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

As of December 31, 2014, details of the Company's significant majority-owned subsidiaries and VIEs are as follows:

Name	Incorporation or acquisition date/place	Shareholder/ nominee owner	Legal ownership %	Principal activities
Subsidiaries:				
KongZhong Information Technologies (Beijing) Co., Ltd. ("KongZhong Beijing")	July 2002 People's Republic of China ("PRC")	KongZhong	100	Providing consulting and technology services
KongZhong China Co., Ltd. ("KongZhong China")	June 2005 the PRC	KongZhong	100	Providing consulting and technology services
Simlife (Beijing) Science Co., Ltd. ("Simlife Beijing")	June 2009 the PRC	Simlife International Inc.	100	Providing consulting and technology services
Success Blueprint Limited ("Success Blueprint")	October 2009 British Virgin Islands	KongZhong	100	Providing novel license to overseas
Dacheng Holdings Limited ("Dacheng Holdings")	January 2010 Cayman Islands	KongZhong	100	Providing internet games services
Dacheng Investment (Hong Kong) Limited ("Dacheng Hong Kong")	January 2010 Hong Kong	KongZhong	100	Providing internet games services
Noumena Innovation (BVI) Ltd. ("Noumena")	March 2012 British Virgin Islands	KongZhong	100	Providing smart mobile games services
Noumena Productions limited	March 2012 Hong Kong	Noumena	100	Providing smart mobile games services
KongZhong (Singapore) Pte. Ltd.	November 2014 Singapore	KongZhong China	100	Providing mobile games and internet games services
VIEs:				

Beijing AirInbox Information Technologies Co., Ltd. ("Beijing AirInbox")	April 2002 the PRC	Linguang Wu SonglinYang Guijun Wang Zhen Huang	45 42 10 3	Providing wireless value-added services to mobile phone users
Beijing Wireless Interactive Network Technologies Co., Ltd. ("Beijing WINT")	February 2005 the PRC	Yang Yang Jingye Sun Li Ai	40 30 30	Providing wireless value-added services to mobile phone users
Beijing Chengxitong Information Technology Co., Ltd. ("Beijing Chengxitong")	November 2005 the PRC	Yang Li Xuelei Wu	90 10	Providing wireless value-added services to mobile phone users

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES- continued

Name	Incorporation or acquisition date/place	Shareholder/ nominee owner	Legal ownership %	Principal activities
Beijing Xinrui Network Technology Co., Ltd. ("Beijing Xinrui")	January 2006 the PRC	Guijun Wang Yang Li	51 49	Providing wireless value-added services to mobile phone users
Shanghai Mailifang Communication Co., Ltd. ("Shanghai Mailifang")	March 2009 the PRC	Xu Guo Yang Yang	90 10	Mobile games developing services
Xiamen Xinreli Technology Co., Ltd. ("Xiamen Simlife")	June 2009 the PRC	Tao Jia Junhong Chen	80 20	Providing wireless value-added services to mobile phone users
Shanghai Dacheng Network Technology Co., Ltd. ("Shanghai Dacheng")	January 2010 the PRC	Leilei Wang Zhen Yang	59 41	Providing internet games services
Subsidiaries of VIE:				
Beijing Boya Wuji Technologies Co., Ltd.	March 2004 the PRC	Beijing AirInbox	100	Providing internet games services
Tianjin Mammoth Technologies Co., Ltd. ("Tianjin Mammoth")	May 2005 the PRC	Beijing AirInbox Beijing WINT	95 5	Mobile games developing services
Beijing Shiyuan Leya Culture Communication Co., Ltd.	July 2008 the PRC	Beijing Xinrui	100	Providing wireless value-added services to mobile phone users
Nanjing Net Book Culture Co., Ltd.	October 2009 the PRC	Beijing Chengxitong	100	Providing internet novel services
		Beijing Xinrui	100	

Beijing Yin'ao Fulai Culture Development Co., Ltd.,	May 2012 the PRC			Providing wireless value-added services to mobile phone users
Beijing Shangshu Boer Culture Communication Co., Ltd.,	July 2012 the PRC	Beijing Xinrui	100	Providing wireless value-added services to mobile phone users
Shanghai KongZhong Brilliant Game Co., Ltd. ("KongZhong Brilliant")	July 2012 the PRC	Shanghai Dacheng	100	Providing internet games services
KongZhongWang JP Co., Ltd.	June 2014 Japan	Beijing AirInbox	100	Providing mobile games services
Dacheng (Singapore) Pte. Ltd.	November 2014 Singapore	Shanghai Dacheng	100	Providing mobile games and internet games services

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

The VIE arrangements

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

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

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

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

The VIE arrangements - continued

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

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

The business operation agreements of Beijing AirInbox and Xiamen Simlife will expire in 2016 and 2024, respectively. The business operation agreement of Beijing AirInbox will be automatically extended for another ten years unless KongZhong Beijing writes to terminate the agreement three months before the expiration of the agreement. The business operation agreement of Xiamen Simlife will be automatically extended for another ten years unless KongZhong Beijing writes to terminate the agreement three months before the expiration of the agreement. The business operation agreements of the remaining VIEs do not contain any expiration date. The termination of the agreements requires thirty day written notice from the Foreign Owned Subsidiaries. The VIEs have no authority to terminate the business operation agreements.

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

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

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

- Agreements that transfer economic benefits to the Foreign Owned Subsidiaries

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

The VIE arrangements - continued

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

The exclusive technical and consulting services agreements of Beijing AirInbox, Shanghai Mailifang, Beijing Xinrui and Shanghai Dacheng will expire in 2024, 2019, 2019 and 2020, respectively. The exclusive technical and consulting services agreements of these VIEs will be automatically extended for another ten years unless the relevant Foreign Owned Subsidiaries write to terminate the agreements three months before the expiration of the agreements. The technical and consulting services agreements of the remaining VIEs do not contain any expiration provision.

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

Risks in relation to the VIE structure

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

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

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

Risks in relation to the VIE structure - continued

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

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

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

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

	As of December 31,	
	2013	2014
Total current assets	$140,476,592	$134,777,487
Total assets	$259,746,443	$211,055,266
Total current liabilities	$57,510,282	$50,862,163
Total liabilities	$76,770,282	$60,722,163

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued

Risks in relation to the VIE structure - continued

	For the years ended December 31,		
	2012	2013	2014
Revenues	$172,090,218	$168,999,541	$217,859,413
Net income	$28,331,383	$16,439,680	$22,996,737

	For the years ended December 31,		
	2012	2013	2014
Net cash provided by operating activities	$43,021,136	$28,830,017	$26,682,007
Net cash (used in) provided by investing activities	$(53,172,297)	$(38,188,141)	$28,503,343
Net cash (used in) financing activities	$-	$(6,588,420)	$(21,201,273)

The VIEs contributed an aggregate of 95.3%, 97.3% and 95.7% of the consolidated revenues for the year ended December 31, 2012, 2013 and 2014, respectively. The Company's operations not conducted through contractual arrangements with the VIEs primarily consist of its non-carrier billing channels business. As of December 31, 2013 and 2014, the VIEs accounted for an aggregate of 62.0% and 48.8%, respectively, of the consolidated total assets, and 88.6% and 54.9%, respectively, of the consolidated total liabilities. The assets not associated with the VIEs primarily consist of cash and cash equivalents, goodwill and intangible assets.

