

The9 LTD  
Form 20-F  
April 29, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 20-F**

**(Mark One)**

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

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
<sup>x</sup> 1934**

**For the fiscal year ended December 31, 2018.**

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

..SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

Date of event requiring this shell company report \_\_\_\_\_

Commission file number: 001-34238

**THE9 LIMITED**

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

**Cayman Islands**

(Jurisdiction of incorporation or organization)

**Building No. 3, 690 Bibo Road**

**Zhang Jiang Hi-Tech Park**

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**People's Republic of China**

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**Shanghai 201203**

**People's Republic of China**

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

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

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

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

**None**

**(Title of Class)**

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

None

(Title of Class)

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

**146,652,558 ordinary shares (excluding 1,702,800 ordinary shares we reserved for issuance upon the exercise of options under our share incentive plan and for our treasury ADSs), par value US\$0.01 per share, as of December 31, 2018.**

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

Emerging growth company ☐

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards<sup>†</sup> provided pursuant to Section 13(a) of the Exchange Act. ☐

<sup>†</sup> The term “new or revised financial accounting standard” refers to any update issued by the by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012. Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

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

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

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

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

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

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## INTRODUCTION

In this annual report, unless otherwise indicated, (1) the terms “we,” “us,” “our company,” “our” and “The9” refer to The9 Limited and, as the context may require, its subsidiaries and our consolidated affiliated entities, (2) the terms “affiliated entities” and “affiliated PRC entities” refer to our consolidated affiliated PRC entities, including, among others, Shanghai The9 Information Technology Co., Ltd., or Shanghai IT, in which we do not have direct equity interests but over which we effectively control through a series of contractual arrangements as described under “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions—Arrangements with Affiliated PRC Entities,” (3) the terms “shares” and “ordinary shares” refer to our ordinary shares, and “ADSs” refers to our American depositary shares, each of which represents three ordinary shares, (4) “China” and “PRC” refer to the People’s Republic of China, and solely for the purpose of this annual report, excluding Taiwan, Hong Kong and Macau, (5) all references to “RMB” and “Renminbi” are to the legal currency of China and all references to “U.S. dollars,” “dollars,” “US\$” and “\$” are to the legal currency of the United States, and (6) all discrepancies in any table between the amounts identified as total amounts and the sum of the amounts listed therein are due to rounding.

Our business is primarily conducted in China and a significant portion of our revenues are denominated in RMB. This annual report contains translations of RMB amounts into U.S. dollars based on the exchange rate set forth in the H.10 statistical release of the Federal Reserve Bank of New York. For the convenience of the readers only, this annual report contains translations of some RMB or U.S. dollar amounts for 2018 at US\$1.00 to RMB6.8755, which was the noon buying rate in effect as of December 31, 2018. The prevailing rate on April 19, 2019 was US\$1.00 to RMB6.7032. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, the rates stated below, or at all. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—Future movements in exchange rates between the U.S. dollar and the RMB may adversely affect the value of our ADSs.”

Effective May 9, 2018, we effected a change of the ratio of the ADSs to ordinary shares from one ADS representing one ordinary share to three ordinary shares. Unless otherwise indicated, ADSs and per ADS amount in this annual report have been retroactively adjusted to reflect the changes in ratio for all periods presented.

## PART I

### Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.



Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

Item 3. KEY INFORMATION

A. Selected Financial Information

The following table presents selected consolidated financial information for our company. You should read the following information in conjunction with “Item 5. Operating and Financial Review and Prospects” below. The selected consolidated statement of operations data for the year ended December 31, 2016, 2017 and 2018 and the selected consolidated balance sheet data as of December 31, 2017 and 2018 have been derived from our audited consolidated financial statements and should be read in conjunction with those statements, which are included in this annual report beginning on page F-1. The selected consolidated statement of operations data for the year ended December 31, 2014 and 2015 and the selected consolidated balance sheet data as of December 31, 2014, 2015 and 2016 have been derived from our audited consolidated financial statements, which are not included in this annual report. The consolidated financial statements were prepared and presented in accordance with United States generally accepted accounting principles, or U.S. GAAP.

	For the Year Ended December 31,					
	2014	2015	2016	2017	2018	
	RMB	RMB	RMB	RMB	RMB	US\$( <sup>1</sup> )
	(in thousands, except for per share and per ADS data)					
Consolidated Statement of Operation Data						
Revenues <sup>(2)</sup>	64,840	46,610	56,286	73,208	17,492	2,544
Sales taxes	(563 )	(199 )	(86 )	(59 )	(61 )	(9 )
Net revenues	64,277	46,411	56,200	73,149	17,431	2,535
Cost of revenue	(85,783 )	(67,744 )	(48,519 )	(23,782 )	(16,436 )	(2,391 )
Gross (loss)/profit	(21,506 )	(21,333 )	7,681	49,367	995	144
Operating expenses	(139,404)	(303,604)	(306,892)	(163,027)	(105,991)	(15,416)
Other operating income/(expenses)	75	(1,563 )	3,605	350	230	33
Loss from operations	(160,835)	(326,500)	(295,606)	(113,310)	(104,766)	(15,239)
Impairment on equity investment and available-for-sale investment	—	—	(244,798)	—	(1,386 )	(202 )
Impairment on other investment	—	—	(2,807 )	(9,109 )	(7,776 )	(1,131 )
Interest income	3,415	775	161	31	194	28
Interest expenses	—	(6,397 )	(56,472 )	(83,922 )	(104,777)	(15,239)
Fair value change on warrants liability	—	(7,129 )	48,057	12,615	2,251	327
Gain/(loss) on disposal of equity investee and available-for-sale investment	33,154	—	(1,217 )	115	—	—
Foreign exchange (loss)/gain	(3,087 )	(7,313 )	(13,131 )	19,206	(20,331 )	(2,957 )
Other income/(expenses), net	2,124	5,396	3,179	4,670	1,599	233
Loss before income tax expense and share of loss in equity method investments	(125,229)	(341,168)	(562,634)	(169,704)	(234,992)	(34,180)
Income tax benefit	—	—	6,079	—	—	—
Recovery of equity investment in excess of cost	—	—	—	60,549	—	—
Share of loss in equity investments	(3,713 )	(13,014 )	(110,535)	(2,938 )	(4,293 )	(624 )
Net loss	(128,942)	(354,182)	(667,090)	(112,093)	(239,285)	(34,804)
Net (loss)/gain attributable to:						
Noncontrolling interest	(21,443 )	(16,656 )	(58,584 )	3,956	(16,333 )	(2,376 )
Redeemable noncontrolling interest	(20,877 )	(32,698 )	(14,724 )	2,117	(5,859 )	(852 )
The9 Limited	(86,622 )	(304,828)	(593,782)	(118,166)	(217,093)	(31,576)
Change in redemption value of redeemable noncontrolling interest	21,077	79,806	82,890	57,126	40,919	5,951
Net loss attributable to holders of ordinary shares	(107,699)	(384,634)	(676,672)	(175,292)	(258,012)	(37,527)
Other comprehensive income/(loss); net of tax:						
Currency translation adjustments	(1,204 )	5,009	(1,755 )	(9,526 )	(1,314 )	(191 )
Total comprehensive loss	(130,146)	(349,173)	(668,845)	(121,619)	(240,599)	(34,995)
Comprehensive (loss)/gain attributable to:						
Noncontrolling interest	(22,995 )	(16,913 )	(58,584 )	13,458	(24,888 )	(3,620 )
Redeemable noncontrolling interest	(20,877 )	(32,698 )	(14,724 )	2,117	(5,859 )	(852 )
The9 Limited	(86,274 )	(299,562)	(595,537)	(137,194)	(209,852)	(30,523)
Change in redemption value of redeemable non-controlling interest	21,077	79,806	82,890	57,126	40,919	5,951

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Comprehensive loss attributable to holders of ordinary shares	(107,351)	(379,368)	(678,427)	(194,320)	(250,771)	(36,474)
Net loss attributable to holders of ordinary shares per share						
Basic	(4.65	) (16.55	) (28.34	) (5.24	) (4.15	) (0.60
Diluted	(4.65	) (16.55	) (28.34	) (5.24	) (4.15	) (0.60
Net loss attributable to holders of ordinary shares per ADS <sup>(3)</sup>						
Basic	(4.65	) (16.55	) (28.34	) (5.24	) (4.15	) (0.60
Diluted	(4.65	) (16.55	) (28.34	) (5.24	) (4.15	) (0.60

	As of December 31,					
	2014	2015	2016	2017	2018	US\$( <sup>1</sup> )
	RMB	RMB	RMB	RMB	RMB	
	(in thousands)					
Consolidated Balance Sheet Data						
Cash and cash equivalents	181,482	49,011	38,878	142,624	4,256	619
Non-current assets	261,477	460,837	262,854	139,997	131,673	19,151
Total assets	517,331	538,095	350,892	323,109	164,687	23,953
Total current liabilities	296,591	427,966	573,749	819,445	908,424	132,125
Total equity	64,888	(241,076)	(702,054)	(802,351)	(1,084,812)	(157,779)
Redeemable noncontrolling interest	131,497	178,605	246,771	306,015	341,075	49,607
Total liabilities, redeemable noncontrolling interest and equity	517,331	538,095	350,892	323,109	164,687	23,953

## Notes:

Translation from Renminbi amounts into U.S. dollars was made at a rate of RMB6.8755 to US\$1.00 for the (1) convenience of the reader only. See “Item 3. Key Information—A. Selected Financial Information—Exchange Rate Information.”

Effective from January 1, 2018, we adopted ASC topic 606 Revenue from Contracts with Customers, a new accounting standard on the recognition of revenue, and have applied such accounting standards to the year ended (2) December 31, 2018. The financial data for the year ended December 31, 2014, 2015, 2016 and 2017 have not been recast and as such are not comparable with the financial data for the year ended December 31, 2018. The adoption of ASC 606 did not have material impact on our financial results.

(3) Each ADS represents three ordinary shares.

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

#### D. Risk Factors

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

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

We incurred a net loss of RMB667.1 million, RMB112.1 million and RMB239.3 million (US\$34.8 million) for the year ended December 31, 2016, 2017 and 2018, respectively, as we continue to incur product development and sales and marketing expenses for our new products and general and administrative expenses while we have not generated significant revenues from our new games or other operations in those periods and since 2009. Our product development, sales and marketing and general and administrative expenses may increase in the future as we continue to explore various opportunities of new product and services development and business expansion in order to grow our revenues. In 2016, we recorded a gross profit of RMB7.7 million primarily due to a decrease in cost of revenues, which resulted from a decrease in amortization of intangible assets following an impairment of intangible assets in mid-2016. In 2017, we had a gross profit of RMB49.4 million, primarily due to an increase in revenue, which was resulted from recognition of deferred licensing fees, and a decrease in cost of revenues, which resulted from a decrease in amortization of intangible assets following an impairment of intangible assets in mid-2016. In 2018, we recorded a gross profit of RMB1.0 million (US\$0.1 million) primarily due to a decrease in revenue. Our ability to achieve profitability depends on the competitiveness of our products and services as well as our ability to control costs and to provide new products and services to meet the market demands and attract new customers. Due to the numerous risks and uncertainties associated with our business, we may not be able to achieve profitability in the short-term or long-term.

