasing virtual items in a game. The following table sets forth our active paying accounts and monthly average revenues per active paying account for MMORPGs, for the periods indicated:

	For the Three Months Ended							
	March 31, 2009	June 30, 2009	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010	December 31, 2010
Quarterly active paying accounts (in thousands) ⁽¹⁾	7,153	8,552	9,031	9,384	9,578	9,608	9,191	9,464
Monthly average revenues per active paying account (in RMB) ⁽²⁾	43.5	41.6	43.1	44.6	35.0	34.7	35.2	36.7

(1) Quarterly active paying accounts refers to the aggregate number of active paying accounts for our MMORPGs operated in China during a given quarter.

(2) Average monthly revenues per active paying account refers to our revenues from the operation of MMORPGs in China during a given quarter divided by quarterly active paying accounts, further divided by three.

Our net revenues and the number of active paying accounts from advanced casual games decreased as many of our advanced casual games have become more mature. The decrease in revenues was offset by an increase in revenues from Maple Story for which we released a major expansion pack in the first quarter of 2010. The following table sets forth our active paying accounts and average monthly revenues per active paying account for advanced casual games, for the periods indicated:

	For the Three Months Ended							
	March 31, 2009	June 30, 2009	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010	December 31, 2010
Quarterly active paying accounts (in thousands) ⁽¹⁾	1,052	1,149	1,209	1,014	1,075	923	834	746
Monthly average revenues per active paying account (in RMB) ⁽²⁾	27.4	20.6	23.7	20.4	28.6	25.3	30.5	27.7

- (1) Quarterly active paying accounts refers to the aggregate number of active paying accounts for our advanced casual games operated in China during a given quarter.
- (2) Average monthly revenues per active paying account refers to our revenues from the operation of advanced casual games in China during a given quarter divided by quarterly active paying accounts, further divided by three.

Other revenue, which mainly represented net revenue generated from game licensing, game operations, and advertising, increased primarily due to the acquisition in 2010 of Mochi Media and Eyedentity, which licensed the operating rights to Dragon Nest in various countries.

Cost of revenues. Our cost of revenues decreased 5.0% from RMB1,933.5 million in 2009 to RMB1,837.2 million (US\$278.3 million) in 2010. This decrease was primarily due to the following reasons:

Platform fees decreased 11% from RMB1,018.5 million in 2009 to RMB909.8 million (US\$137.8 million) in 2010 primarily due to a decrease in revenues generated from our online games operations. Platform fees represented approximately 21.2% of our net revenues in 2009 compared to approximately 20.2% of our net revenues in 2010. The decrease in platform fees as a percentage of net revenues is primarily due to an increase of revenues generated from game licensing, game operations outside China and overseas advertising revenue, for which we do not pay Shanda Networking any platform fees, as well as a net decrease in server software rental fee of RMB36.2 million in 2010.

Upfront and ongoing licensing fees for online games decreased 8% from RMB797.1 million in 2009 to RMB730.3 million (US\$110.7 million) in 2010 and represented approximately 16.6% and 16.2% of our net revenues in 2009 and 2010, respectively. The decrease in upfront and ongoing licensing fees is primarily due to a decrease in revenues generated from games we license from third parties.

Other expenses increased 67% from RMB117.9 million in 2009 to RMB197.1 million (US\$29.8 million) in 2010 primarily due to an increase of amortization of intellectual property rights related to games we acquired through the acquisition of various companies and an increase in advertising expenses as a result of the increase in advertising revenues. Other expenses represented approximately 2.4% and 4.4% of our net revenues in 2009 and 2010, respectively.

Gross profit. As a result of the foregoing, our gross profit decreased 7% from RMB2,873.2 million in 2009 to RMB2,667.5 million (US\$404.2 million) in 2010. Our gross margin, which is equal to our gross profit divided by our net revenues, decreased from 59.8% in 2009 to 59.2% in 2010.