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

Relevant PRC laws and regulations restrict the VIEs from transferring a portion of their net assets, equivalent to the balance of their statutory reserve and their share capital, to the Company in the form of loans and advances or cash dividends. Please refer to Note 31 for disclosure of restricted net assets.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

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

Basis of consolidation

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

Cash and cash equivalents

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

Term deposits

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

Restricted cash

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

Fair value

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

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Fair value - continued

Level 1

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

Level 2

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

Level 3

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

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

Fair value of acquired assets is discussed in Note 3.

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Short-term investments

The Company's short-term investments comprise debt and equity securities, which are classified as either held-to-maturity securities, trading securities or available-for-sale securities. Investments in securities that the Company has the positive intent and ability to hold the securities to maturity are classified as held-to-maturity securities and recorded at amortized cost. Trading securities are carried at their fair values and the unrealized gains or losses from the changes in fair values are included in net earnings. Investments in securities that have readily determinable fair value not classified as held-to-maturity or as trading securities are classified as available-for-sale securities. Available-for-sale securities are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss). Realized gains or losses are included in earnings during the period in which the gain or loss is realized.

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

Use of estimates

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

Property and equipment, net

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

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

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

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

Impairment of long-lived assets

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

Business combinations

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

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Goodwill and indefinite-lived intangible assets

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

The first step compares the fair value of each reporting unit (operating segment or one level below an operating segment) to its carrying amount, including goodwill. As of December 31, 2013 and 2014, there were three reporting units, internet games, mobile games and wireless value-added services ("WVAS"). If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of the affected reporting unit's goodwill to the carrying value of that goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. No impairment loss was recorded during the years ended December 31, 2012, 2013 and 2014 (see Note 12).

The Company has determined that the Company's trademarks do not have determinable useful lives. Consequently, the carrying amount of trademarks are not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the assets might be impaired. Such impairment test consists of a comparison of the fair value of the trademarks with their carrying amount and an impairment loss is recognized if and when the carrying amounts of the trademarks exceed their fair values. The estimates of fair values of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. Significant assumptions are inherent in this process, including estimates of discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. No impairment loss was recorded during the years ended December 31, 2012, 2013 and 2014.

Long-term investments

For investments in investees over which the Company does not have significant influence, the Company carries the investments at cost. The Company reviews the long-term investments for impairment whenever events or circumstances indicate that an other-than-temporary decline has occurred. An impairment loss is recognized in earnings equal to the amount of the investment's carrying amount in excess of its fair value at the assessment date. The fair value of the investment would then become the new cost basis of the investment. Impairment losses of $nil, $2 million and $2 million were recorded for the years ended December 31, 2012, 2013 and 2014, respectively (see Note 11).

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Revenue recognition and cost of revenues

The Company's revenues are derived from internet games services, mobile games services and WVAS. The Company's revenues are net of sales tax.

(i) Internet games

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

Online game operation revenues

The Company adopts the item-based revenue model. The basic game play functions are free of charge or require an initial fee to access the game, and players are charged for purchases of in-game items. Revenue from the initial fee to access the game is recognized ratably based on the period during which the player is expected to continue to play the game. Revenues from the sales of in-game items are recognized when the items are consumed by the players or over the estimated lives of the items.

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

Revenues from licensing arrangement

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

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

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Revenue recognition and cost of revenues - continued

(i) Internet games - continued

Revenues from licensing arrangement - continued

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

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

(ii) Mobile games

The mobile games revenues are derived from both carrier billing channels and non-carrier billing channels.

Revenues from carrier billing channels

The Company recognizes revenues collected and collectable from carrier billing channels through providing mobile games services on the platforms of Mobile Operator. Mobile phone users download the mobile games in the same manner as the WVAS and the Company recognizes revenues from such services in the same way as the WVAS revenues are recognized. Mobile phone users could also download games on Android platforms and the Company recognizes revenues from such services in the same way as revenues from non-carrier billing channels.

Revenues from non-carrier billing channels

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Revenue recognition and cost of revenues - continued

(iii) WVAS

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

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

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

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

- Service fees paid to the Mobile Operator which are charged to the Company as a percentage, ranging from 15% to 70%, of gross revenues less bad debts.
- Fixed transmission fees that are charged on a basis of each transmission (regardless whether the customers can be billed or pay the Mobile Operator).

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Sales taxes

The Company reports revenues net of sales taxes. Sales taxes recorded were $5,793,557 and $5,786,615, respectively in 2012 and 2013, and a reversal of an over provision of $333,622 in 2014 as the entities of the Company were no longer required to pay sales taxes under the relevant tax reform program.

Value-added taxes

On January 1, 2012, the PRC Ministry of Finance and the State Administration of Taxation officially launched a pilot value-added taxes ("VAT") reform program ("Pilot Program"), applicable to businesses in selected industries. Businesses in the Pilot Program would pay VAT instead of sales tax. Starting from August 1, 2013, the Pilot Program was expanded to cover all regions in the PRC. Starting from June 1, 2014, the telecommunications service industry as a whole was included in the Pilot Program. The applicable VAT rates are 6% and 3% for the entities that are general taxpayer and small-scale taxpayer, respectively.

Allowance for credit losses

The allowance for credit losses related to accounts receivable is maintained at a level considered by management to be adequate to absorb an estimate of probable future losses existing at the balance sheet date. In estimating probable losses, the Company reviews accounts that are past due or in bankruptcy and accounts that may have higher credit risk using information available about the customer. The Company arrives at an estimated loss for specific doubtful accounts. This process is based on estimates, and ultimate losses may differ from those estimates. Receivable balance is written off when the Company determines that the balance is uncollectible. Subsequent recoveries, if any, are credited to the allowance when received. The Company considers an accounts receivable balance past due when payment has not been received within the stated terms. The charges related to allowance for credit losses for the years ended December 31, 2012, 2013 and 2014 were $5,626, $342,442 and $316,966, respectively.

Movement of allowance for credit losses is as follows:

	Balance at beginning of the year	Charged to expense	Written-off	Balance at end of the year
2012	$ 222,007	$ 5,626	$ (222,007)	$ 5,626
2013	$ 5,626	$ 342,442	$ (5,626)	$ 342,442
2014	$ 342,442	$ 316,966	$ (342,442)	$ 316,966

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Operating leases

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

Government subsidies

The Company receives subsidies from the local government authorities as incentives for local area development and technology development. The Company records the government subsidies that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Company with no future related costs, as income in certain periods. The Company recognized total government subsidies of $301,359, $2,176,449 and $1,138,909 and recognized such amounts as income for the years ended December 31, 2012, 2013 and 2014, respectively.

Foreign currency translation

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

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

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

Product development expenses

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Income taxes

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

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

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

Comprehensive income

Comprehensive income includes net income, unrealized gain on available-for-sale securities and foreign currency translation adjustments. Comprehensive income is reported in the statements of comprehensive income.