Our cash and cash equivalents decreased from RMB142.6 million as of December 31, 2017 to RMB4.3 million (US\$0.6 million) as of December 31, 2018, primarily due to the cash outflows from operating activities associated with our product development and sales and marketing efforts for our new games, such as Pop Fashion, Q Jiang San Guo and Knight Forever. We recorded negative operating cash flow of RMB179.8 million, RMB86.7 million and RMB101.2 million (US\$14.7 million) for the year ended December 31, 2016, 2017 and 2018, respectively. Furthermore, as of December 31, 2016, 2017 and 2018, we recorded net current liabilities of RMB485.7 million, RMB636.3 million and RMB875.4 million (US\$127.3 million), respectively. Our net current liabilities positions as of December 31, 2016, 2017 and 2018 were primarily due to the continuous cash outflow in connection with our product development and sales and marketing activities. See “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Results of Operations.” We cannot assure you that our liquidity position will improve in the future. We may continue to incur losses, negative cash flows from operating activities and net current liabilities, which may materially and adversely affect our business, prospects, liquidity, financial condition and results of operations.

We had an accumulated deficit of approximately RMB3,233.1 million (US\$470.2 million) and total current liabilities exceeded total assets by approximately RMB743.7 million (US\$108.2 million) as of December 31, 2018. If we are unable to achieve profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern. There can be no assurance that we can obtain additional financing. Our ability to obtain additional financing is subject to a number of factors, which may be beyond our control. See “—We may not be able to obtain additional financing to support our business and operations, and our equity or debt financings may have an adverse effect on our business operations and share price.”

Our consolidated financial statements for each of the three years ended December 31, 2018 included in this annual report beginning on page F-1 have been prepared based on the assumption that we will continue on a going concern basis. The auditors of our consolidated financial statements have included in their audit reports an explanatory paragraph relating to substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts of liabilities that might result from the outcome of this uncertainty.

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

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

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

We currently depend on a limited number of games for substantially all of our revenues. In addition, we currently focus on developing a number of proprietary games and obtaining licenses to games to grow our business. We have invested significant time and resources in developing our proprietary online games, including a new mobile game that we are developing based on the intellectual property relating to CrossFire, or the CrossFire New Mobile Game. In addition, our subsidiary Asian Way Development Limited obtained a right from T3 Entertainment Co., Ltd., or T3 Entertainment, to develop a mobile game based on the intellectual property relating to a game called Audition and has sub-licensed all of its rights and obligations with respect to the development, marketing, distribution and publishing of the game to a third-party entity. However, there is no assurance that we can successfully develop the games we invest in, that we may successfully launch the games as expected on a timely basis, or at all, or if any newly launched games such as CrossFire New Mobile Game would be widely accepted by game players. In particular, the development and operation of a game usually involves significant investments and dedication of time and resources, but the resulting game product may not yield the financial return that we anticipate. Our business strategies may also involve the development and marketing of new products and services for which there are no established markets in China or in which we lack experience and expertise. If any of our games encounters any adverse development or if we are unable to develop, purchase or license additional games that are attractive to users, our business, financial condition and results of operations may be materially and adversely affected. We cannot assure you that we will be able to launch new games or continue operating existing games on a commercially viable basis or in a timely manner, or at all, or that we will be able to implement our other growth strategies. If any of these occur, our competitiveness may be harmed and our business, financial condition and results of operations may be materially and adversely affected.

New lines of business or new products and services may subject us to additional risks.

From time to time, we may implement new lines of business or offer new products and services within our existing lines of business. In January 2018, we decided to build up our blockchain-related technology capacities and we plan to provide customized services in connection with the development of blockchain-technology-enabled products. In March 2019, we entered into a joint venture agreement with Faraday&Future Inc., or F&F, to establish a joint venture and serve China with electric vehicles designed and developed by F&F. However, there are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. There may be licensing and compliance requirements regarding new lines of business and the regulatory regime governing certain new markets could remain unclear. We may invest significant time and resources to develop new lines of business or new products and services, and the attention of our management may be distracted from our core business. Moreover, there can be no assurance that the introduction and development of new lines of business or new products and services would not encounter significant difficulties or delay or would achieve the profitability as we expect. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and prospects.





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

We may continue to experience material decrease in cash and cash equivalents balance and we may require additional cash resources to fund our working capital and expenditure needs, such as product developments expenses, payment of license fees and royalties, sales and marketing activities, as well as investment or acquisition transactions. We expect to continue to incur product development costs to develop our proprietary online games, primarily mobile games, and license fees and royalties to obtain game licenses from third-party developers. If our internal financial resources are insufficient to satisfy our cash requirements, we may seek additional financing through the issuance of equity securities or through debt financing, such as borrowings from commercial banks or other financial institutions or lenders. However, we cannot assure you that such efforts may succeed. For example, we entered into a share purchase agreement in June 2017 with each of Ark Pacific Special Opportunities Fund I, L.P. or AP Fund, and Incisight Limited, or Incisight, which is wholly owned by Mr. Jun Zhu, our chairman and chief executive officer, to raise an aggregate of US\$30.0 million through equity financing. Such transactions did not succeed and were terminated in February 2019. To meet our anticipated capital needs, we have engaged and are considering multiple alternatives, including but not limited to additional equity financings, debt financings, launch of new games, other financing transactions, and cost control. See “Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” There can be no assurance that we will be able to successfully complete any such transaction or conduct any cost control measure with results favorable to us, or at all. If we are unable to obtain the necessary financing, we may need to license or sell our assets, seek to be acquired by another entity and/or cease operations.

Any equity or debt financing may result in dilution to our existing shareholders’ interests or an increase in our debt service obligations. For example, in December 2015, we issued and sold senior secured convertible notes, or the Convertible Notes, in an aggregate principal amount of US\$40,050,000 to Splendid Days Limited, or Splendid Days, in three tranches at initial conversion prices of US\$7.8, US\$15.6 and US\$23.4 per ADS, respectively. In connection with the sale of Convertible Notes, we also issued warrants, or the Warrants, in an aggregate principal amount of US\$9,950,000 to Splendid Days in four tranches at initial exercise prices of US\$4.5, US\$7.8, US\$15.6 and US\$23.4 per ADS, each representing three ordinary shares, respectively. As of the date of this annual report, only the first tranche of the Warrants in a principal amount of US\$5,000,000 with the initial exercise of US\$4.5 per ADS was still outstanding. In December 2015, we obtained an entrusted loan of approximately RMB31.6 million from a third party. In 2016, we obtained bank loans of approximately RMB25.0 million which was subsequently fully repaid in 2017. See “Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” The Convertible Notes and the aforesaid loans significantly increased our debt obligations and any conversion or exercise, as applicable, of the Convertible Notes and Warrants by Splendid Days and any issuance of new shares may cause significant dilution to our existing shareholders’ interest in our company.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance, our indebtedness, including the Convertible Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. For example, in June 2016, Asian Development Limited, or Asian Development, our wholly-owned subsidiary, borrowed a loan of HK\$92.3 million from a financial services company,

which is secured by a pledge of shares of L&A International Holding Limited, or L&A. As Asian Development is currently in default of the loan due to a sharp decline in the share price of L&A, the lender is entitled to foreclose the pledged L&A shares. If the market value of the pledged shares cannot cover the total outstanding amount owed by Asian Development to the lender, the lender may also make a claim against Asian Development for any outstanding amounts of the loan. As of the date of this annual report, we had not received any claims from the lender against Asian Development. In addition, we entered into a deed of settlement with Splendid Days, the holder of the Convertible Notes, in March 2019, pursuant to which the Convertible Notes should be repaid by May 31, 2019 by the proceeds from planned sale of the mortgaged properties. Our business may not generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations. Incurrence of additional indebtedness could also result in operating and financing covenants restricting our business operations. In addition, we cannot assure you that any such future financing will be available to us in amounts or on terms acceptable to us, if at all. If we fail to obtain sufficient financing to fund our capital needs, our business, financial condition and results or operations could be materially and adversely affected.

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

In December 2015, we completed the issuance and sale of the Convertible Notes. Pursuant to the terms of the Convertible Notes, if we undergo a change of control, holders of the Convertible Notes will be entitled to require us to redeem all or part of the Convertible Notes, at a price payable in cash equal to 100% of the outstanding principal amount of the Convertible Notes, plus all accrued and unpaid interest thereon, if any. The Convertible Notes define a “change of control” to include: (1) our company’s consolidation with, or merger with or into, any other company, and vice versa; (2) our company disposing of all or substantially all of its assets; (3) the adoption of a plan relating to the liquidation or dissolution of our company; or (4) Mr. Jun Zhu, our chairman and chief executive officer, ceasing to directly or indirectly own 20% or more of the total outstanding and issued shares of our company on a fully-diluted and as-converted basis. In addition, pursuant to the terms of the Convertible Notes, if there is a continuing event of default, the holders will be entitled to declare any of the Convertible Notes immediately due and payable, and request redemption by us at a price equal to the outstanding principal amount plus all accrued and unpaid interest thereon, if any. “Events of default” as defined in the Convertible Notes include, among other things, an event of default of any indebtedness of our company or our principal subsidiaries in the amount exceeding US\$500,000. In March 2017, AP Fund has provided us with a waiver agreement waiving its right to declare the Convertible Notes immediately due and payable and request redemption as a result of the default of Asian Development under the HK\$92.3 million loan. We entered into a deed of settlement with Splendid Days, the holder of the Convertible Notes, in March 2019, pursuant to which the Convertible Notes should be repaid by May 31, 2019 by the proceeds from planned sale of the mortgaged properties. If there is a change of control of our company and any event of default under the Convertible Notes, and our cash flows and capital resources are insufficient to fund our debt service obligation, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations, which could cause a material and adverse impact on our operations and financial results.

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

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

The Convertible Notes are secured by a pledge of our 100% equity interest in each of The9 Computer Technology Consulting (Shanghai) Co., Ltd., or The9 Computer, and China The9 Interactive (Shanghai) Limited, or C9I Shanghai, our wholly-owned subsidiaries in China. Each of The9 Computer and C9I Shanghai holds a significant portion of our assets and operations in China, and The9 Computer possesses the effective control over Shanghai IT, the affiliated PRC entity that operates our online game business and other ICP related businesses, through a series of contractual arrangements. If we default under the Convertible Notes in the future, the holders may enforce their claims against our equity interests in these two wholly-owned subsidiaries to satisfy our obligations under the Convertible Notes. In such an event, the holders could gain ownership of all the equity interests in The9 Computer and C9I Shanghai, and, as a result, own and control these subsidiaries as well as Shanghai IT. As we conduct substantially all of our operations in China through Shanghai IT, if we default under the Convertible Notes, we could lose control or ownership of our assets and operations in China, which would materially and adversely affect our operations and financial results. In addition, the Convertible Notes are also secured by a mortgage over our office building in Shanghai, which we currently use as our principal executive offices. In March 2019, we entered into a deed of settlement with Splendid Days, the holder of the Convertible Notes, and agreed to use the proceeds from planned sale of the mortgaged properties to repay the Convertible Notes.