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Operating expenses. Our operating expenses increased 17% from RMB1,138.8 million in 2009 to RMB1,334.6 million (US\$202.2 million) in 2010. This increase was primarily due to the following reasons:

Our product development expenses increased 37% from RMB339.8 million in 2009 to RMB465.8 million (US\$70.6 million) in 2010. The increase was primarily due to (i) an increase in salary and benefits from RMB239.2 million in 2009 to RMB317.2 million (US\$48.1 million) in 2010 due to salary and headcount increases, (ii) an increase in share-based compensation from RMB2.1 million in 2009 to RMB29.8 million (US\$4.5 million) in 2010 as a result of our restricted shares granted to product development staff, (iii) an increase in amortization of intangible assets from RMB4.6 million in 2009 to RMB11.3 million (US\$1.7 million) primarily related to software technology we acquired through the acquisition of various companies, and (iv) an increase in rental and property management fee from RMB5.1 million in 2009 to RMB17.1 million (US\$2.6 million) in 2010. Product development expenses represented approximately 7.1% of our net revenues in 2009 and 10.3% of our net revenues in 2010.

Our sales and marketing expenses increased 16.1% from RMB432.9 million in 2009 to RMB501.8 million (US\$76.0 million) in 2010. The increase was primarily due to (i) an increase in salary and benefits from RMB25.4 million in 2009 to RMB46.6 million (US\$7.1 million) in 2010 due to salary and headcount increases, (ii) an increase in advertising and promotion expenses relating to our online games from RMB175.0 million in 2009 to RMB199.3 million (US\$30.2 million) in 2010, and (iii) an increase of amortization of intangible assets related to the acquisition of various companies from nil in 2009 to RMB8.7 million (US\$1.3 million). Sales and marketing expenses represented approximately 9.0% and 11.1% of our net revenues in 2009 and 2010, respectively.

Our general and administrative expenses increased 0.2% from RMB366.1 million in 2009 to RMB367.0 million (US\$55.6 million) in 2010. This increase was primarily due to (i) an increase in salary and benefits from RMB66.6 million in 2009 to RMB94.3 million (US\$14.3 million) in 2010 due to salary and headcount increases, (ii) a net increase in bad debt expenses in the amount of RMB14.9 million (US\$2.3 million), (iii) an increase of amortization of intangible assets related to the acquisition of various companies from nil in 2009 to RMB13.3 million (US\$2.0 million), and (iv) an increase in miscellaneous administrative expenses in the amount of RMB12.7 million (US\$1.9 million). The increase in expenses was partially offset by (i) a decrease in share-based compensation from RMB121.6 million in 2009 to RMB75.1 million (US\$11.4 million) in 2010 primarily due to the fact that the Company recognized a reduction in share-based compensation expense resulting from the departure of certain senior executives in the first quarter of 2010 and the net effect of a failure to meet certain performance targets related to stock option awards and (ii) a decrease in business tax in the amount of RMB32.0 million (US\$4.8 million). General and administrative expenses accounted for approximately 7.6% and 8.1% of our net revenues in 2009 and 2010, respectively.

Income from operations. As a result of the foregoing, our operating income decreased 23% from RMB1,734.4 million in 2009 to RMB1,332.9 million (US\$202.0 million) in 2010. Our operating margin, which is equal to our operating profit divided by our net revenues, decreased from 36.1% in 2009 to 29.6% in 2010.

Income before income tax expenses and equity in earning (loss) of affiliated companies. Our income before income tax expenses, equity in earning (loss) of affiliated companies decreased 16.6% from RMB1,930.3 million in 2009 to RMB1,610.4 million (US\$244.0 million) in 2010. This decrease was primarily due to the decrease in income from operations, offset in part by (i) an increase in interest income, which increased from RMB26.3 million in 2009 to RMB61.7 million (US\$9.3 million) in 2010, and (ii) other income, and in particular, government incentives, which increased from RMB177.0 million in 2009 to RMB232.3 million (US\$35.2 million) in 2010.