Advertising costs

The Company expenses advertising costs as incurred. Total advertising expenses were $5,802,006, $8,412,925 and $5,726,530 for the years ended December 31, 2012, 2013 and 2014, respectively, and have been included as part of selling and marketing expenses.

Share-based compensation

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Net income per share

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

Warrants

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

Recently issued accounting standards adopted

In March 2013, the Financial Accounting Standards Board ("FASB") has issued an authoritative pronouncement related to parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. When a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity, the parent is required to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. For an equity method investment that is a foreign entity, the partial sale guidance still applies. As such, a pro rata portion of the cumulative translation adjustment should be released into net income upon a partial sale of such an equity method investment. However, this treatment does not apply to an equity method investment that is not a foreign entity. In those instances, the cumulative translation adjustment is released into net income only if the partial sale represents a complete or substantially complete liquidation of the foreign entity that contains the equity method investment. In addition, the amendments in this pronouncement clarify that the sale of an investment in a foreign entity includes both: (1) events that result in the loss of a controlling financial interest in a foreign entity (i.e., irrespective of any retained investment); and (2) events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes also referred to as a step acquisition). Accordingly, the cumulative translation adjustment should be released into net income upon the occurrence of those events. The amendments in this pronouncement are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments, it should apply them as of the beginning of the entity's fiscal year of adoption. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continued

Recently issued accounting standards adopted - continued

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

The amendments in this ASU state that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

Recent accounting pronouncements not yet adopted

In April 2014, the FASB issued a new pronouncement which amends the criteria for reporting discontinued operations while enhancing disclosures in this area. It also addresses sources of confusion and inconsistent application related to financial reporting of discontinued operations guidance in US GAAP.

Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment.

In addition, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations.

The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. This disclosure will provide information about the ongoing trends in a reporting organization's results from continuing operations. The amendments in the ASU are effective in the first quarter of 2015 for public organizations with calendar year ends. Early adoption is permitted. The Company does not expect the adoption of this guidance will have a significant effect on its consolidated financial statements.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Recent accounting pronouncements not yet adopted - continued

In May 2014, the FASB issued a new pronouncement which affects any entity using US GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts. In addition, the existing requirements for the recognition of a gain or loss on the transfer of non-financial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, Intangibles—Goodwill and Other) are amended to be consistent with the guidance on recognition and measurement in this ASU.

The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

For a public entity, the amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted.

An entity should apply the amendments in this ASU using one of the following two methods:

1. Retrospectively to each prior reporting period presented and the entity may elect any of the following practical expedients:

For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.

For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Recent accounting pronouncements not yet adopted - continued

For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue.

2. Retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application.

If an entity elects this transition method it should also provide the additional disclosures in reporting periods that include the date of initial application of the amount by which each financial statement line item is affected in the current reporting period by the application of this ASU as compared to the guidance that was in effect before the change.

The Company is currently evaluating the impact on its consolidated financial statements of adopting this guidance

In June 2014, the FASB issued a new pronouncement which requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation - Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved.

The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted.

Entities may apply the amendments in this ASU either: (a) prospectively to all awards granted or modified after the effective date; or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this ASU as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. In addition, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. The Company does not expect the adoption of this guidance will have a significant effect on its consolidated financial statements.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Recent accounting pronouncements not yet adopted - continued

In August, 2014, the FASB issued a new pronouncement which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements. Furthermore, an entity must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern." The new standard is effective for fiscal years ending after December 15, 2016. The Company does not expect the adoption of this guidance will have a significant effect on its consolidated financial statements.

In January 2015, the FASB issued a new pronouncement which eliminates from US GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item.

If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item.

The FASB heard from stakeholders that the concept of extraordinary items causes uncertainty because it is unclear when an item should be considered both unusual and infrequent. Additionally, some stakeholders said that although users find information about unusual or infrequent events and transactions useful, they do not find the extraordinary item classification and presentation necessary to identify those events and transactions. Other stakeholders noted that it is extremely rare in current practice for a transaction or event to meet the requirements to be presented as an extraordinary item.

The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of this guidance will have a significant effect on its consolidated financial statements.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

3. ACQUISITION OF NOUMENA

On March 20, 2012, the Company obtained the control over Noumena and certain assets from a related party of Noumena, a developer of cross-platform smart phone mobile game engines. The total consideration was $19.11 million, consisting of cash consideration of $14.88 million and share consideration of $4.23 million. $9 million out of $14.88 million cash consideration was paid and $4.23 million share consideration was settled by issuance of 40 million ordinary shares of KongZhong, equivalent to 1 million American Depositary Shares ("ADSs", each representing 40 ordinary shares) in 2012. $3 million and $2.88 million of the cash consideration were paid in 2013 and 2014, respectively. This acquisition was recorded using the acquisition method of accounting and, accordingly, the acquired assets and liabilities were recorded at fair value at the date of acquisition. The acquisition-related cost of $77,783 was recorded as general and administrative expenses as incurred in 2012. The revenues and net income of Noumena in the amounts of $2,946,157 and $2,074,536 respectively were included in the Company's consolidated statement of comprehensive income for the year ended December 31, 2012.

Total consideration estimated at acquisition date:

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

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

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

The goodwill arising from the acquisition of Noumena was allocated to and included in the mobile games segment as of December 31, 2013 and 2014. The useful life of product technologies is 3 years.

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

3. ACQUISITION OF NOUMENA - continued

Fair value of acquired assets

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

Pro forma

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

	For the years ended December 31, 2012 (unaudited)
Revenues	$ 186,949,412
Net income	$ 26,161,809
Income per share - basic	$ 0.02
Income per share - diluted	$ 0.02

4. AVAILABLE-FOR-SALE SECURITIES

In February 2014, the Company made an investment in Ourgame International Holdings Limited ("Ourgame") for a consideration of RMB100 million (equivalent to $16.3 million) and recorded it as a long-term investment. Ourgame has become listed in Hong Kong since June 2014 and accordingly, the investment has a readily determinable fair value. Based on its expected period of holding, the Company has accounted for the investment as available-for-sale securities under current assets thereafter.

5. HELD-TO-MATURITY SECURITIES

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

6. TRADING SECURITIES

The Company from time to time invests in publicly traded equity and debt securities in China's stock market, and accounts for such investments as trading securities. The Company recognized gain related to trading securities of $261,473, $nil and $nil in the statements of comprehensive income for the years ended December 31, 2012, 2013 and 2014, respectively.

7. LOANS TO THIRD PARTY

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

8. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

	As of December 31,	
	2013	2014
Prepayment to service providers	$2,553,524	$9,561,090
Employee advances	1,000,762	332,923
Other deposits	1,110,945	1,134,027
Interest receivables	2,880,612	5,063,320
VAT recoverable	-	2,174,745
Other current assets	216,727	803,799
	$7,762,570	$19,069,904

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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(In US dollars)

9. RESTRICTED CASH

In connection with the requirements of a game license agreement entered into during 2012, a deposit was placed with bank as a pledged asset for the issuance of a standby letter of credit in favor of the licensor. The deposit is restricted as to withdrawal or usage for five years since the issuance of the standby letter of credit in 2012. In 2014, after the Company's payment of $15 million for the game license fee, the deposit was reduced to $21.9 million as of December 31, 2014, $10.9 million of which was expected to be released within a year, and accordingly recorded as a current asset.