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

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

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

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

Our operations are primarily conducted in China and a significant majority of our revenues are sourced from China. Accordingly, our results of operations, financial condition and prospects are influenced by economic, political and legal development in China. Although the Chinese economy has grown significantly in the past decade, its growth started to slow down since 2012. Economic conditions in China are sensitive to global economic conditions, as well as changes in domestic economic and political policies and the expected or perceived overall economic growth rate in China. Subsequent to the financial crisis in 2008, there has been considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies adopted by the central banks and financial authorities of some of the world's leading economies, including the United States and China. There have been concerns over unrest and terrorist threats in the Middle East and Africa, which have resulted in volatility in oil and other markets, and over the conflicts involving Ukraine and Syria. Following a referendum in June 2016 in which voters in the United Kingdom approved an exit from the European Union, the U.K. government initiated a process to leave the European Union (a process often referred to as "Brexit") and negotiations between the United Kingdom and the European Union remain ongoing and are complex. There have also been concerns on the relationship among China and other Asian countries, which may result in or intensify potential conflicts in relation to territorial disputes. In March 2018, the United States announced the imposition of tariffs on steel and aluminum entering the United States and in June 2018 announced further tariffs targeting goods imported from China. Recently both China and the U.S. have each imposed tariffs indicating the potential for further trade barriers. Tariff discussions between the U.S. and China are ongoing and fluid. Any prolonged slowdown in the global or Chinese economy or the recurrence of any financial disruptions in any jurisdiction may significantly restrict our ability to obtain financing in the capital markets or from financial institutions on commercially reasonable terms, or at all. In addition, our customers may reduce, delay or cease discretionary spending on our products and services, while we may have difficulty expanding our customer base fast enough, or at all, to offset the impact of decreased spending by our existing customers.

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

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

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

- the availability of other forms of entertainment;
- customer demand for our in-game items; and
- critical reviews and public reception of our new products.

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

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

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

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

In addition to developing and offering our own proprietary games, we and our joint ventures also seek to offer games licensed from game licensors. Historically, we have operated a number of games licensed from game licensors, most of which already expired or terminated. There is no assurance that we or our joint ventures will be able to acquire new online game licenses or favorable terms or at all, or that we or our joint ventures will be able to renew the game licenses upon their expiration.

We and our joint ventures need to renew existing licenses and may need to obtain new online game licenses, and any failure to do so on favorable terms or at all may materially and adversely affect our business, financial condition and results of operations. Online game developers may not grant or continue to grant licenses to us or our joint ventures due to commercial or other reasons. For example, our exclusive license from Smilegate Entertainment Inc., or Smilegate, to publish and operate CrossFire 2 in China was terminated in 2017 due to the slowdown of massively multiplayer online game market. If we or our joint ventures are unable to maintain a satisfactory relationship with the online game developers that have licensed games to us or our joint ventures, resulting in licenses not being renewed or licenses being prematurely terminated, or should any of these game developers either establish similar or more favorable relationships with our competitors in violation of their contractual arrangements with us or our joint ventures, or otherwise, our operating results and our business would be harmed. We cannot assure you that online game developers will renew their license agreements with us or our joint ventures, or grant us or our joint ventures a license for any new online games that they will develop or make available to us or our joint ventures expansion packs for existing games. Any failure to obtain or renew online game licenses from online game operators could harm our future results of operations or the growth of our business.



***If we are unable to successfully launch and operate CrossFire New Mobile Game in China, our future results of operations may be materially and adversely affected.***

We have invested a significant amount of financial and personnel resources in development of our proprietary CrossFire New Mobile Game and we expect to launch this game in the second half of 2019. In November 2017, we entered into an exclusive publishing agreement with a third-party company, pursuant to which this third-party company was granted with an exclusive right to publish the CrossFire New Mobile Game in China. There is no assurance that CrossFire New Mobile Game can be successfully developed, tested and launched, or that once CrossFire New Mobile Game is launched, we will be able to continue to operate the game at a profit or at all. The relevant Chinese governmental authorities may delay or deny the granting of the approvals required for the open beta test, commercial launch or operation of CrossFire New Mobile Game due to the content of the game or other factors. Furthermore, there is no assurance that CrossFire New Mobile Game will attract sufficient users and be commercially successful.

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

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

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

From time to time, subject to the availability of the necessary financial resources, we make equity investments into selected targets, such as online game developers, operators or application platforms, or establish joint venture with business partners, to seek business growth opportunities. For example, in August 2014, we formed a joint venture company, System Link, with Qihoo 360, for publishing and operating Firefall, a massive multiplayer online first person shooting game, or MMOFPS, in China. In the same month, System Link licensed Firefall from our subsidiary Red 5 Singapore Pte. Ltd., or Red 5 Singapore, for a term of five years. In November 2015, our joint venture Oriental Shiny, which is majority-owned by System Link, obtained an exclusive license from Smilegate to publish and operate CrossFire 2 in China for an initial term of three years, subject to an extension to five years. In March 2019, we entered into a joint venture agreement with F&F. The immediate objective of this joint venture is to exclusively manufacture and distribute certain electric car model designed and developed by F&F in China. Our contribution to the joint venture is subject to the satisfaction of certain conditions, such as the establishment of the joint venture and funding arrangements. We will be a 50% partner in the joint venture upon its establishment with control over business operations. We may have limited power to direct or otherwise participate in the management of operations and strategies of the companies in which we invest or the joint venture we establish. The diversion of our management's attention away from our business and any difficulties encountered in managing our interests in the respective investees or joint ventures could have an adverse effect on our ability to manage our business. Any material disputes with our investment or joint venture partners and existing shareholders may also require us to allocate significant corporate and other resources. For example, Red 5 and its affiliates are currently in dispute with Qihoo 360 and its affiliates regarding System Link and Firefall and various legal proceedings have been initiated and are ongoing in connection with such dispute. The process of legal proceedings may be lengthy and costly and may divert the attention of our management. If we cannot settle the dispute with Qihoo 360 and cannot obtain a judgment in favor of us, we may incur additional costs or damages and our business, financial condition and results of operations may be adversely affected. In addition, if our relationship with Qihoo 360 continues to deteriorate and we fail to identify an alternative partner with similar resources, we may no longer be able to continue to carry out the business conducted through System Link or its affiliates, and our operating results, business prospect and reputation may be materially and adversely affected. Our investments may also be subject to market conditions and therefore are uncertain whether our resources and expenses devoted are able to be converted into revenue. For example, the license to publish and operate CrossFire 2 was terminated in 2017 due to the slowdown of massively multiplayer online game market. In addition, we may not recover our equity investments if the companies in which we invest do not perform well and equity investments could result in the incurrence of impairment losses, which could materially and adversely affect our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

There is no assurance that our online games, including our mobile games, or other content posted on our websites, whether proprietary or licensed from third parties, do not or will not infringe upon patents, valid copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others.

Some of our employees were previously employed at other companies, including our current and potential competitors. We also intend to hire additional personnel to expand our product development and technical support teams. To the extent these employees have been involved in research at our company similar to research in which they had been involved at their former employers, we may become subject to claims that such employees have used or disclosed trade secrets or other proprietary information of their former employers. In addition, our competitors may file lawsuits against us in order to gain an unfair competitive advantage over us.

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

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

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

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

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

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

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

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

Our business relies on our ability to hire and retain additional qualified employees, including skilled and experienced online game developers. Since our industry is characterized by high demand and intense competition for talent, we may need to offer higher compensation and other benefits in order to retain key personnel in the future. We cannot assure you that we will be able to attract or retain the qualified game developers or other key personnel that we will need to achieve our business objectives.



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

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

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

In September 2009, the General Administration of Press and Publication, Radio, Film and Television, or GAPPRFT (formerly known as the General Administration of Press and Publication, or GAPP), promulgated the Circular Regarding the Implementation of the Department Reorganization Regulation by State Council and Relevant Interpretation by State Commission Office for Public Sector Reform to Further Strengthen the Administration of Pre-approval on Online Games and Approval on Import Online Games, or the GAPP Circular, which provides that foreign investors shall not control or participate in PRC online game operation businesses indirectly or in a disguised manner by establishing joint venture companies or entering into relevant agreements with, or by providing technical supports to, such PRC online game operation companies, or by inputting the users’ registration, account management or game card consumption directly into the interconnected gaming platform or fighting platform controlled or owned by the foreign investor. In addition, on February 4, 2016, the GAPPRFT and the MIIT jointly issued the Administrative Measures on Network Publication, or the Network Publication Measures, which took effect in March 2016. Pursuant to the Network Publication Measures, wholly foreign-owned enterprises, Sino-foreign equity joint ventures and Sino-foreign cooperative enterprises shall not engage in the provision of web publishing services, including online game services. Project cooperation involving internet publishing services between an internet

publishing service provider and a wholly foreign-owned enterprise, Sino-foreign equity joint venture, or Sino-foreign cooperative enterprise within China or an overseas organization or individual shall be subject to prior examination and approval by the GAPPRFT. It is unclear whether the authorities will deem our VIE structure as a kind of such “manners of cooperation” by foreign investors to gain control over or participate in domestic online game operators, and it is not clear whether GAPPRFT and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China.

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

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

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

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

- requiring Shanghai IT or us to discontinue any portion or all of our operations related to online games.

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

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

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

These contractual arrangements are governed by PRC law and provide for the resolution of disputes through arbitration in the PRC. The legal environment in the PRC is not as developed as in some other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. We have historically derived significant revenues from Shanghai IT. For the year ended December 31, 2016, 2017 and 2018, Shanghai IT contributed 60.4%, 25.8% and 92.2%, respectively, of our total revenues. In the event we are unable to enforce the contractual arrangements, we may not be able to have the power to direct the activities that most significantly affect the economic performance of Shanghai IT, and our ability to conduct our business may be negatively affected, and we may not be able to consolidate the financial results of Shanghai IT into our consolidated financial statements in accordance with U.S. GAAP.