Income tax expenses. Our income tax expenses decreased 30.0% from RMB428.7 million in 2009 to RMB300.3 million (US\$45.5 million) in 2010, primarily due to (i) a decrease in our pre-tax income from RMB1,930.3 million in 2009 to RMB1,610.4 million (US\$244.0 million) in 2010, (ii) a RMB69.6 million deferred tax liability accrued in 2009 with respect to the dividend declared by Shengqu to Shanda Games (HK), (iii) an increase in amortization of accrued deferred tax liability related to intangible assets arising from the acquisition of various companies from RMB9.0 million in 2009 to RMB28.4 million (US\$4.3 million) in 2010, and (iv) a decrease of valuation allowance from RMB70.8 in 2009 to RMB55.9 million (US\$8.5 million) in 2010. The decrease in income tax expenses was offset in part by an increase of RMB51.9 million (US\$7.9 million) in income tax expenses mainly due to the loss of preferential tax status by certain of our PRC companies. As a result of the foregoing, our effective

income tax rate decreased from 22% in 2009 to 19% in 2010.

Equity in earning (loss) of affiliated companies. We incurred losses of RMB5.4 million (US\$0.8 million) in 2010, as compared to losses of RMB30.0 million in 2009, primarily as a result of our investments in several companies through 18 Capital.

Net income attributable to non-controlling interest. Our net income attributable to non-controlling interest decreased from RMB18.6 million in 2009 to RMB15.9 million (US\$2.4 million) in 2010 as a result of the decrease in Actoz's profitability.

Net income attributable to our company. Net income attributable to our company decreased from RMB1,453.0 million in 2009 to RMB1,288.8 million (US\$195.3 million) in 2010.

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Net revenues. Our net revenues increased 42% from RMB3,376.8 million in 2008 to RMB4,806.7 million (US\$704.2 million) in 2009. Net revenues from MMORPGs increased 50% from RMB2,948.5 million in 2008 to RMB4,422.1 million (US\$647.8 million) in 2009. Net revenues from advanced casual games decreased 14% from RMB355.8 million in 2008 to RMB305.6 million (US\$44.8 million) in 2009.

Our net revenues from MMORPGs increased primarily due to an increase in net revenues from our existing MMORPGs and the introduction of new MMORPGs. The increase in net revenues from our existing MMORPGs is primarily driven by net revenue increase of 47% from Mir II and Wool as a result of the release of certain updates and expansion packs. Net revenues from new MMORPGs that we introduced in 2009 totaled RMB334.9 million (US\$49.1 million) for the year ended December 31, 2009, primarily due to the commercialization of AION.

The increase in our net revenue from MMORPGs was primarily driven by an increase in active paying accounts and average monthly revenues per active paying account. The number of active paying accounts for MMORPGs increased on a quarterly basis in 2009 as a result of the release of updates and expansion packs and the introduction of new virtual items in our MMORPGs, as well as numerous promotions that we offered to our game players. Average monthly revenues per active paying account for each quarter in 2009 were lower than that of the corresponding quarter of 2008 primarily due to an increase in the number of new game players and lower average monthly revenues per active paying account of these new game players. In general, new game players tend to generate lower monthly average revenues per active paying account because MMORPGs are designed such that fewer premium virtual items are available for purchase at the lower level of the game. As the game player progresses to higher levels of the game, more premium virtual items are available for game players to purchase, which in general will increase such player's spending and thus our monthly average revenues per active paying account. The following table sets forth our active paying accounts and monthly average revenues per active paying account for MMORPGs, for the periods indicated:

	For the Three Months Ended							
	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008	March 31, 2009	June 30, 2009	September 30, 2009	December 31, 2009
Quarterly active paying accounts (in thousands) ⁽¹⁾	4,078	4,218	5,162	5,864	7,153	8,552	9,031	9,384
Monthly average revenues per active paying account (in RMB) ⁽²⁾	51.9	54.2	49.0	49.4	43.5	41.6	43.1	44.6

(1) Quarterly active paying accounts refers to the aggregate number of active paying accounts for our MMORPGs operated in China during a given quarter.