In October 2014, the Company entered into an agreement with a bank for a term loan of $42.4 million (equivalent to approximately RMB260 million). The repayment of the loan was secured by a deposit of RMB260 million (equivalent to approximately $42.4 million) placed with a bank. The deposit was expected to be released within a year from the deposit date and accordingly recorded as a current asset as of December 31, 2014.

10. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following:

	As of December 31,	
	2013	2014
Computer and transmission equipment	$15,312,698	$17,305,410
Furniture and office equipment	1,162,452	1,288,057
Motor vehicles	807,082	860,109
Leasehold improvements	2,917,621	2,885,943
Communication equipment	543,308	541,704
Office building	705,297	703,384
	21,448,458	23,584,607
Less: accumulated depreciation	(15,605,936)	(17,925,416)
	$5,842,522	$5,659,191

Depreciation expenses for the years ended December 31, 2012, 2013 and 2014 are $2,175,564, $2,202,865 and $2,319,480 respectively.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

11. LONG-TERM INVESTMENTS

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

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

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

Since the completion of this investment, Meteor has been in a continuous loss-making position and failed to create the type of profit-generating business that was contemplated at the time of the Company's investment. As a result, the Company recorded a full impairment loss of $2 million in the year ended December 31, 2014 since it does not expect any positive cash flows from the investment in Meteor in the future and has no intention to hold this investment for recovery.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

12. GOODWILL

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

	2013 Internet games	Mobile games	WVAS	Total	2014 Internet games	Mobile games	WVAS	Total
Gross amount:								
Beginning balance	$68,408,299	$20,274,048	$43,929,382	$132,611,729	$70,506,823	$20,882,730	$44,035,400	$135,4
Exchange differences	2,098,524	608,682	106,018	2,813,224	(191,276)	(55,479)	(12,317)	(259
Ending balance	70,506,823	20,882,730	44,035,400	135,424,953	70,315,547	20,827,251	44,023,083	135,
Accumulated impairment loss:								
Beginning balance	(3,182,185)	-	(41,878,521)	(45,060,706)	(3,279,803)	-	(41,878,521)	(45,1
Exchange differences	(97,618)	-	-	(97,618)	8,898	-	2,653	11,5
Ending balance	(3,279,803)	-	(41,878,521)	(45,158,324)	(3,270,905)	-	(41,875,868)	(45,1
Goodwill, net	$67,227,020	$20,882,730	$2,156,879	$90,266,629	$67,044,642	$20,827,251	$2,147,215	$90,0

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

12. GOODWILL - continued

As of December 31, 2012, the Company performed an annual impairment test on goodwill. The Company estimated the fair values of the reporting units using the income approach valuation methodology. The income approach valuations included cash flow discount rates of 26%, 24% and 25%, and terminal value growth rates of 3%, 1% and 1% for internet games, mobile games and WVAS reporting units, respectively. Based on the results of the goodwill impairment test, the fair value of each reporting unit was more than the respective carrying value. Accordingly, there was no goodwill impairment needed to be recognized for the fiscal year 2012.

As of December 31, 2013, the Company performed an annual impairment test on goodwill. The Company estimated the fair values of the reporting units using the income approach valuation methodology. The income approach valuations included cash flow discount rates of 27%, 25% and 26%, and terminal value growth rates of 3%, 3% and 1% for internet games, mobile games and WVAS reporting units, respectively. Based on the results of the goodwill impairment test, the fair value of each reporting unit was more than the respective carrying value. Accordingly, there was no goodwill impairment needed to be recognized for the fiscal year 2013.

As of December 31, 2014, the Company performed an annual impairment test on goodwill. The Company estimated the fair values of the reporting units using the income approach valuation methodology. The income approach valuations included cash flow discount rates of 27%, 26% and 26%, and terminal value growth rates of 3%, 3% and 1% for internet games, mobile games and WVAS reporting units, respectively. Based on the results of the goodwill impairment test, the fair value of each reporting unit was more than the respective carrying value. Accordingly, there was no goodwill impairment needed to be recognized for the fiscal year 2014.

No goodwill impairment loss was recognized during the years ended December 31, 2012, 2013 and 2014.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

13. ACQUIRED INTANGIBLE ASSETS, NET

Acquired intangible assets, net consist of the following:

	As of December 31, 2013					As of December 31, 2014		
	Gross carrying amount	Accumulated amortization	Exchange difference	Accumulated impairment	Net carrying amount	Gross carrying amount	Accumulated amortization	Exchang differen
Intangible assets not subject to amortization								
Trademarks with indefinite life	$282,182	$-	$9,179	$-	$291,361	$282,182	$-	$8,388
Intangible assets subject to amortization								
Agreements with Mobile Operator	3,113,746	(3,113,746)	-	-	-	3,113,746	(3,113,746)	-
Operating platforms	243,974	(240,527)	650	-	4,097	243,974	(243,974)	-
Service licenses	57,071	(57,071)	-	-	-	57,071	(57,071)	-
Contracts with content providers	120,999	(120,999)	-	-	-	120,999	(120,999)	-
Non-compete agreement	388,516	(388,516)	-	-	-	388,516	(388,516)	-
Self-developed contents	379,089	(379,089)	-	-	-	379,089	(379,089)	-
Product technologies	4,966,102	(4,966,102)	-	-	-	4,966,102	(4,966,102)	-
	5,713	(5,713)	-	-	-	5,713	(5,713)	-

Contracts with service providers								
Subscriber list	16,710	(16,710)	-	-	-	16,710	(16,710)	-
Trademarks	36,874	(36,874)	-	-	-	36,874	(36,874)	-
Core technologies	8,281,231	(6,022,186)	84,060	-	2,343,105	8,281,231	(6,947,441)	243,03
Software	115,150	(40,730)	3,156	-	77,576	115,150	(65,464)	3,875
Game licenses	80,094,217	(4,206,258)	1,161,598	(1,812,939)	75,236,618	80,381,424	(22,127,367)	1,239,
Employment contract	380,898	(380,898)	-	-	-	380,898	(380,898)	-
Copyright	813,074	(45,518)	6,274	-	773,830	813,074	(181,584)	4,053
Total	$99,295,546	$(20,020,937)	$1,264,917	(1,812,939)	78,726,587	$99,582,753	$(39,031,548)	$1,498,

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

13. ACQUIRED INTANGIBLE ASSETS, NET - continued

The weighted average amortization period of the intangible assets subject to amortization was three years as of December 31, 2013 and 2014, respectively.

For purposes of recognition and measurement of an impairment loss, each intangible asset is considered the lowest level asset group that generates identifiable independent cash flow. In 2013, owing to the unsatisfactory performance for one game and expected cessation for another game, the carrying amount of these game licenses exceeded the sum of undiscounted future cash flows expected to generate from the use and eventual disposition of such licenses, which were insignificant. Accordingly, the Company recognized an impairment loss of $250,553 and $1,562,386 respectively in the consolidated statement of comprehensive income in 2013, which were reported in cost of revenues and impairment loss of intangible assets, respectively. The licenses impaired in 2013 were originally included in the internet game segment. In 2014, owing to the uncertainty of the success of a game development, the carrying amount of the relevant game licenses exceeded the sum of undiscounted future cash flows expected to generate from the use and eventual disposition of such licenses, which were insignificant. Accordingly, the Company recognized an impairment loss of $1,323,260 in the consolidated statement of comprehensive income in 2014, which was reported in impairment loss of intangible assets. The licenses impaired in 2014 were originally included in the internet game segment.