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

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

Pursuant to the Equity Pledge Agreements with the shareholders of Shanghai IT, such shareholders agreed to pledge their equity interests in Shanghai IT to secure their performance under the relevant contractual arrangements. The equity pledges of Shanghai IT under these Equity Pledge Agreements have been registered with the relevant local administration for industry and commerce pursuant to the new PRC Property Rights Law. According to the PRC Property Rights Law and PRC Guarantee Law, the pledgee and the pledgor are prohibited from making an agreement prior to the expiration of the debt performance period to transfer the ownership of the pledged equity to the pledgee when the obligor fails to pay the debt due. However, under the PRC Property Rights Law, when an obligor fails to pay its debt when due, the pledgee may choose to either conclude an agreement with the pledgor to obtain the pledged equity or seek payments from the proceeds of the auction or sell-off of the pledged equity. If Shanghai IT or its shareholders fail to perform their obligations secured by the pledges under the Equity Pledge Agreements, one remedy in the event of default under the agreements is to require the pledgors to sell the equity interests of Shanghai IT in an auction or private sale and remit the proceeds to our wholly-owned subsidiaries in China, net of related taxes and expenses. Such an auction or private sale may not result in our receipt of the full value of the equity interests in Shanghai IT. We consider it very unlikely that the public auction process would be undertaken since, in an event of default, our preferred approach is to ask The9 Computer, our PRC wholly-owned subsidiary and a party to the Call Option Agreement, to replace or designate another PRC person or entity to replace the existing shareholders of Shanghai IT pursuant to the direct transfer option we have under the option agreement.

In addition, in the registration forms of the local branch of State Administration for Industry and Commerce for the pledges over the equity interests under the Equity Pledge Agreements, the amount of registered equity interests in Shanghai IT pledged to us was stated as RMB23.0 million, which represent 100% of the registered capital of Shanghai IT. The Equity Pledge Agreements with the shareholders of Shanghai IT provide that the pledged equity interest shall constitute continuing security for any and all of the indebtedness, obligations and liabilities under all of the contractual arrangements and the scope of pledge shall not be limited by the amount of the registered capital of Shanghai IT. However, it is possible that a PRC court may take the position that the amount listed on the equity pledge registration forms represents the full amount of the collateral that has been registered and perfected. If this is the case, the obligations that are supposed to be secured under the Equity Pledge Agreements in excess of the amount listed on the equity pledge registration forms could be determined by the PRC court as unsecured debt, which takes last priority among creditors and often does not have to be paid back at all. We do not have agreements that pledge the assets of Shanghai IT for the benefit of us.

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

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

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

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

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

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

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

We cannot assure you that we are able to obtain and maintain requisite approvals or fulfill other requisite registration or filing procedures required by the relevant PRC governmental authorities in a timely manner, or at all. From time to time, we also rely on certain third-party licensors of domestically developed online games to obtain approvals and complete filings with the PRC regulatory authorities. If we or any such third-party licensors fail to obtain the required approvals or complete the filings, we may not be able to continue the operation of such games. If any such negative event occurs, our business, financial condition and results of operations may be materially and adversely affected.



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

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

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

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

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

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

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

Our subsidiaries and affiliated entities in the PRC are subject to enterprise income tax, or EIT, on the taxable income as reported in their respective statutory financial statements adjusted in accordance with the Enterprise Income Tax Law of the People's Republic of China, or EIT Law, which was approved by the National People's Congress on March 16, 2007. The EIT Law went into effect as of January 1, 2008 and was amended on February 24, 2017 and December 29, 2018, which unified the tax rate generally applicable to both domestic and foreign-invested enterprises in the PRC. Our subsidiaries and affiliated entities in the PRC are generally subject to EIT at a statutory rate of 25%. Shanghai IT, our affiliated entity which holds a High and New Technology Enterprise, or HNTE, qualification is entitled to enjoy a 15% preferential EIT rate. However, we cannot assure you that Shanghai IT will meet these criteria and continue to be qualified as an HNTE if we apply to the tax authorities in the future.

Moreover, unlike the tax regulations effective before 2008, which specifically exempted withholding taxes on dividends payable to non-PRC investors from foreign-invested enterprises in the PRC, the EIT Law and its implementation rules provide that a withholding income tax rate of 10% will be applicable to dividends payable by Chinese companies to non-PRC-resident enterprises unless otherwise exempted or reduced according to treaties or arrangements between the PRC central government and the governments of other countries or regions. While the Tax Agreement between the PRC and Hong Kong provides dividends paid by a foreign-invested enterprise in the PRC to its corporate shareholder, which is considered a Hong Kong tax resident, will be subject to withholding tax at the rate of 5% of total dividends, this is limited to instances where the corporate shareholder directly holds at least 25% of the shares of the company that is to pay dividends for at least twelve consecutive months immediately prior to receiving the dividends and meets certain other criteria prescribed by the relevant regulations. Furthermore, under the Administrative Measures for Non-Resident Enterprises to Enjoy Treatments under Tax Treaties, non-resident taxpayers which satisfy the criteria for entitlement to tax treaty benefits may, at the time of tax declaration or withholding declaration through a withholding agent, enjoy the tax treaty benefits, and be subject to follow-up administration by the tax authorities. If the non-resident taxpayer does not apply to the withholding agent for the tax treaty benefits, or such taxpayer do not satisfy the criteria for entitlement of tax treaty benefits, the withholding agent will withhold tax pursuant to the provisions of PRC tax laws.

In February 2018, the State Administration of Taxation, or SAT issued the Announcement of the State Administration of Taxation on Issues Relating to "Beneficial Owner" in Tax Treaties on issues relating to "beneficial owner" in tax treaties, or Circular No. 9, which took effect on April 1, 2018. Circular No. 9 provides detailed guidance to determine whether the applicant engages in substantive business activities to constitute a "beneficial owner". When determining the applicant's status of the "beneficial owner" regarding tax treatments in connection with dividends, interests or royalties in the tax treaties, several factors, including without limitation, whether the applicant is obligated to pay more than 50% of his or her income in the past twelve months to residents in third country or region, whether the business operated by the applicant constitutes the actual business activities, and whether the other country or region to the tax treaties does not levy any tax or grant tax exemption on relevant incomes at all or levy tax at an extremely low rate, will be taken into account, and it will be analyzed according to the actual circumstances of the specific cases. If the non-resident taxpayer does not apply to the withholding agent for the tax treaty benefits, or such taxpayer does not

satisfy the criteria to be entitled to tax treaty benefits, the withholding agent should withhold tax pursuant to the provisions of PRC tax laws. We cannot assure you that any dividends to be distributed by our subsidiaries to us or by us to our non-PRC shareholders and ADS holders, whose jurisdiction of incorporation has a tax treaty with China providing a different withholding arrangement, will be entitled to the benefits under the relevant withholding arrangement.

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

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

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

On March 23, 2016, the Ministry of Finance and the SAT jointly issued the Circular on the Pilot Program for Overall Implementation of the Collection of Value Added Tax Instead of Business Tax, or Circular 36, which took effect on May 1, 2016. Pursuant to Circular 36, all companies operating in construction, real estate, finance, modern service or other sectors which were required to pay business tax are required to pay VAT in lieu of business tax. As a result of Circular 36, the services provided by Shanghai IT, The9 Computer and C9I Shanghai as general VAT payers are subject to VAT at the rate of 6%, and the services provided by our other PRC subsidiaries and affiliated PRC entities as small-scale VAT payers are subject to VAT at the rate of 3%. While as general VAT payers may reduce their VAT payable amount by the VAT which they paid in connection with their purchasing activities, or the Input VAT, those companies as small-scale VAT payers may not reduce their VAT payable amount by their Input VAT. As a result, some of our subsidiaries and affiliated PRC entities may be subject to more unfavorable tax treatment as a result of the tax reform, and our business, financial condition and results of operations could be materially and adversely affected.

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

In connection with the EIT Law, the SAT issued, on February 3, 2015, the Notice on Several Issues regarding Enterprise Income Tax for Indirect Property Transfer by Non-resident Enterprises, or SAT Circular 7, which further specifies the criteria for judging reasonable commercial purpose, and the legal requirements for the voluntary reporting procedures and filing materials in the case of indirect property transfer. SAT Circular 7 has listed several factors to be taken into consideration by tax authorities in determining whether an indirect transfer has a reasonable commercial purpose. However, despite these factors, an indirect transfer satisfying all the following criteria shall be deemed to lack reasonable commercial purpose and be taxable under the PRC laws: (i) 75% or more of the equity

value of the intermediary enterprise being transferred is derived directly or indirectly from the PRC taxable properties; (ii) at any time during the one year period before the indirect transfer, 90% or more of the asset value of the intermediary enterprise (excluding cash) is comprised directly or indirectly of investments in the PRC, or 90% or more of its income is derived directly or indirectly from the PRC; (iii) the functions performed and risks assumed by the intermediary enterprise and any of its subsidiaries that directly or indirectly hold the PRC taxable properties are limited and are insufficient to prove their economic substance; and (iv) the foreign tax payable on the gains derived from the indirect transfer of the PRC taxable properties is lower than the potential PRC tax on the direct transfer of such assets. Nevertheless, the indirect transfer falling into the scope of the safe harbor under SAT Circular 7 may not be subject to PRC tax and such safe harbor includes qualified group restructuring, public market trading and tax treaty exemptions. According to SAT Circular 7, where the payer fails to withhold tax in a sufficient amount, the transferor can declare and pay such tax to the tax authority by itself within the statutory time period. Late payment of applicable tax will subject the transferor to default interest.

On October 17, 2017, the SAT released the Public Notice Regarding Issues Concerning the Withholding of Non-resident Enterprise Income Tax at Source, or SAT Public Notice 37, which further elaborates the relevant implementation rules regarding the calculation, reporting and payment obligations of the withholding tax by the non-resident enterprises.

Under SAT Circular 7 and SAT Public Notice 37, the entities or individuals obligated to pay the transfer price to the transferor shall be the withholding agent and shall withhold the PRC tax from the transfer price. If the withholding agent fails to do so, the transferor shall report to and pay the PRC tax to the PRC tax authorities. In case neither the withholding agent nor the transferor complies with the obligations under SAT Circular 7 and SAT Public Notice 37, other than imposing penalties such as late payment interest on the transferors, the tax authority may also hold the withholding agent liable and impose a penalty of 50% to 300% of the unpaid tax on the withholding agent, provided that such penalty imposed on the withholding agent may be reduced or waived if the withholding agent has submitted the relevant materials in connection with the indirect transfer to the PRC tax authorities in accordance with SAT Circular 7 and SAT Public Notice 37.

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

We have limited business insurance coverage in China.

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

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

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

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

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

Our management has concluded that our internal controls over financial reporting were effective as of December 31, 2018. We however were not subject to the requirement to provide an attestation report on our management's assessment of our internal control over financial reporting as we were not an accelerated filer or a large accelerated filer (as defined in § 240.12b-2 under the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of December 31, 2018.

If we fail to maintain effective internal controls over financial reporting in the future, our management and, if applicable, our independent registered public accounting firm may not be able to conclude that we have effective internal controls over financial reporting at a reasonable assurance level. This could result in a loss of investor confidence in the reliability of our financial conditions which in turn could negatively impact the trading price of our ADSs and result in lawsuits being filed against us by our shareholders or otherwise harm our reputation. Furthermore, we have incurred and anticipate that we will continue to incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.