(2) Average monthly revenues per active paying account refers to our revenues from the operation of MMORPGs in China during a given quarter divided by quarterly active paying accounts, further divided by three.

Our net revenues from advanced casual games decreased as we released a major expansion pack for one of our significant advanced casual games in 2008 and did not release such an expansion pack in 2009. The following table sets forth our active paying accounts and average monthly revenues per active paying account for advanced casual games, for the periods indicated:

For the Three Months Ended

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	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008	March 31, 2009	June 30, 2009	September 30, 2009	December 31, 2009
Quarterly active paying accounts (in thousands) ⁽¹⁾	1,661	1,421	1,380	961	1,052	1,149	1,209	1,014
Monthly average revenues per active paying account (in RMB) ⁽²⁾	19.7	20.6	23.6	25.1	27.4	20.6	23.7	20.4

(1) Quarterly active paying accounts refers to the aggregate number of active paying accounts for our advanced casual games operated in China during a given quarter.

(2) Average monthly revenues per active paying account refers to our revenues from the operation of advanced casual games in China during a given quarter divided by quarterly active paying accounts, further divided by three.

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Cost of revenues. Our cost of revenues increased 30% from RMB1,489.4 million in 2008 to RMB1,933.5 million (US\$283.3 million) in 2009. This increase was primarily due to the following reasons:

Platform fees increased 18% from RMB864.9 million in 2008 to RMB1,018.5 million (US\$149.2 million) in 2009 primarily due to an increase in servers and services provided to support the growth in our game player base and in our revenues that we generated from our online games operations. Platform fees represented approximately 25.6% of our net revenues in 2008 compared to approximately 21.2% of our net revenues in 2009. The decrease in platform fees as a percentage of net revenues resulted primarily from the fact that following the reorganization, we paid Shanda Networking a service fee related to various platform support services described in *Cost of Revenues Platform Fees* based upon a fixed percentage of the portion of the face value of prepaid cards distributed and used in our games, which has resulted in lower fees as a percentage of our net revenues.

Upfront and ongoing licensing fees for online games increased 53% from RMB520.9 million in 2008 to RMB797.1 million (US\$116.8 million) in 2009 and represented approximately 15.4% and 16.6% of our net revenues in 2008 and 2009, respectively. The increase in upfront and ongoing licensing fees as a percentage of net revenues from 2008 to 2009 is primarily due to the commencement of amortization of upfront fee for new games launched in the second half of 2008 and 2009.

Other expenses increased 14% from RMB103.6 million in 2008 to RMB117.9 million (US\$17.3 million) in 2009 primarily due to an increase of amortization of intangible assets related to the acquisition of various companies and an increase in labor cost. Other expenses represented approximately 3.1% and 2.4% of our net revenues in 2008 and 2009, respectively.

Gross profit. As a result of the foregoing, our gross profit increased 52% from RMB1,887.4 million in 2008 to RMB2,873.2 million (US\$420.9 million) in 2009. Our gross margin, which is equal to our gross profit divided by our net revenues, increased from 55.9% in 2008 to 59.8% in 2009.

Operating expenses. Our operating expenses increased 56% from RMB730.5 million in 2008 to RMB1,138.8 million (US\$166.8 million) in 2009. This increase was primarily due to the following reasons:

Our product development expenses increased 42% from RMB238.8 million in 2008 to RMB339.8 million (US\$49.8 million) in 2009. The increase was primarily due to (i) an increase in salary and benefits from RMB182.8 million in 2008 to RMB239.2 million (US\$35.0 million) in 2009 due to salary and headcount increases and (ii) an increase in outsourced product development costs from RMB24.1 million in 2008 to RMB57.4 million (US\$8.4 million) in 2009 as a result of our investments through 18 Capital. Product development expenses represented approximately 7.1% of our net revenues in 2008 and 2009, respectively.