During 2012, 2013 and 2014, the Company obtained certain new game licenses from third party game developers. The intangible assets recognized comprise the relevant initial license fee payments, minimum royalty fee payments and value of warrants issued in connection with obtaining these licenses.

The Company recorded intangible assets relating to the game licenses by reference to the fair values of cash installment payments and warrants because the fair values of the game licenses were not readily determinable at the transaction dates. The Company estimated the useful lives of the game licenses to be three years and amortizes such intangible assets from commercial launches of the games over the useful lives. As of December 31, 2014, only certain games had been launched and relevant intangible assets started amortization.

The Company recorded amortization expenses of $5,452,441, $2,785,142, and $19,203,618 for the years ended December 31, 2012, 2013, and 2014, respectively. The amortization expenses for the years ending December 31, 2015, 2016, 2017, 2018, 2019 and thereafter are expected to be $22,973,341, $24,069,410, $6,661,446, $1,378,849, and $136,188.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

14. ACCOUNTS PAYABLE

Accounts payable consisted of the following:

	As of December 31,	
	2013	2014
Game license fees payable	$26,280,480	$13,246,572
Fees payable to content and channel providers	6,589,293	5,075,274
Royalty fees payable	5,448,409	11,622,820
Fees payable to mobile operators	635,500	968,382
Others	560,697	686,269
	$39,514,379	$31,599,317

15. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	As of December 31,	
	2013	2014
Accrued welfare benefits	$167,290	$196,455
Accrued payroll and bonus	4,126,279	5,719,423
Advance from customers	1,149,073	793,565
Accrued professional service fees	2,351,363	3,663,273
Accrued marketing expense	6,393,334	5,545,844
Other tax payables	2,148,117	-
Acquisition payable	2,880,600	-
Others	8,667	661,791
	$19,224,723	$16,580,351

The balance of acquisition payable as of December 31, 2013 represented the outstanding consideration in relation to the acquisition of Noumena (see Note 3). Such consideration was settled in 2014.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

16. SHORT-TERM BANK LOAN

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

In October 2014, the Company entered into a financing agreement with a bank and obtained US dollars loans totaling $42,428,890 for the purpose of special cash dividend distribution. The repayment was expected to be in October 2015 and secured by a pledge of RMB deposits of RMB260,000,000 (see Note 9).

17. INCOME TAXES

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

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

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

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

In 2014, KongZhong Beijing, Beijing AirInbox, Beijing Xinrui, Tianjin Mammoth renewed their "high and new technology enterprise" ("HNTE") status for additional six years through a new application process since their operations continue to qualify for HNTE status after the 2011 renewal under simplified application process. KongZhong China, Beijing Chengxitong and Beijing WINT also renewed their HNTE status in 2012 for additional three years through simplified application process after they first obtained such status in 2009. The HNTE status allows qualifying China-based enterprises to use a 15% tax rate for three years. After the first six years, enterprises will go through a new application process in order to renew their HNTE status. The Company believes it is highly likely that its qualifying entities will continue to obtain the renewal of the HNTE status in the future and has assumed so in calculating deferred tax assets and liabilities.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

17. INCOME TAXES - continued

Xiamen Simlife, Shanghai Dacheng and KongZhong Brilliant qualified for software enterprise for tax purposes. They were entitled to an exemption from income tax for two years commencing from the first year that presents accumulated earnings under the PRC tax law and entitled to a 50% relief from income tax for the following three years. The preferential tax treatment of Xiamen Simlife started in 2010, Shanghai Dacheng started in 2011 and KongZhong Brilliant started in 2014.

	As of December 31,	
	2013	2014
Current deferred tax assets		
Accrued expenses	$298,992	$616,812
Less: valuation allowance	(298,992)	(616,812)
Current deferred tax assets, net	$-	$-
Non-current deferred tax assets		
Net operating loss carry forwards	116,765	2,100,763
Less: valuation allowance	(116,765)	(2,100,763)
Non-current deferred tax assets, net	$-	$-

The Company operates through multiple subsidiaries and VIEs and the valuation allowance is considered on each individual entity basis. A full valuation allowance has been established because the Company believes that it is more likely than not that its deferred tax assets will not be realized as it does not expect to generate sufficient taxable income in the future. The tax losses carried forward as of December 31, 2014 amounted to $15,907,836 and will expire by 2019.

The income taxes expense consists of:

For the years ended December 31,

	2012	2013	2014
Current	$3,558,263	$722,971	$1,047,999
Deferred	(67,421)	(10,569)	-
Total	$3,490,842	$712,402	$1,047,999

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

17. INCOME TAXES - continued

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

	For the years ended December 31,		
	2012	2013	2014
	%	%	%
Applicable rate for reconciliation purpose (note)	25	25	25
Effect of tax holiday granted to PRC entities	(7.6)	(6.5)	(7.4)
Effect on tax rates in different tax jurisdiction	12.5	(2.3)	(7.1)
Tax effect of expenses that are not deductible in determining taxable profit (note)	3.1	1.1	1.0
Tax effect of allowable special deduction in determining taxable profit (note)	(20.5)	(14.9)	(16.8)
Change in valuation allowance	(0.6)	0.9	9.7
Effective tax rate for the year	11.9	3.3	4.4

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

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

	For the years ended December 31,		
	2012	2013	2014
Increase in income tax expense	$2,207,096	$1,399,105	$1,758,665
Impact on net income per ordinary share-basic	$0.00	$0.00	$0.00

Impact on net income per ordinary share-diluted	$0.00	$0.00	$0.00

The Company did not identify any significant unrecognized tax benefits or incur any interest or penalties related to potential underpaid income tax expenses for each of the three years ended December 31, 2014. The Company does not expect to have a significant increase or decrease on unrecognized tax benefits within 12 months from December 31, 2014.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

17. INCOME TAXES - continued

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

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

Aggregate undistributed earnings of the Company's subsidiaries, VIEs and its VIEs' subsidiaries located in the PRC that are available for distribution to the Company of approximately $219,178,436 at December 31, 2014 are considered to be indefinitely reinvested and accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon the distribution of those amounts to the Company. The Chinese tax authorities have also clarified that distribution made out of pre January 1, 2008 retained earnings will not be subject to the withholding tax.

18. LONG-TERM LIABILITIES

In connection with the acquisition of the intangible assets relating to a game license obtained in 2012, the Company was required to make certain cash payments by installment. The total cash installment payments amounted to $55,000,000 with a present value of $53,460,269 on the acquisition date. The Company has recorded the outstanding current and noncurrent payment liabilities of $10,000,000 and $9,860,000 under accounts payable and long-term liabilities, respectively as of December 31, 2014.