## Changes in accounting standards may adversely affect our financial statements

A change in accounting standards or practices may have a significant effect on our results of operations and may affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the application thereof and changes to current practices may adversely affect our reported financial results or the way we conduct our business. For example, Accounting Standards Codification 606, “Revenue from Contracts with Customers,” or ASC 606, became effective on January 1, 2018. We adopted ASC 606 on January 1, 2018. There may be other standards that become effective in the future that may have a material impact on our consolidated financial statements and will result in a significant gross up of both our assets and liabilities.

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

As an auditor of companies that are traded publicly in the United States and as an audit firm registered with the Public Company Accounting Oversight Board, or PCAOB, our independent registered public accounting firm is required by the laws of the United States to undergo regular inspections by the PCAOB. As our auditor is located in the PRC, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the PRC authorities, our auditor, like other independent registered public accounting firms operating in the PRC, is not currently inspected by the PCAOB. On May 24, 2013, the PCAOB announced that it had entered into a memorandum of understanding on enforcement and cooperation with the CSRC and the PRC Ministry of Finance, or the MOF, which establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the United States and China. However, direct PCAOB inspections of independent registered accounting firms in China are still not permitted by Chinese authorities. On December 7, 2018, the SEC and the PCAOB issued a joint statement highlighting continued challenges faced by the U.S. regulators in their oversight of financial statement audits of U.S.-listed companies with significant operations in China. The joint statement reflects a heightened interest in an issue that has vexed U.S. regulators in recent years. However, it remains unclear what further actions the SEC and PCAOB will take to address the problem.

The lack of direct PCAOB inspections in China prevents the PCAOB from regularly evaluating audit documentation located in China and its related quality control procedures. As a result, our investors may be deprived of the benefits of the PCAOB’s oversight of our auditors through such inspections. The inability of the PCAOB to conduct inspections of our auditors’ work papers in China makes it more difficult to evaluate the effectiveness of our auditor’s audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections. Investors may consequently lose confidence in our reported financial information and procedures and the quality of our financial statements.

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

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

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

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

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

#### Risks Related to Doing Business in China

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

Currently, most of our recurring users are young males, including students. Due to the recent population and higher degree of user loyalty to mobile games, easy access to personal computers and mobile devices, and lack of more appealing forms of entertainment in China, many teenagers frequently play online games. This may result in these teenagers spending less time on, or refraining from, other activities, including education and sports. In April 2007, various governmental authorities, including GAPP, MIIT, the Ministry of Education, the Ministry of Public Security, and other relevant authorities jointly issued a circular concerning the mandatory implementation of an “anti-fatigue system” in online games, which aims to protect the physical and psychological health of minors. This circular required all online games to incorporate an “anti-fatigue system” and an identity verification system, both of which have limited the amount of time that a minor or other user may continuously spend playing an online game. We have implemented such “anti-fatigue” and identification systems on all of our online games as required. Since March 2011, various governmental authorities, including MIIT, the Ministry of Education, the Ministry of Public Security, and other relevant authorities have jointly launched the “Online Game Parents Guardianship Project for Minors,” which allows

parents to require online game operators to take relevant measures to limit the time spent by the minors playing online games and the minors' access to their online game accounts. On February 5, 2013, the Ministry of Culture, MIIT, GAPP and various other governmental authorities, jointly issued the Working Plan on the Comprehensive Prevention Scheme on Online Game Addiction of Minors, which further strengthens the administration of Internet cafés, reinstates the importance of the “anti-fatigue system” and “Online Game Parents Guardianship Project for Minors” as prevention measures against the online game addiction of minors and orders all relevant governmental authorities to take all necessary actions in implementing such measures. In addition, on December 1, 2016, the Ministry of Culture (currently known as the Ministry of Culture and Tourism) issued the Circular on Regulating Online Game Operations and Strengthening Interim and Ex Post Regulation, or the MOC Online Games Regulation, which became effective on May 1, 2017. Pursuant to the MOC Online Games Regulation, an enterprise engaged in online game operations shall strictly comply with the provisions of the “Online Game Parents Guardianship Project for Minors,” and online game operators are encouraged to set upper limits on the consumption by users who are minors, limit the amount of time that such users are allowed to spend on online games, and take technical measures to block scenes and functions, among other things, that are not suitable for users who are minors. Further strengthening of these systems, or enactment by the PRC government of any additional laws to further tighten its administration over the Internet and online games may result in less time spent by customers or fewer customers playing our online games, which may materially and adversely affect our business results and prospects for future growth.

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

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

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

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

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

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

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

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

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

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

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

In addition, MIIT has published regulations that subject website operators to potential liability for content included on their websites and the actions of users and others using their websites, including liability for violations of PRC laws prohibiting the dissemination of content deemed to be socially destabilizing. The Ministry of Public Security has the authority to order any local Internet service provider to block any Internet website maintained outside China at its sole discretion. Periodically, the Ministry of Public Security has stopped the dissemination over the Internet of information which it believes to be socially destabilizing. The State Secrecy Bureau, which is directly responsible for the protection of State secrets of the PRC government, is authorized to block any website it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the dissemination of online information.

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



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

We are exposed to foreign exchange risk arising from various currency exposures. A portion of our financial assets and liabilities, primarily the Convertible Notes, are denominated in U.S. dollars while currently a significant portion of our revenues are denominated in RMB, the legal currency in China. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency risk. The value of the RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions and China's foreign exchange policies. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a managed band based on market supply and demand and by reference to a basket of certain foreign currencies. Since the change in policy in July 2005, the RMB appreciated more than 20% against the U.S. dollar over the following three years. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the RMB and the U.S. dollar remained within a narrow band. In June 2010, the People's Bank of China announced that the PRC government would reform the RMB exchange rate regime and increase the flexibility of the exchange rate. Between June 30, 2010 and December 30, 2011, the value of the RMB appreciated approximately 7.2% against the U.S. dollar. On April 16, 2012, the People's Bank of China further enlarged the floating band of RMB's trading prices against the U.S. dollar in the inter-bank spot foreign exchange market from 0.5% to 1% around the middle rate released by the China Foreign Exchange Trade System each day. There remains significant international pressure on the PRC government to adopt a more lenient RMB policy, which could result in further appreciation of RMB against other major currencies. It is difficult to predict how long the current situation may last and when and how RMB exchange rates may change going forward. Renminbi was added to its group of global reserve currencies by The International Monetary Fund on November 30, 2015, which makes Renminbi to some extent more susceptible to market forces. In recent years, Renminbi has depreciated significantly in the backdrop of a surging U.S. dollar and persistent capital outflows of China.

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

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

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

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

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

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

***Failure to comply with PRC regulations regarding the registration requirements for employee stock ownership plans or share option plans may subject the PRC plan participants or us to fines and other legal or administrative sanctions.***

In February 2012, SAFE promulgated the Notice of the State Administration of Foreign Exchange on the Relevant Issues Concerning the Administration of Foreign Exchange for Domestic Individuals' Participation in Equity Incentive Programs of Overseas Listed Companies, or Circular 7. Under Circular 7, PRC residents who participate in stock incentive plan in an overseas publicly-listed company are required to register with SAFE or its local branches and complete certain other procedures. Participants of a stock incentive plan who are PRC residents must retain a qualified PRC agent, which could be a PRC subsidiary of such overseas publicly listed company or another qualified institution selected by such PRC subsidiary, to conduct the SAFE registration and other procedures with respect to the stock incentive plan on behalf of its participants. Such participants must also retain an overseas entrusted institution to handle matters in connection with their exercise of stock options, the purchase and sale of corresponding stocks or interests and fund transfers. In addition, the PRC agent is required to amend the SAFE registration with respect to the

stock incentive plan if there is any material change to the stock incentive plan, the PRC agent or the overseas entrusted institution or other material changes. We and our PRC employees who have been granted stock incentive awards are be subject to these regulations. However, neither our PRC plan participants nor we have completed such requisite registration and other procedures. In addition, we cannot assure you that we will be able to complete the relevant registration for new employees who participate in such stock incentive plan in the future in a timely manner or at all. Failure of our PRC plan participants to complete their SAFE registrations may subject these PRC residents or us to fines and legal sanctions and may also limit our ability to contribute additional capital into our PRC subsidiary, limit our PRC subsidiary's ability to distribute dividends to us, or otherwise materially adversely affect our business. We also face regulatory uncertainties that could restrict our ability to adopt additional incentive plans for our directors and employees under PRC law.

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

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

Our current corporate structure and business operations may be affected by the newly enacted Foreign Investment Law

On March 15, 2019, the National People's Congress promulgated the Foreign Investment Law, or the FIL, which will take effect on January 1, 2020 and replace the existing laws regulating foreign investment in China, namely, the Sino-Foreign Equity Joint Venture Law, the Sino-Foreign Cooperative Joint Venture Law and the Wholly Foreign-owned Enterprise Law, or Existing FIE Laws, together with their implementation rules and ancillary regulations. The FIL embodies an expected PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. See "Item 4. Information on the Company—B. Business Overview—Government Regulations—Regulation on Foreign Investment."

Uncertainties still exist in relation to interpretation and implementation of the FIL, especially in regard to, including, among other things, the nature of variable interest entities contractual arrangements, the promulgation schedule of both the "negative list" under the FIL and specific rules regulating the organization form of foreign-invested enterprises within the five-year transition period. While FIL does not define contractual arrangements as a form of foreign investment explicitly, we cannot assure you that future laws and regulations will not provide for contractual arrangements as a form of foreign investment. Therefore, there can be no assurance that our control over our affiliated PRC entities through contractual arrangements will not be deemed as foreign investment in the future. In the event that any possible implementing regulations of the FIL, any other future laws, administrative regulations or provisions deem contractual arrangements as a way of foreign investment, or if any of our operations through contractual arrangements is classified in the "restricted" or "prohibited" industry in the future "negative list" under the FIL, our contractual arrangements may be deemed as invalid and illegal, and we may be required to unwind the variable interest entity contractual arrangements and/or dispose of any affected business. Also, if future laws, administrative

regulations or provisions mandate further actions to be taken with respect to existing contractual arrangements, we may face substantial uncertainties as to whether we can complete such actions in a timely manner, or at all. Furthermore, under the FIL, foreign investors or the foreign investment enterprise should be imposed legal liabilities for failing to report investment information in accordance with the requirements. In addition, the FIL provides that foreign invested enterprises established according to the existing laws regulating foreign investment may maintain their structure and corporate governance within a five-year transition period, which means that we may be required to adjust the structure and corporate governance of certain of our PRC subsidiaries in such transition period. Failure to take timely and appropriate measures to cope with any of these or similar regulatory compliance challenges could materially and adversely affect our current corporate structure, corporate governance and business operations.

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

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

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

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

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

#### Risks Related to Our Shares and ADSs

Our ADSs may be delisted from the Nasdaq Capital Market as a result of our not meeting the Nasdaq Capital Market continued listing requirements.