Our sales and marketing expenses increased 112% from RMB204.5 million in 2008 to RMB432.9 million (US\$63.4 million) in 2009. The increase was primarily due to (i) an increase in the number of prepaid cards sold, (ii) the impact of the new contractual arrangements with Shengfutong, effective July 1, 2008 and (iii) an increase in advertising and promotion expenses relating to our online games from RMB87.8 million in 2008 to RMB175.0 million (US\$25.6 million) in 2009. Sales and marketing expenses represented approximately 6.1% and 9.0% of our net revenues in 2008 and 2009, respectively.

Our general and administrative expenses increased 27% from RMB287.2 million in 2008 to RMB366.1 million (US\$53.6 million) in 2009. This increase was primarily due to an increase in share-based compensation from RMB17.1 million in 2008 to RMB121.6 million (US\$17.8 million) in 2009, arising from options granted to our directors, officers and employees in 2009, including an accumulated expense of RMB61.6 million (US\$9.0 million) incurred upon the consummation of our initial public offering in the third quarter of 2009. The increase in expenses was offset in part by a decrease in general corporate expenses allocated from Shanda Interactive from RMB27.3 million in 2008 to RMB11.2 million (US\$1.6 million) in 2009, due to the fact that after the reorganization, we operated as a standalone entity and assumed more of our general and administrative functions. General and administrative expenses accounted for approximately 8.4% and 7.6% of our net revenues in 2008 and 2009, respectively.

Income from operations. As a result of the foregoing, our operating income increased 50% from RMB1,156.9 million in 2008 to RMB1,734.4 million (US\$254.1 million) in 2009. Our operating margin, which is equal to our operating profit divided by our net revenues, increased from 34.3% in 2008 to 36.1% in 2009.

Income before income tax expenses and equity in earning (loss) of affiliated companies. Our income before income tax expenses, equity in earning (loss) of affiliated companies increased 61% from RMB1,196.4 million in 2008 to RMB1,930.3 million (US\$282.8 million) in 2009. This increase was primarily due to the increase in income from operations, as well as an increase in other income, namely, government incentives, which increased from RMB18.4 million in 2008 to RMB177.0 million (US\$25.9 million) in 2009.

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Income tax expenses. Our income tax expenses increased 72% from RMB249.9 million in 2008 to RMB428.7 million (US\$62.8 million) in 2009, primarily due to (i) an increase of RMB183.5 million (US\$26.9 million) in income taxes as a result of the increase in our pre-tax income from RMB1,196.4 million in 2008 to RMB1,930.3 million (US\$282.8 million) in 2009 after applying the new enterprise income tax rate of 25%, (ii) an increase of RMB32.6 million (US\$4.8 million) in accrued deferred tax liability related to withholding obligations arising from dividend that Shengqu declared to Shanda Games (HK) from RMB37.0 million in 2008 to RMB69.6 million (US\$10.2 million) in 2009, and (iii) an increase of valuation allowance of RMB29.8 million from RMB41.0 in 2008 to RMB70.8 million (US\$10.4 million) in 2009 for foreign tax credits due to the uncertainty surrounding their realization. The increase in income tax expenses was offset in part by a decrease of RMB103.8 million (US\$15.2 million) in income tax expenses due to preferential tax rates enjoyed by certain of our PRC companies. As a result of the foregoing, our effective income tax rate increased from 21% in 2008 to 22% in 2009.

Equity in earning (loss) of affiliated companies. We incurred losses of RMB30.0 million (US\$4.4 million) in 2009, as compared to a profit of RMB0.9 million in 2008, primarily as a result of our investments in two companies through 18 Capital.

Net income attributable to non-controlling interest. Our net income attributable to non-controlling interest increased from RMB11.9 million in 2008 to RMB18.6 million (US\$2.7 million) in 2009, as a result of the increase in Actoz's profitability.

Net income attributable to our company. Net income attributable to our company increased from RMB935.5 million in 2008 to RMB1,453.0 million (US\$212.9 million) in 2009.