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

19. CONVERTIBLE SENIOR NOTE

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

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

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

19. CONVERTIBLE SENIOR NOTE - continued

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

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

	For the years ende December 31, 2012
Interest expense at coupon rate	$ 26,730
Amortization of debt discount	36,297
Total interest expense recognized	$ 63,027

20. SHARE REPURCHASE

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

On October 26, 2012, the Board of Directors authorized to purchase the ADSs on the open market (the "2012 Purchase Plan"). The aggregate value of ADSs to be purchased under the 2012 Purchase Plan shall not exceed $20,000,000, and the number of ADSs to be purchased shall not exceed 5,000,000 ADSs. During 2012, the Company repurchased 362,807 ADSs for a total consideration of $2,071,731. During 2013, the Company repurchased 1,592,558 ADSs for a total consideration of $10,123,821. All such ADSs repurchased by the Company in 2012 and 2013 under the 2012 Purchase Plan were cancelled during 2013. During 2014, there were no share repurchases.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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(In US dollars)

21. EMPLOYEE EQUITY INCENTIVE PLAN

The Company's 2002 employee equity incentive plan ("2002 Plan") allows the Company to offer a variety of incentive awards to employees, consultants or external service advisors of the Company. Options to purchase 105,000,000 ordinary shares are authorized under the 2002 Plan. In 2005, the shareholders authorized additional 32,000,000 options under the 2002 Plan. The Company's 2006 Equity Incentive Plan ("2006 Plan") allows the Company to offer a variety of incentive awards to employees, consultants or advisors of the Company. 40,000,000 nonvested ordinary shares are authorized under the 2006 Plan. In 2008, the shareholders authorized additional 140,000,000 nonvested ordinary shares under the 2006 Plan. The Company's 2013 Equity Incentive Plan ("2013 Plan") allows the Company to offer a variety of incentive awards to officers, other employees, prospective employees, directors, consultants and advisors of the Company. The total number of ordinary shares that may be transferred pursuant to the incentive awards granted under the 2013 Plan shall not exceed 80,000,000 ordinary shares. The majority of the options and nonvested shares will vest over four years where 25% of the options and nonvested shares will vest at the end of the first year, 6.25% will vest quarterly in the second year through the fourth year. The stock options expire 10 years from the date of grant.

As of December 31, 2014, 5,417,940 options, 2,682,500 nonvested shares and incentive awards that may be transferred to 74,320,000 ordinary shares were available for future grants under the 2002 Plan, the 2006 Plan and the 2013 Plan, respectively.

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

21. EMPLOYEE EQUITY INCENTIVE PLAN- continued

Stock options

A summary of the stock option activities is as follows:

	Outstanding options		
	Number of options	Weighted average exercise price	Weighted average grant-date fair value
Options outstanding at January 1, 2012	50,685,617	$ 0.10	$ 0.07
Forfeited	(2,921,040)	$ 0.11	$ 0.08
Exercised	(4,710,120)	$ 0.06	$ 0.03
Options outstanding at December 31, 2012	43,054,457	$ 0.10	$ 0.08
Granted	13,320,000	$ 0.21	$ 0.06
Forfeited	(1,515,040)	$ 0.12	$ 0.08
Exercised	(8,602,960)	$ 0.10	$ 0.06
Options outstanding at December 31, 2013	46,256,457	$ 0.10	$ 0.12
Granted	9,520,000	$ 0.22	$ 0.06
Forfeited	(8,832,517)	$ 0.22	$ 0.06
Exercised	(4,052,480)	$ 0.11	$ 0.09
Options outstanding at December 31, 2014	42,891,460	$ 0.14	$ 0.12

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

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

Option grants	2012	2013		2014	
Weighted average risk-free interest rate	N/A	0.60	%	0.81	%
Weighted average expected option life	N/A	2.75 years		2.75 years	
Weighted average volatility rate	N/A	54.36	%	52.94	%
Weighted average dividend yield	-	-		-	

(1) Risk-free interest rate

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

(2) Expected life

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

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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(In US dollars)

21. EMPLOYEE EQUITY INCENTIVE PLAN - continued

Stock options - continued

(3) Volatility

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

(4) Dividend yield

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

(5) Exercise price

The exercise price of the options was determined by the Board of Directors.

(6) Fair value of underlying ordinary shares

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

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

	For the years ended December 31, 2012	2013	2014
Stock options	N/A	$ 0.26	$ 0.22

The total intrinsic value of options exercised during the years ended December 31, 2012, 2013 and 2014 was $212,849, $31,708 and $111,476 respectively.

The following table summarizes information with respect to stock options outstanding at December 31, 2014:

	Options outstanding				Options exercisable			
	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value	Number exercisable	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value
Average exercise price								
$0.07	7,420,857			482,356	7,420,857			482,356
$0.09	1,600,000			76,800	1,600,000			76,800
$0.10	10,245,560			412,384	7,295,560			293,646
$0.12	2,000,000			31,500	1,500,000			23,625
$0.13	3,832,520			36,775	3,832,520			36,775
$0.14	400,000			-	-			-
$0.15	2,352,523			-	2,352,523			-
$0.19	9,920,000			-	2,480,000			-
$0.22	5,120,000			-	-			-
Total	42,891,460	$ 0.14	6.72 years	1,039,815	26,481,460	$ 0.11	5.54 years	913,202

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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(In US dollars)

21. EMPLOYEE EQUITY INCENTIVE PLAN - continued

Stock options - continued

The number of the options expected to vest was 16,410,000 with a weighted-average exercise price of $0.18 and the weighted-average remaining contractual term of 8.84 years. The aggregate intrinsic value of the option expected to vest was $126,613 as of December 31, 2014.

Nonvested shares

A summary of the nonvested share activities is as follows:

	Number of nonvested shares outstanding	Weight average grant-date fair value
Nonvested shares outstanding at January 1, 2012	56,475,000	$ 0.12
Vested	(33,920,000)	$ 0.12
Nonvested shares outstanding at December 31, 2012	22,555,000	$ 0.13
Vested	(12,885,000)	$ 0.15
Nonvested shares outstanding at December 31, 2013	9,670,000	$ 0.11
Granted	3,680,000	$ 0.22
Forfeited	(825,000)	$ 0.11
Vested	(5,525,000)	$ 0.12
Nonvested shares outstanding at December 31, 2014	7,000,000	$ 0.16

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

The total intrinsic value of shares vested in the year of 2012, 2013 and 2014 was $4,647,040, $2,325,743 and $747,256, respectively.

The following table summarizes information with respect to nonvested shares outstanding at December 31, 2014:

	Nonvested share outstanding	
	Number outstanding	Aggregate intrinsic value
Grant date		
October 3, 2011	3,400,000	459,850
May 21, 2014	3,600,000	486,900
Total	7,000,000	946,750

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

21. EMPLOYEE EQUITY INCENTIVE PLAN - continued

Nonvested shares - continued

The Company recorded share-based compensation expenses of $4,464,497, $1,573,729 and $1,547,780 for the years ended December 31, 2012, 2013 and 2014, respectively. The amount of stock-based compensation currently estimated to be expensed from 2015 through 2018 related to unvested share-based payment awards at December 31, 2014 is $1,598,581. This amount will be recognized as presented in the following table.