Our ADSs are currently listed on the Nasdaq Capital Market under the symbol "NCTY." We must continue to meet the requirements set forth in Nasdaq Listing Rule 5550 to remain listing on the Nasdaq Capital Market. The listing standards of the Nasdaq Capital Market provide that a company, in order to qualify for continued listing, must maintain a minimum ADS price of US\$1.00 and satisfy standards relative to minimum shareholders' equity, minimum market value of publicly held shares (MVPHS), minimum market value of listed securities (MVLS) and various additional requirements. On October 3, 2018, we received a letter from the Listing Qualifications Department of Nasdaq, pursuant to which Nasdaq informed us that due to our failure to regain compliance with the continued listing requirement of US\$50 million minimum Market Value of Listed Securities ("MVLS") for the Nasdaq Global Market as set in the Nasdaq Listing Rule 5450(b)(2)(A), our ADSs would be delisted from the Nasdaq Global Market unless

measures are taken prior to a certain timeline. We later transferred our listing venue to Nasdaq Capital Market with which we fully comply with the continued listing standards. After Nasdaq's approval of such transfer, we have been compliant with the minimum MVLS for the Nasdaq Capital Market till the date of this annual report. If we fail to satisfy Nasdaq Capital Market's continued listing requirements and fail to regain compliance on a timely basis, our ADSs could be delisted from Nasdaq Capital Market.

However, there can be no assurance that our ADSs will be eligible for trading on any such alternative exchanges or markets in the United States. If Nasdaq determines to delist our ordinary shares, or if we fail to list our ADSs on other stock exchanges or find alternative trading venue for our ADSs, the market liquidity and the price of our ADSs and our ability to obtain financing for our operations could be materially and adversely affected.



There can be no assurance that we will not be classified as a passive foreign investment company, or PFIC, for any taxable year, which could result in adverse U.S. federal income tax consequences to U.S. Holders of our ADSs or ordinary shares.

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

Based on the market price of our ADSs and the value and composition of our assets and liabilities, we believe we were not a PFIC for U.S. federal income tax purposes for our taxable year ended December 31, 2018. However, because PFIC status is a factual determination made annually after the close of each taxable year on the basis of the composition of our income and assets, there can be no assurance that we will not be a PFIC for the current taxable year or any future taxable year. Further, as previously disclosed, although not free from doubt, we believed that we were a PFIC for U.S. federal income tax purposes for prior years. In addition, it is possible that one or more of our subsidiaries were also PFICs for such year for U.S. federal income tax purposes.

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

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

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

If our shareholders sell or are perceived by the market to sell substantial amounts of our ADSs, including those issued upon the exercise of outstanding options, in the public market, the market price of our ADSs could fall. Such sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. If any existing shareholder or shareholders sell or are perceived by the market to sell a substantial amount of ordinary shares, the prevailing market price for our ADSs could be adversely affected. In December 2015, we issued and sold the Convertible Notes in an aggregate principal amount of US\$40,050,000 to Splendid Days in three tranches at initial conversion prices of US\$7.8, US\$15.6 and US\$23.4 per ADS, each representing three ordinary shares, respectively. In connection with the sale of Convertible Notes, we also issued the Warrants in an aggregate principal amount of US\$9,950,000 to Splendid Days in four tranches at initial exercise prices of US\$4.5, US\$7.8, US\$15.6 and US\$23.4 per ADS, respectively. Among the four tranches Warrants, only the first tranche of the principal amount of US\$5,000,000 with the initial exercise price of US\$4.5 per ADS is still outstanding. See “Item 5—Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” Pursuant to the relevant agreement, we registered the ordinary shares into which the Convertible Notes are convertible and the Warrants are exercisable on a registration statement on F-3, which was declared effective by the SEC on June 17, 2016. Upon registration, any ordinary shares that Splendid Days would acquire by conversion of the Convertible Notes or exercise of the Warrants will become freely tradable.

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

The market price for our ADSs may be volatile.

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

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

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

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

Our corporate affairs are governed by our memorandum and articles of association and by the Companies Law (2018 Revision) and common law of the Cayman Islands. The rights of our shareholders and the fiduciary duties of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States, and provides significantly less protection to investors. Therefore, our public shareholders may have more difficulties protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States. In addition, shareholders of Cayman Islands companies may not have standing to initiate a shareholder derivative action before the federal courts of the United States. As a result, our shareholders may not be able to protect their interests if they are harmed in a manner that would otherwise enable them to sue in a United States federal court.

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

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

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

As a holder of ADSs, you will not have any direct right to attend general meetings of our shareholders or to cast any votes at such meetings. You may give voting instructions to the depositary of our ADSs to vote the underlying shares represented by your ADSs but only if we ask the depositary to request your instruction. Otherwise, you will not be able to exercise your right to vote with respect to the underlying shares represented by your ADSs unless you withdraw the shares and become the registered holder of such shares prior to the record date for the general meeting. However, you may not receive sufficient advance notice of a shareholders' meeting to withdraw the underlying shares represented by your ADSs and become the registered holder of such shares to allow you to attend the general meeting and to vote directly with respect to any specific matter or resolution to be considered and voted upon at the general meeting. Pursuant to our amended and restated memorandum and articles of association, a shareholders' meeting may be convened by us on seven business days' notice. If we ask for your instructions, the depositary will notify you of the upcoming vote and arrange to deliver our voting materials to you. We cannot assure you that you will receive the voting materials in time to ensure that you can instruct the depositary to vote the underlying shares represented by your ADSs. Pursuant to the amended and restated deposit agreement dated November 2010 that we entered into with our depositary, if after complying with the procedures set forth in the deposit agreement, the depositary does not receive voting instructions from the holder of the relevant ADSs on or before the instruction date, the depositary shall vote such underlying shares represented by the relevant ADSs in accordance with the recommendations of our board of directors as advised by our company in writing. In addition, the depositary and its agents are not responsible for failing to carry out your voting instructions or for the manner of carrying out your voting instructions, if any such action or non-action is in good faith. This means that you may not be able to exercise your right to direct how the underlying shares represented by your ADSs are voted and you may have no legal remedy if the underlying shares represented by your ADSs are not voted as you requested.

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

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

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

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

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

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

#### Item 4. INFORMATION ON THE COMPANY

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

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

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

In July 2014, we and Qihoo 360 entered into an agreement to form a joint venture in which each party shall own 50% equity interest in the joint venture and share profits based on the respective equity interests in the joint venture. The joint venture, System Link Corporation Limited, or System Link, was formed in August 2014. In August 2014, our subsidiary Red 5 Singapore Pte. Ltd., or Red 5 Singapore, a wholly-owned subsidiary of Red 5, entered into a license agreement with System Link for publishing and operating Firefall, a MMOFPS game, for a five-year term in China. In April 2016, System Link ceased to operate Firefall in China. We do not consolidate the results of System Link into our results of operations and treat it as an equity investee. Currently, Red 5 and its affiliates are in dispute with Qihoo 360 and its affiliates regarding System Link and Firefall and various legal proceedings have been initiated and are ongoing in connection with such dispute. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—Our equity investments or establishment of joint ventures and any material disputes with our investment or joint venture partners may have an adverse effect on our financial results, business prospects and our

ability to manage our business.”

In April 2016, Shanghai The9 Education Technology Inc., or The9 Education, one of our then consolidated affiliated entities, previously listed on the New Third Board. In August 2017, Shanghai IT entered into a transaction with Beijing Yingke Artwork Co., Ltd., or Beijing Yingke, and certain other parties, pursuant to which Beijing Yingke would acquire all of the equity interest in The9 Education for an aggregate consideration of RMB12.0 million and Shanghai IT would assume the assets and liabilities of The9 Education after the completion of the transaction. Prior to the transaction, Shanghai IT and an unrelated third party held 70% and 30% of equity interest in The9 Education, respectively. Moreover, The9 Education issued certain new shares to Beijing Yingke in November 2017. The transaction was closed in January 2018 and we no longer consolidate The9 Education since then.

In July 2017, we completed a share exchange transaction with a Korean company IE Limited, or IE, whereby we exchanged approximately 12,500,000 ordinary shares newly issued by us at a per share price of US\$1.2 for approximately 14.6% equity interest of Smartposting Co., Ltd., a wholly-owned subsidiary of IE, held by IE. We do not consolidate the results of Smartposting Co., Ltd. into our results of operations and treat it as an equity investee.

In January 2018, we completed a share exchange transaction with Red Ace Limited, or Red Ace, a British Virgin Islands company, whereby we exchanged approximately 3,571,429 ordinary shares newly issued by us for approximately 29.0% equity interest of Maxline Holdings Limited, a Cayman Islands company engaged in the provision of information technology infrastructure solutions, website and mobile app design, held by Red Ace. We do not consolidate the results of Maxline Holdings Limited into our results of operations and treat it as an equity investee.



In September 2018, we completed a share exchange transaction with Leading Choice Holding Limited, or Leading Choice, a company incorporated in Hong Kong, and the shareholder of Leading Choice for the issuance and sale of 21,000,000 ordinary shares of our company to Leading Choice in exchange for 20% equity interest in Leading Choice at that time as consideration.

In September 2018, we completed a share exchange transaction with Plutux Limited, or Plutux, a company incorporated in Gibraltar, and a shareholder of Plutux for the issuance and sale of 21,000,000 ordinary shares of our company to the participating shareholder of Plutux in exchange for 8% equity interest in Plutux at that time as consideration.

In March 2019, we signed a joint venture agreement with F&F to establish a joint venture to manufacture, market, distribute, and sell electric cars in China. Under the terms of the joint venture agreement, we will make capital contribution of up to US\$600.0 million in three equal installments to the joint venture, and F&F will make contributions including its use right in a piece of land in China for electric cars manufacturing and will grant the joint venture an exclusive license to manufacture, market, distribute and sell certain F&F's car model and other potential selected car models in China, in each case subject to the satisfaction of certain conditions, such as the establishment of the joint venture and funding arrangements.

Effective May 9, 2018, we effected a change of the ratio of the ADSs to ordinary shares from one ADS representing one ordinary share to three ordinary shares. Unless otherwise indicated, ADSs and per ADS amount in this annual report have been retroactively adjusted to reflect the changes in ratio for all periods presented.

In 2017 and 2018, we received several written notifications from the Nasdaq Stock Market indicating that we no longer met the continued listing requirement for the Nasdaq Global Market. We regained compliance and continued to list on Nasdaq Global Market. On October 3, 2018, we received a letter from the Listing Qualifications Department of Nasdaq, pursuant to which Nasdaq informed us that due to our failure to regain compliance with the continued listing requirement of US\$50 million minimum Market Value of Listed Securities, or MVLS, for the Nasdaq Global Market as set in the Nasdaq Listing Rule 5450(b)(2)(A), our ADSs will be delisted from the Nasdaq Global Market unless measures are taken prior to a certain timeline. We decided to transfer our listing venue to Nasdaq Capital Market with which we fully comply with the continued listing standards. After Nasdaq's approval of such transfer, we have been compliant with the minimum MVLS for the Nasdaq Capital Market till the date of this annual report. For further discussion about Nasdaq rules deficiency, see "Item 3. Key Information—D. Risk Factors—Risks Related to Our Shares and ADSs—Our ADSs may be delisted from the Nasdaq Capital Market as a result of our not meeting the Nasdaq Capital Market continued listing requirements."