B. LIQUIDITY AND CAPITAL RESOURCES**Cash Flows and Working Capital**

Beginning from July 1, 2008 which is the effective date of the reorganization, we have financed our operations through our internally generated cash from operations and the proceeds from our initial public offering of ADSs in September 2009. As of December 31, 2010, we had approximately RMB1,571.8 million (US\$238.2 million) in cash and cash equivalents, of which RMB484.1 million (US\$73.3 million) was held by our PRC operating companies. Our cash and cash equivalents primarily consist of cash on hand, demand deposits and liquid investments with original maturities of three months or less that are placed with banks and other financial institutions. Although we consolidate the results of our PRC operating companies in our consolidated financial statements and we can utilize their cash and cash equivalents in our operations, we do not have direct access to the cash and cash equivalents or future earnings of our PRC operating companies. However, these cash balances can be utilized by us for our normal operations pursuant to the contractual arrangements with our PRC operating companies that provide us with the substantial ability to control our PRC operating companies and their operations. See Item 4, Information on the Company Organizational Structure and Item 10, Additional Information Exchange Controls.

The following table shows our cash flows with respect to operating activities, investing activities and financing activities in the years ended December 31, 2008, 2009 and 2010:

	2008 RMB	Year Ended December 31,		US\$
		2009 RMB	2010 RMB	
		(in millions)		
Net cash provided by operating activities	1,144.5	2,010.5	1,745.3	264.4
Net cash used in investing activities	(144.2)	(1,904.2)	(1,950.1)	(295.5)
Net cash used in financing activities	(748.3)	1,050.5	(20.6)	(3.1)
Effect of exchange rate changes on cash	(16.7)	13.5	(2.0)	(0.2)
Net increase in cash and cash equivalents	235.3	1,170.3	(227.4)	(34.4)
Cash, beginning of the period	393.6	628.9	1,799.2	272.6
Cash, end of the period	628.9	1,799.2	1,571.8	238.2

For the year ended December 31, 2010, we had net cash provided by operating activities of RMB1,745.3 million (US\$264.4 million). This was primarily attributable to (i) net income attributable to our company of RMB1,304.7 million, (ii) an add-back of the non-cash expenses in the amount of RMB441.7 million, including share-based compensation expenses, corporate expense allocation, depreciation of property and equipment, equity in loss of affiliated companies and amortization of intangible assets, (iii) an decrease of RMB24.1 million in accounts receivables primarily related to advertising activities, (iv) a decrease of RMB13.3 million in accounts receivable from related parties, primarily Shengfutong, and (v) an increase of RMB13.9 million in accounts payables. Our net cash provided by operating activities was partially reduced by the payment of upfront licensing fees and prepayment of upfront licensing fees relating to new online games that we licensed from third parties in the aggregate amount of RMB25.0 million and a decrease of RMB27.1 million in other payables and accruals.

For the year ended December 31, 2009, we had net cash provided by operating activities of RMB2,010.5 million (US\$294.5 million). This was primarily attributable to (i) our net income attributable to our company of RMB1,471.6 million, (ii) an add-back of the non-cash expenses in the amount of RMB366.9 million, including share-based compensation expenses, corporate expense allocation, depreciation of property and equipment, equity in loss of affiliated companies and amortization of intangible assets, (iii) a decrease of RMB130.5 million in accounts receivable from related parties, primarily Shengfutong, (iv) an increase of RMB31.7 million in licensing fees payable due to an increase in our revenues generated from licensed games, (v) an increase of RMB160.5 million in other payables and accruals, and (vi) an increase in taxes payable of RMB51.9 million due to an increase in our pre-tax income. Our net cash provided by operating activities was partially reduced by payment of upfront licensing fees and prepayment of upfront licensing fees of RMB125.5 million relating to new online games that we licensed from third parties and a decrease of RMB77.3 million in deferred revenue.