Year	
2015	740,732
2016	401,700
2017	371,449
2018	84,700
Total	1,598,581

That cost is expected to be recognized over a weighted average period of 2.66 years. To the extent the actual forfeiture rate is different from the Company's original estimate, share-based compensation related to these awards may require to be adjusted.

22. WARRANTS

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

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

22. WARRANTS - continued

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

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

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

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

Exercisable multiple was not considered by the Company in the valuation since it was assumed that the warrant holders have no incentive to exercise the warrants before maturity as the Company does not pay dividends, and theoretically, holders of call options are better off to hold the warrants until maturity. During 2013, warrants to purchase 120 million of ordinary shares were exercised by the holder and cash proceeds of $17,800,000 was received by the Company. During 2014, warrants to purchase 40 million of ordinary shares were exercised by the holder and cash proceeds of $5,940,000 was received by the Company. In addition, warrants to purchase 40 million of ordinary shares were forfeited in 2014. As of December 31, 2014, the warrants for the purchases of up to 80 million ordinary shares of the Company remained outstanding. The exercise of the warrants, the corresponding issuance of ordinary shares and forfeiture of warrants were recorded in equity.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

22. WARRANTS - continued

A summary of the warrant activities is as follows:

	Number of underlying shares
Underlying shares outstanding at January 1, 2012	80,000,000
Issued	280,000,000
Underlying shares outstanding at December 31, 2012	360,000,000
Exercised	(200,000,000)
Underlying shares outstanding at December 31, 2013	160,000,000
Exercised	(40,000,000)
Forfeited	(40,000,000)
Underlying shares outstanding at December 31, 2014	80,000,000

23. SEGMENT AND GEOGRAPHIC INFORMATION

Segment reporting

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

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

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

23. SEGMENT AND GEOGRAPHIC INFORMATION - continued

Segment reporting - continued

	For the years ended December 31, 2012	2013	2014
Revenues			
Internet games	$82,902,851	$93,792,294	$118,099,837
Mobile games	20,970,977	16,908,282	45,036,427
WVAS	76,712,323	62,953,219	64,459,705
	180,586,151	173,653,795	227,595,969
Cost of revenues			
Internet games	(39,539,750)	(45,534,441)	(61,443,104)
Mobile games	(10,934,999)	(7,780,237)	(22,977,318)
WVAS	(52,655,523)	(43,085,208)	(44,858,641)
	(103,130,272)	(96,399,886)	(129,279,063)
Gross profit			
Internet games	43,363,101	48,257,853	56,656,733
Mobile games	10,035,978	9,128,045	22,059,109
WVAS	24,056,800	19,868,011	19,601,064
	77,455,879	77,253,909	98,316,906
Operating expenses			
Product development	(18,382,383)	(26,401,720)	(25,107,372)
Selling and marketing	(24,586,039)	(26,674,024)	(42,522,684)
General and administrative	(11,629,273)	(8,976,176)	(12,564,600)
Impairment loss on intangible assets	-	(1,562,386)	(1,323,260)
Total operating expenses	(54,597,695)	(63,614,306)	(81,517,916)
Government subsidies	$301,359	$2,176,449	$1,138,909
Income from operations	$23,159,543	$15,816,052	$17,937,899

Service lines of internet games

The internet games revenues are derived from online game operation revenues and licensing revenues including royalties. Revenues of internet games by service line for the years ended December 31, 2012, 2013 and 2014 are as follows:

	For the years ended December 31,		
	2012	2013	2014
Internet games			
Online game operation	$77,676,406	$91,308,244	$116,756,333
Licensing arrangement	5,226,445	2,484,050	1,343,504
	$82,902,851	$93,792,294	$118,099,837

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

23. SEGMENT AND GEOGRAPHIC INFORMATION- continued

Service lines of mobile games

The mobile games revenues comprise revenues from carrier billing channels and revenues from non-carrier billing channels. Revenues of mobile games by service line for the years ended December 31, 2012, 2013 and 2014 are as follows:

	For the years ended December 31,		
	2012	2013	2014
Mobile games			
- Carrier billing channels	$15,451,852	$10,135,756	$23,808,707
- Non-carrier billing channels	5,519,125	6,772,526	21,227,720
	$20,970,977	$16,908,282	$45,036,427

Service lines of WVAS

The WVAS include Wireless Application Protocol ("WAP") services, Multimedia Messaging Services ("MMS"), Short Messaging Services ("SMS"), Interactive Voice Response services ("IVR"), and Color Ring Back Tones ("CRBT"). Revenues of WVAS by service line for the years ended December 31, 2012, 2013 and 2014 are as follows:

	For the years ended December 31,		
	2012	2013	2014
WVAS			
- SMS	$38,647,552	$31,844,446	$31,922,975
- IVR	13,255,971	14,658,612	13,210,504
- MMS	3,346,206	1,096,133	968,026
- WAP	2,651,647	708,984	364,750
- CRBT and others	18,810,947	14,645,044	17,993,450

	$76,712,323	$62,953,219	$64,459,705

Geographical information

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

	For the years ended December 31,		
	2012	2013	2014
PRC	$170,672,905	$167,752,785	$221,935,017
Asia-pacific	3,702,017	913,465	162,797
Europe and America	6,211,229	4,987,545	5,498,155
	$180,586,151	$173,653,795	$227,595,969

The Company's long-lived assets as of December 31, 2013 and 2014 were all located in the PRC.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

24. CASH DIVIDEND

On October 17, 2014, the Board of Directors of the Company declared a special one-time cash dividend of $40,999,308, representing $0.022 per ordinary share, or 0.88 per ADS, to the record holders of the Company's shares as of October 27, 2014. Such dividend was recorded as a reduction against retained earnings.

25. FAIR VALUE MEASUREMENTS

Measured on recurring basis

The Company measured its financial assets and liabilities including time deposits, available-for-sale securities and game license payment liabilities at fair value on a recurring basis as of December 31, 2013 and 2014.

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

The Company did not have Level 2 investments as of December 31, 2013 and 2014.

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

The following table shows the fair value of the Company's financial assets and liabilities measured at recurring basis as of December 31, 2013 and 2014:

	As of December 31, 2013 Fair Value Measurements at the Reporting Date Using				As of December 31, 2014 Fair Value Measurements at the Reporting Date Using			
	Quoted prices in active markets for identical instruments (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)	Total balance	Quoted prices in active markets for identical instruments (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)	Total balance
Time deposits	$72,520,957	$ -	$-	$72,520,957	$40,777,831	$ -	$-	$40,777,831
Available-for-sale securities	-	-	-	-	20,013,487	-	-	20,013,487
Game license payment liabilities	-	-	39,260,000	39,260,000	-	-	19,860,000	19,860,000
Total	$72,520,957	$ -	$39,260,000	$111,780,957	$60,791,318	$ -	$19,860,000	$80,651,318

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KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

25.FAIR VALUE MEASUREMENTS - continued

	Fair Value measurement Using Significant Unobservable is inputs (level 3) Game license payment liabilities
Opening balance	$ 39,260,000
Transfer into Level 3	-
Transfer out of Level 3	-
Total gains or losses for the period	
Included in earning (or changes in net assets)	600,000
Settlements	(20,000,000)
Closing balance	$ 19,860,000

<u>Measured on nonrecurring basis</u>

The Company measured the fair value of the purchased intangible using the "cost," "income approach-excess earnings" or "with & without" valuation methods. In addition, the Company measured the fair value of intangible assets using income approach method based on which to recognize the impairment loss in 2013 and 2014. These intangible assets are considered Level 3 assets because the Company used unobservable inputs, such as forecast financial performance of the acquired businesses or assets and discount rates to determine the fair value of these purchased assets.