Our principal executive office is located at Building No. 3, 690 Bibo Road, Zhangjiang Hi-Tech Park, Pudong New Area, Shanghai 201203, People's Republic of China, and our telephone number is +86-21-5172-9999. Our registered

office in the Cayman Islands is located at the offices of CARD Corporate Services Ltd, c/o Collas Crill Corporate Services Limited, Floor 2, Willow House, Cricket Square, PO Box 709, Grand Cayman KY1-1107 Cayman Islands. Our agent for service of process in the United States is CT Corporation System located at 111 Eighth Avenue, New York, New York 10011.

## B. Business Overview

We primarily operate and develop proprietary and licensed online games. We are developing several proprietary mobile games, including CrossFire New Mobile Game, Q Jiang San Guo and Audition.

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

In 2018, we stepped into the blockchain-related service market. We have invested in several companies to conduct activities related to the development of blockchain-technology-enabled products.

## Products and Services

### Online Games

We operate and develop proprietary or licensed online games, primarily mobile games, and TV games.

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

Game	Developer/ Licensor	Description	Status
Knight Forever	The9	Mobile game	Launched in China in June 2018, and launched in South Korea, Taiwan, Hong Kong, Macau in September 2018
CrossFire New Mobile Game	The9 / Smilegate	Mobile game	Under development
Q Jiang San Guo	The9	Mobile game	Under development
Audition	Asian Way Development Limited / T3 Entertainment	Mobile game	Under development
Pop Fashion	The9	Mobile game	Launched in China in December 2018, and launched in Korea in March 2019

*Knight Forever*. is our proprietary mobile game that we have been developing since 2017. We launched Knight Forever in China in June 2018, and later in South Korea, Taiwan, Hong Kong, Macau in September 2018. In March 2019, it was also launched in Singapore, Malaysia, North America and Europe.

*CrossFire New Mobile Game*. In January 2016, we obtained a right from Smilegate to develop a mobile game based on the intellectual property relating to CrossFire, or the CrossFire New Mobile Game. The development of the game is financed with funding through Inner Mongolia Culture Assets and Equity Exchange. See “Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Cash Flows and Working Capital.” In November 2017, we entered into an exclusive publishing agreement with a third-party company, pursuant to which this third-party company was granted with an exclusive right to publish the CrossFire New Mobile Game in China. We

expect to launch CrossFire New Mobile Game in the second half of 2019.

*Q Jiang San Guo.* Q Jiang San Guo is our proprietary mobile game that we have been developing since 2017. We plan to start the online test in South Korea and Taiwan in June 2019.

*Audition.* Asian Way Development Limited obtained a right from T3 Entertainment to develop a mobile game based on the intellectual property relating to a game called Audition and has sublicensed all of its rights and obligations with respect to the development, marketing, distribution and publishing of the game to a third-party company.

*Pop Fashion* is a proprietary game developed by us. Pop Fashion is a match-3 game which was launched on the third-party platform in China in December 2018. We started online operations in South Korea in March 2019.

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

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

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

#### Blockchain-Related Services

In January 2018, The9 Singapore Pte. Ltd, our wholly-owned subsidiary in Singapore, reached a partnership agreement with Ginkoo Technology Company Limited, or Ginkoo Technology, to provide blockchain related services. We plan to provide the services related to the development, investment and financing of blockchain-technology-enabled products, such as cryptocurrencies, to global enterprises, while Ginkoo Technology will provide technical support for us to build up the block-chain technology capacities.

In February 2018, The9 Singapore Pte. Ltd entered into a partnership agreement with C&I Singapore Renewable and Innovative Tech Pts. Ltd., or C&I, a joint venture established by Comtec Solar Systems Group Limited (SEHK: 00712) and ISDN Holdings Limited (SEHK: 01656 and SGX:I07). Pursuant to this agreement, we will provide C&I with related blockchain technology with respect to the trading and distribution of solar energy. We are also contemplating to explore further cooperation to create a decentralized platform for the trading and distribution of solar generated energy with other solar energy companies and consumers.

#### *Electric Vehicles*

In March 2019, we entered into a joint venture agreement with F&F, to establish a joint venture and serve China with electric vehicles designed and developed by F&F. We will be a 50% partner in the joint venture with control over business operations. The joint venture will serve the China market with manufacturing, marketing, distribution and sale of certain car model and other potential selected car models designed and developed by F&F, in each case subject to the satisfaction of certain conditions, such as the establishment of the joint venture and funding arrangements.

#### Other Products and Services

Our other products and services mainly consist of technical consulting services in connection with our blockchain-related business.

#### Customer Service

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

## Purchase of In-game Items

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

## Pricing, Distribution and Marketing

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

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

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

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

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

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

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

## Game Development and Licensing

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

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

## Technology

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

proprietary software, including game monitor tools, that are integrated with our websites and customer service center operations; and



hardware platform and server sites primarily consisting of IBM storage systems, HP, H3C and Cisco network equipment.

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

## Competition

Our major competitors include, but are not limited to, online game operators in China. These include Tencent Holdings Limited (which operates CrossFire, League of Legends and Dungeon & Fighter), NetEase, Inc. (which operates Onmyoji, Knives Out), Happy-elements Inc. (which operates Anipop).

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

## Intellectual Property

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

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

## Legal Proceedings

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

## Government Regulations

### Regulations on Foreign Investment

Investment activities in the PRC by foreign investors are principally governed by the Catalogue for the Guidance of Foreign Investment Industry, or the Catalogue, which was promulgated and is amended from time to time by the MOFCOM, and the National Development and Reform Commission, or NDRC, and together with Existing FIE Laws and their respective implementation rules and ancillary regulations. The Catalogue lays out the basic framework for foreign investment in China, classifying businesses into three categories with regard to foreign investment: “encourage,” “restricted” and “prohibited.” Industries not listed in the catalog are generally deemed as falling into a fourth category “permitted” unless specifically restricted by other PRC laws. In addition, on June 28, 2018, the MOFCOM and the NDRC jointly promulgated the Special Management Measures (Negative List) for the Access of Foreign Investment, or the 2018 Negative List, which became effective on July 28, 2018 to amend the Guidance Catalog and the previous negative list thereunder.

On March 15, 2019, the National People's Congress promulgated the FIL, which will come into effect on January 1, 2020 and upon then the FIL will replace the Existing FIE Laws. The FIL embodies an expected regulatory trend in PRC to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. The FIL, by means of legislation, establishes the basic framework for the access, promotion, protection and administration of foreign investment in view of investment protection and fair competition.

According to the FIL, foreign investment shall enjoy pre-entry national treatment, except for those foreign invested entities that operate in industries deemed to be either “restricted” or “prohibited” in the “negative list.” The FIL provides that foreign invested entities operating in foreign “restricted” or “prohibited” industries will require entry clearance and other approvals. However, it is unclear whether the “negative list” will differ from the 2018 Negative List. In addition, the FIL does not comment on the concept of “de facto control” or contractual arrangements with variable interest entities, however, it has a catch-all provision under definition of “foreign investment” to include investments made by foreign investors in China through means stipulated by laws or administrative regulations or other methods prescribed by the State Council. Therefore, it still leaves leeway for future laws, administrative regulations or provisions to provide for contractual arrangements as a form of foreign investment. See “Item 3. Key Information—D. Risk Factors—Our current corporate structure and business operations may be affected by the newly enacted Foreign Investment Law.”

The FIL also provides several protective rules and principles for foreign investors and their investments in the PRC, including, among others, that local governments shall abide by their commitments to the foreign investors; foreign-invested enterprises are allowed to issue stocks and corporate bonds; except for special circumstances, in which case statutory procedures shall be followed and fair and reasonable compensation shall be made in a timely manner, expropriate or requisition the investment of foreign investors is prohibited; mandatory technology transfer is prohibited, allows foreign investors’ funds to be freely transferred out and into the territory of PRC, which run through the entire lifecycle from the entry to the exit of foreign investment, and provide an all-around and multi-angle system to guarantee fair competition of foreign-invested enterprises in the market economy. In addition, foreign investors or the foreign investment enterprise should be imposed legal liabilities for failing to report investment information in accordance with the requirements. Furthermore, the FIL provides that foreign invested enterprises established according to the existing laws regulating foreign investment may maintain their structure and corporate governance within five years after the implementing of the FIL, which means that foreign invested enterprises may be required to adjust the structure and corporate governance in accordance with the current PRC Company Law and other laws and regulations governing the corporate governance.

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

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

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

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

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

- Telecommunications Regulations (2000), as amended in 2014 and 2016;

- The Administrative Rules for Foreign Investments in Telecommunications Enterprises (2001), as amended in 2008 and 2016;

- The Administrative Measures for Telecommunications Business Operating License (2017);

- The Administrative Measures for Internet Information Services (2000), as amended in 2011;

- The Tentative Measures for Administration of Internet Culture (2003), as amended and reissued in 2011 and further amended in 2017;

- Administrative Measures on Network Publication (2016);

- The Tentative Measures for Administration of Online Games (2010), as amended in 2017; and

- The Foreign Investment Industrial Guidance Catalogue (2017), as amended in 2018.

In July 2006, MIIT issued the MII Notice. The MII Notice prohibits ICP license holders from leasing, transferring or selling a telecommunications business operating license to any foreign investors in any form, or providing any resource, sites or facilities to any foreign investors for their illegal operation of telecommunications businesses in China. The notice also requires that ICP license holders and their shareholders directly own the domain names and trademarks used by such ICP license holders in their daily operations. The notice further requires each ICP license holder to have the necessary facilities for its approved business operations and to maintain such facilities in the regions covered by its license. In addition, all the value-added telecommunication service providers are required to maintain network and information security in accordance with the standards set forth under relevant PRC regulations. The local authorities in charge of telecommunications services are required to ensure that existing ICP license holders conduct a self-assessment of their compliance with the MII Notice and submit status reports to MIIT before November

1, 2006. For those which are not in compliance with the above requirements and further fail to rectify the situation, the relevant governmental authorities would have broad discretion in adopting one or more measures against them, including but not limited to revoking their operating licenses. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—PRC laws and regulations restrict foreign ownership of Internet content provision, Internet culture operation and Internet publishing licenses, and substantial uncertainties exist with respect to the application and implementation of PRC laws and regulations.”