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For the year ended December 31, 2008, we had net cash provided by operating activities of RMB1,144.5 million. This was primarily attributable to our net income attributable to our company of RMB947.4 million, an increase of RMB111.2 million in deferred revenue due to the increased proceeds received from our distributors for the sale of prepaid cards for the period prior to the reorganization and from Shengfutong beginning as of the reorganization, which were for the sale of prepaid cards and subsequently activated and charged to our games to purchase virtual items or time units in our online games but had not yet been recognized as net revenues, an increase of RMB60.1 million in licensing fees payable due to an increase in our revenues generated from licensed games and an increase of RMB48.2 million in taxes payable due to the increase in our pre-tax income. Our net cash provided by operating activities was partially reduced by an increase of RMB233.7 million in receivable due from related parties, primarily Shengfutong, an add-back of the non-cash expenses including share-based compensation expenses, corporate expense allocation, depreciation of property and equipment and amortization of intangible assets in the amount of RMB209.4 million and the payment of RMB75.5 million in upfront licensing fees and prepayment for upfront license fees relating to new online games that we licensed from third parties.

In 2010, we had net cash used in investing activities of RMB1,950.1 million (US\$295.5 million). This was primarily attributable to (i) a net increase in time deposits with maturity dates over one year of RMB1,035.0 million, (ii) the acquisition of various companies, including Mochi Media, Goldcool, and Eyedentity, in the aggregate amount of RMB979.6 million, and (iii) the deposit of RMB523.0 million to a bank in China as collateral for a loan in the amount equal to the U.S. dollar equivalent. The cash used in investing activities was partially reduced by a decrease in deposit of RMB702.1 million, which was a deposit to a bank in China as collateral for a loan which was repaid in 2010, in the amount equal to the U.S. dollar equivalent in 2009.

In 2009, we had net cash used in investing activities of RMB1,904.2 million (US\$279.0 million). This was primarily attributable to a net increase in time deposits with maturity dates over three months of RMB502.3 million, payments of RMB108.6 million for the purchase of property, equipment, software and intangible assets, the deposit of RMB702.1 million to a bank in China as collateral for a loan in the amount equal to the U.S. dollar equivalent, the purchase of the equity interest in Actoz from Shanda Interactive for RMB479.7 million, and the acquisition of Chengdu Simo and its affiliates for RMB112.2 million.

In 2008, we had net cash used in investing activities of RMB144.2 million (US\$21.1 million). This was primarily attributable to a net increase in time deposits with maturities of over three months of RMB46.7 million, the payment of RMB58.9 million for the purchase of property, equipment, software and intangible assets, the payment of loan receivables of RMB14.0 million and the repurchase by Actoz of its own shares of RMB17.9 million.

In 2010, we had net cash provided in financing activities of RMB20.6 million (US\$3.1 million). This was primarily attributable to net proceeds from cash received from a loan of RMB947.0 million, offset by a repayment of a loan of RMB717.1 million and cash used for repurchase of common stock of RMB255.9 million.

In 2009, we had net cash provided in financing activities of RMB1,050.5 million (US\$153.9 million). This was primarily attributable to net proceeds from our initial public offering of RMB1,041.2 million, and cash received from a loan of RMB1,077.7 million, offset by a repayment of a loan of RMB375.6 million and payment in the amount of RMB700.4 million to Shanda Interactive relating to a dividend we had declared prior to the consummation of our initial public offering. We had net cash used in financing activities of RMB748.3 million in 2008, which was primarily due to a dividend to Shanda Interactive we had declared prior to the consummation of our initial public offering.

We believe that our existing cash and cash equivalents, cash flows from operations, short-term investments, time deposits with a maturity of over one year, and marketable securities will be sufficient to meet the anticipated cash needs for our operating activities, capital expenditures and other obligations for at least the next twelve months. We may, however, require additional cash resources due to changed business conditions or other future developments. We may sell additional equities or obtain credit facilities to enhance our liquidity position or to or increase our cash reserves for future operations. The sale of additional equity would result in further dilution to our shareholders. The incurrence of indebtedness would result in increased fixed obligations and could result in operating covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all. Please see Item 10, Additional Information Exchange Controls for a discussion of impediments to

capital flows in and out of China.