Goodwill and cost method investments are measured at fair value on a nonrecurring basis when impairment is recognized.

The Company measured the fair value of cost method investment in U4iA and Meteor using income approach method based on which to recognize the impairment loss in 2013 and 2014, respectively. The cost method investment in Meteor is considered as Level 3 assets because the Company used unobservable inputs, such as forecast financial performance and future cash flow to determine the fair value of the cost method investment.

Warrants and intangible assets purchased with issued warrants as consideration are measured at fair value on a nonrecurring basis on the transaction date (see Note 22).

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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26. NET INCOME PER SHARE

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

	For the years ended December 31,		
	2012	2013	2014
Net income (numerator), basic and diluted	$25,739,968	$20,661,649	$22,587,921
Shares (denominator):			
Weighted average ordinary shares outstanding used in computing basic net income per share	1,661,864,846	1,714,924,612	1,828,191,540
Effect of dilutive securities:			
Plus incremental weighted average ordinary shares from assumed conversions of stock options, nonvested shares and warrants using the treasury stock method	59,757,910	36,696,728	47,328,554
Total weighted average shares used in computing diluted net income per share	1,721,622,756	1,751,621,340	1,875,520,094
Net income per share, basic	$0.02	$0.01	$0.01
Net income per share, diluted	$0.01	$0.01	$0.01

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

For the years ended December 31, 2012, 2013 and 2014, the Company had the following securities outstanding which could potentially dilute basic net income per share in the future, but were excluded from the computation of diluted net income per share in 2012, 2013 and 2014 as their effects would have been antidilutive:

	For the years ended December 31,		
	2012	2013	2014
Options, nonvested shares and warrants	285,312,520	11,320,000	97,392,523

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

27. CONCENTRATIONS

(a) Dependence on Mobile Operator

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

The following table shows the revenues and percentage of total revenues derived from those operators for the years ended December 31, 2012, 2013 and 2014:

	For the years ended December 31,		
	2012	2013	2014
Percentage of Total Revenues			
Revenues collected through operators			
China Mobile	36 %	30 %	27 %
China Unicom	7 %	5 %	4 %
China Telecom	6 %	6 %	5 %
Mobile games revenues collected through operators			
China Mobile	8 %	6 %	10 %
China Unicom	-	-	-
China Telecom	-	-	-
WVAS revenues collected through operators			
China Mobile	28 %	24 %	17 %
China Unicom	7 %	5 %	4 %
China Telecom	6 %	6 %	5 %

Net accounts receivable from the operators as of December 31, 2013 and 2014 were as follows:

	Percentage of accounts receivable as of December 31, 2013		2014	
China Mobile	63	%	58	%
China Unicom	9	%	7	%
China Telecom	9	%	9	%

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

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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(In US dollars)

27. CONCENTRATIONS - continued

(b) Internet games revenue

The Company derived the majority of internet games revenue from two games which accounted for approximately 40%, 51% and 50% of total revenues in 2012, 2013 and 2014, respectively.

(c) Credit risk

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

28. PRC CONTRIBUTION PLAN AND PROFIT APPROPRIATION

The employees of the Company in the PRC participate in a government-mandated defined contribution plan pursuant to which pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require the Company accrue these benefits based on certain percentages of the employees' salaries. The total provision for such employee benefit was $3,480,839, $5,135,732 and $4,799,750 for the years ended December 31, 2012, 2013 and 2014, respectively.

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

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

As of December 31, 2013 and 2014, the total statutory reserve amounted to $10,723,748 and $11,467,537, respectively.

29. RELATED PARTY TRANSACTIONS

Leilei Wang indirectly owns more than 10% of Prosten Technology Holdings Limited ("Prosten"). Prosten and its subsidiaries engage in the business of providing solutions to companies that provide mobile and search services. In 2012, 2013 and 2014, Prosten and its subsidiaries provided the Company mobile value-added services valued at $1.5 million, $1.0 million and $0.1 million, respectively. The accounts payable to Prosten and its subsidiaries as of December 31, 2013 and 2014 were $73,216 and $198,051 respectively.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(In US dollars)

30. COMMITMENTS AND CONTINGENCIES

(a) Operating lease as lessee

The Company leases certain office premises under non-cancelable leases. Rental expenses under operating leases for the years ended December 31, 2012, 2013 and 2014 were $2,424,259, $3,449,577 and $3,905,147, respectively.

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

Year ending	
2015	$4,010,632
2016	2,167,849
2017	86,669
2018	46,096

(b) Purchase obligations

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

Year ending	
2015	$833,187
2016	78,252
2017	27,849
2018	3,785
2019 and thereafter	-

(c) Sales tax

The subsidiaries and VIEs incorporated in the PRC are subject to the sales tax at rates of 3% to 5% on PRC taxable revenues, as defined by the related tax rules and regulations. When determining the PRC taxable revenues for sales tax purpose, the subsidiaries and VIEs adopted a "net" basis, i.e. deducting profit sharing with content providers from revenues. However, as the deductible items for sales tax purposes are not clearly defined, the Company would be subject to additional sales tax if the net basis used by the Company was determined inappropriate for the computation of sales tax. Additional business tax amounting to $4,910,109 could arise had the gross revenue been used for sales tax calculations as of December 31, 2014.

KONGZHONG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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31. RESTRICTED NET ASSETS

Relevant PRC laws and regulations restrict the Company's PRC subsidiaries and VIEs from transferring a portion of their net assets, equivalent to the balance of their statutory reserves and their share capital, to KongZhong in the form of loans, advances or cash dividends. The balance of restricted net assets were $77,426,504 and $76,657,282, of which $49,357,157 and $47,850,580 was attributed to the paid in capital, additional paid in capital and statutory reserves of the VIEs and $28,069,347 and $28,806,702 were attributed to the paid in capital, additional paid in capital and statutory reserves of the Company's PRC subsidiaries, as of December 31, 2013 and 2014, respectively. The PRC subsidiaries' accumulated profits may be distributed as dividends to KongZhong without the consent of a third party. The VIEs' revenues and accumulated profits may be transferred to KongZhong through contractual arrangements without the consent of a third party. Under applicable PRC law, loans from PRC companies to their offshore affiliated entities require governmental approval, and advances by PRC companies to their offshore affiliated entities must be supported by bona fide business transactions.

32. SUBSEQUENT EVENT

In December 2014, the Company entered into an agreement to acquire 8.89 million issued ordinary shares of Forgame Holdings Limited ("Forgame") for a total consideration of HK$124,506,200 in cash (equivalent to approximately US$16.4 million). The acquisition was completed in January 2015 and the investment represented 7% equity interest in Forgame. As the Company has no significant influence over Forgame and Forgame is a listed company in Hong Kong, this investment will be recorded as available-for-sale securities.

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