From time to time, we evaluate possible investments, acquisitions or divestments and may, if a suitable opportunity arises, make an investment or acquisition or conduct a divestment, which may have a material effect upon our liquidity and capital resources. Please see Item 4, Information on the Company Our Online Game Development and Sourcing Model Investment and Acquisition for a description of our significant investments and acquisitions.

Table of Contents**Capital Expenditures**

Our capital expenditures amounted to RMB62.0 million, RMB113.7 million, and RMB86.0 million (US\$13.0 million) in 2008, 2009 and 2010, respectively.

Our capital expenditures in 2008, 2009 and 2010 principally consisted of purchases of, or investments in, our online game network infrastructure, which we funded primarily from net cash flow from operations. We expect our capital expenditures in 2011 and 2012 to primarily consist of leasehold improvements, purchases of additional servers, computer software and equipment. In addition, we expect that our capital expenditures will increase in the future as our online game business continues to develop and expand and as we make technological improvements to our network infrastructure and purchase other intangible assets.

C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.

We focus our research and development activities principally on the development of updates, expansion and sequels of our online game related content and the development of integrated service platform.

Our research and development efforts and plans consist of:

outsourcing and in-house development of updates, expansions and sequels of our existing online game;

sourcing new games via investment and in-house development; and

improving our server management and control systems.

Our product development expenses were RMB238.8 million, RMB339.8 million and RMB465.8 million (US\$70.6 million) in 2008, 2009 and 2010, respectively.

D. TREND INFORMATION

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from January 1, 2010 to December 31, 2010 that are reasonably likely to have a material effect on our net revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

E. OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2010, we do not have any outstanding derivative financial instruments, off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts. We do not engage in trading activities involving non-exchange traded contracts.

F. CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table sets forth our contractual obligations as of December 31, 2010:

	Payments Due by Period			More Than 3 Years
	Total	Less than 1 Year (RMB in millions)	1-3 Years	
Operating lease obligations:				
Office premises	81.5	43.0	38.5	
Computer servers, software and equipment	20.9	20.0	0.9	
Total contractual obligations	102.4	63.0	39.4	

As of December 31, 2010, substantially all of our operating lease arrangements for servers and related services provide for the calculation of lease payments based on formulas that reference the actual number of users of the relevant servers. Our rental expenses under these operating leases were RMB96.9 million, RMB133.4 million and RMB134.8 million (US\$20.4 million) in 2008, 2009 and 2010, respectively. As future lease payments for these arrangements are based on the actual number of users and thus cannot be reasonably estimated, they are not included in the minimum lease payments shown above. As of December 31, 2010, we had entered into maintenance contracts in relation to the servers we owned amounting to RMB20.9 million (US\$3.2 million).

As of December 31, 2010, capital commitments for purchase of equipment and game licenses were RMB76.7 million (US\$11.1 million).

Table of Contents**Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. DIRECTORS AND SENIOR MANAGEMENT**

The following table sets forth certain information relating to our directors and executive officers as of March 31, 2011. The business address of each of our directors and executive officers is No. 1 Office Building, 690 Bibo Road, Pudong New Area, Shanghai 201203, China.

Name	Age	Position
Qunzhao Tan ⁽¹⁾	35	Chairman of the Board of Directors and Chief Executive Officer
Tianqiao Chen ⁽¹⁾	37	Director
Danian Chen ⁽¹⁾	32	Director
Grace Wu	40	Director
Lai Xing Cai ⁽²⁾	68	Independent Director
Andy Lin ⁽²⁾	37	Independent Director
Heng Wing Chan ⁽²⁾	64	Independent Director
Hai Ling	41	President
Richard Wei	48	Chief Financial Officer
Xiangdong Zhang	35	Chief Producer
Jisheng Zhu	38	Chief Technology Officer and Acting Chief Operating Officer
William Chen	38	Vice President
Thomas Yih	37 	