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

With respect to the online gaming industry in China, since online games fall into the definition of “Internet culture products” under The Tentative Measures for Administration of Internet Culture (2017), a commercial operator of online games must, in addition to obtaining the ICP License, obtain an Internet culture operation license from the appropriate culture administrative authorities for its operation of online games. Furthermore, according to The Tentative Measures for Administration of Internet Publication (2002), the provision of online games is deemed an Internet publication activity. Therefore, approval from the appropriate press and publication administrative authorities as an Internet publisher or cooperation with a licensed Internet publisher is required for an online game operator to carry on its online gaming businesses in China. In February 2016, the GAPPRT and the MIIT jointly issued the Administrative Measures on Network Publication, which took effect in March 2016 and replaced the Tentative Administrative Measures on Internet Publication. The Administrative Measures on Network Publication further strengthen and expand the supervision and management on the network publication service, including online games service. Furthermore, online games, including mobile games, regardless of whether imported or domestic, shall be subject to a content review and approval by or a filing with the Ministry of Culture and GAPPRT prior to commencement of operations in China.

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

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

In September 2009, GAPP further promulgated the GAPP Circular, which provides that foreign investors are prohibited from making investment and engaging in online game operation services by setting up foreign-invested enterprises in China. Further, foreign investors shall not control and participate in PRC online game operation businesses indirectly or in a disguised manner by establishing joint venture companies or entering into agreements with or providing technical support to such PRC online game operation companies, or by inputting the users' registration, account management, game cards consumption directly into the interconnected gaming platform or fighting platform controlled or owned by the foreign investor. In addition, on February 4, 2016, the GAPPRFT and the MIIT jointly issued the Administrative Measures on Network Publication, or the Network Publication Measures, which took effect in March 2016. Pursuant to the Network Publication Measures, wholly foreign-owned enterprises, Sino-foreign equity joint ventures and Sino-foreign cooperative enterprises shall not engage in the provision of web publishing services, including online game services. Project cooperation involving internet publishing services between an internet publishing service provider and a wholly foreign-owned enterprise, Sino-foreign equity joint venture, or Sino-foreign cooperative enterprise within China or an overseas organization or individual shall be subject to prior examination and approval by the GAPPRFT. It is not clear whether GAPPRFT and MIIT have regulatory authority over the ownership structures of online game companies based in China and online game operation in China.

The relevant governmental authorities have broad discretion in adopting one or more of administrative measures against companies now in compliance with these measures, including revoking relevant licenses and relevant registration. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—PRC laws and regulations restrict foreign ownership of Internet content provision, Internet culture operation and Internet publishing licenses, and substantial uncertainties exist with respect to the application and implementation of PRC laws and regulations.”



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

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

Enterprises engaged in online game operations that intend to change a version of an online game, increase the types of virtual items, adjust the functions and consumption period of virtual items or hold intermittent campaigns shall, on the official homepage of the online game or in conspicuous locations within the online game, promptly make public the name, functions, price, exchange rate and expiration date of each relevant virtual items, the means of gifting, transferring or trading the virtual items and other relevant information.

Enterprises engaged in online game operations that provide random draws of virtual items and value-added services of an online game shall not require users to participate in the random draws with legal tender or virtual currency.

Enterprises engaged in online game operations shall publish the random draw results on the official website of an online game or in conspicuous locations within the online game, and keep relevant records for at least 90 days for any future inquiries by competent authorities.

An enterprise engaged in online game operations that provide random draws of virtual items and value-added services of an online game shall concurrently offer users alternative ways to acquire the virtual items and value-added services with the same performance, such as through exchange with virtual items or payment with virtual currency.

Enterprises engaged in online game operations shall not offer services for the exchange of online game virtual currency with legal tender or physical items, except where the said enterprise terminates its online gaming products and services, and refunds the virtual currency unused by users in the form of legal tender or by other means acceptable to the users.

Enterprises engaged in online game operations shall not offer services for the exchange of virtual items with legal tender.

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

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

## Regulations on Internet Content

The PRC government has promulgated measures relating to Internet content through a number of ministries and agencies, including MIIT, MCT and GAPPRFT. These measures specifically prohibit Internet activities, including the operation of online games that result in the publication of any content which is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise State security or secrets. See “Item 3. Key Information—D. Risk Factors—Risks Related to Doing Business in China—The laws and regulations governing the online game industry in China are developing and subject to future changes. If we fail to obtain or maintain all applicable permits and approvals, our business and operations could be materially and adversely affected.” If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

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

Internet content in China is also regulated and restricted from a state security standpoint. The National People’s Congress, China’s national legislative body, has enacted a law that may subject to criminal punishment in China any

effort to: (1) gain improper entry into a computer or system of strategic importance; (2) disseminate politically disruptive information; (3) leak state secrets; (4) spread false commercial information; or (5) infringe intellectual property rights.

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

## Regulations on Privacy Protection

PRC laws and regulations prohibit Internet content providers from collecting and analyzing personal information from their users without user's prior consent. We require our users to accept a user agreement whereby they agree to provide certain personal information to us. In addition, PRC law prohibits Internet content providers from disclosing to any third parties any information transmitted by users through their networks unless otherwise permitted by law. If an Internet content provider violates these regulations, it may be liable for damages caused to its users and it may be subject to administrative penalties such as warnings, fines, confiscation of its unlawful income, revocation of licenses, cancellation of filings, shutdown of their websites or even criminal liabilities.

On November 7, 2016, the Standing Committee of the National People's Congress promulgated the Cybersecurity Law of the PRC, or the Cybersecurity Law, which came into effect on June 1, 2017. Pursuant to the Cybersecurity Law, network operators shall perform their cybersecurity obligations according to the requirements of the classified protection system for cybersecurity, including: (a) formulating internal security management systems and operating instructions, determining the persons responsible for cybersecurity, and implementing the responsibility for cybersecurity protection; (b) taking technological measures to prevent computer viruses, network attacks, network intrusions and other actions endangering cybersecurity; (c) taking technological measures to monitor and record the network operation status and cybersecurity incidents; (d) taking measures such as data classification, and back-up and encryption of important data; and (e) other obligations stipulated by laws and administrative regulations. In addition, network operators shall comply with the principles of legitimacy to collect and use personal information and disclose their rules of data collection and use, clearly express the purposes, means and scope of collecting and using the information, and obtain the consent of the persons whose data is gathered.

## Import Regulations

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

## Regulations on Intellectual Property Rights

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

## Regulations on Foreign Currency Exchange and Dividend Distribution

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

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

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

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

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

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

On April 26, 2016, SAFE issued the Circular of the State Administration of Foreign Exchange on Further Promoting Trade and Investment Facility and Improving the Examination and Verification of the Authenticity, pursuant to which

when handling the remittance of profits exceeding the equivalent of US\$50,000 abroad for a domestic institution, a bank should examine the authenticity of the transaction by reviewing related corporate approvals, tax filing record and other materials.

On June 9, 2016, SAFE promulgated the Notice of the State Administration of Foreign Exchange on Reforming and Standardizing the Foreign Exchange Settlement Management Policy of Capital Account, or SAFE Circular 16, effective on June 9, 2016, which reiterates some of the rules set forth in Circular 19, but changes the prohibition against using RMB capital converted from foreign currency-denominated registered capital of a foreign-invested company to issue RMB entrusted loans to a prohibition against using such capital to issue loans to non-affiliated enterprises.

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

- The Wholly Foreign Invested Enterprise Law (1986), as amended in 2000 and 2016; and



· Administrative Rules under the Wholly Foreign Invested Enterprise Law (1990), as amended in 2001 and 2014.

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

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

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

As a result of the uncertainties relating to the interpretation and implementation of SAFE Circular 37 and other regulations of SAFE, we cannot predict how these regulations will affect our business operations or strategies. For example, our present or future PRC subsidiaries' ability to conduct foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, may be subject to compliance with such SAFE registration requirements by relevant PRC residents, over whom we have no control. In addition, we cannot assure you that any such PRC residents will be able to complete the necessary approval and registration procedures required by the SAFE regulations. We have requested all of our shareholders who, based on our knowledge, are PRC residents or whose ultimate beneficial owners are PRC residents to comply with all applicable SAFE registration requirements, but we

have no control over our shareholders. We cannot assure you that the PRC beneficial owners of our company and our subsidiaries have completed the required SAFE registrations. Nor can we assure you that they will be in full compliance with the SAFE registration in the future. Any non-compliance by the PRC beneficial owners of our company and our subsidiaries may subject us or such PRC resident shareholders to fines and other penalties. It may also limit our ability to contribute additional capitals to our PRC subsidiaries and our subsidiaries' ability to distribute profits or make other payments to us.

#### C. Organizational Structure

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

#### D. Property, Plants and Equipment

Our headquarters are located on premises comprising approximately 14,000 square meters in an office building in Shanghai, China. We purchased the office building in which our headquarters are located, and lease all of our other premises from unrelated third-parties. Our office building has been mortgaged to secure the Convertible Notes in the aggregate principal amount of US\$40,050,000 issued and sold to Splendid Days and an entrusted loan of approximately RMB31.6 million that we obtained from a third party in December 2015, which may be sold to repay the Convertible Notes. We may switch to another principal executive office. In addition, we have subsidiaries located in the United States and Singapore and small branch offices in Beijing, China.

#### Item 4A. UNRESOLVED STAFF COMMENTS

None.

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

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

##### A. Operating Results

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

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

**Revenue Composition and Sources of Revenue.** In 2016, 2017 and 2018, we generated substantially all of our revenues from online game services, and the remaining portion of our revenues from other services. The following table sets forth our revenues generated from providing online game services and other services, both in absolute amounts and as percentages of total revenues for the periods indicated.

	For the Year Ended December 31,						
	2016		2017		2018		
	RMB	%	RMB	%	RMB	US\$	%
	(in thousands, except percentages)						
Revenue <sup>(1)</sup> :							
Online game services	48,566	86.3	71,564	97.8	16,551	2,407	94.6
Other revenues	7,720	13.7	1,644	2.2	941	137	5.4
Total revenues	56,286	100.0	73,208	100.0	17,492	2,544	100.0

(1) Effective from January 1, 2018, we adopted ASC topic 606, a new accounting standard on the recognition of revenue, and have applied such accounting standards to the year ended December 31, 2018. The financial data for the year ended December 31, 2016 and 2017 have not been recast and as such are not comparable with the financial data for the year ended December 31, 2018. The adoption of ASC topic 606 did not have material impact on our financial results.

**Online Game Services.** In 2016, 2017 and 2018, revenues from our online game services amounted to RMB48.6 million, RMB71.6 million and RMB16.6 million (US\$2.4 million), respectively. We primarily generate our online game service revenues through item-based revenue models. Under an item-based revenue model, players of our games play the games for free, but are charged for purchases of in-game items, such as performance-enhancing items, clothing and accessories. Thus, we generate revenues through the sale of such in-game premium features that players use game points to purchase. The distribution of points to end users is typically made through sales of prepaid online points. Fees from prepaid online points are deferred when initially received. This revenue is recognized over the life of the premium features or as the premium features are consumed. Future usage patterns may differ from the historical usage patterns on which the virtual items and services consumption model is based. We will continue to monitor the operational statistics and usage patterns affecting our recognition of these revenues.

Before August 1, 2018, we recorded our IPTV revenue on a gross basis. As we became an agent in the operation of IPTV games since August 1, 2018, we started to record our IPTV revenues net of amounts we paid to third-party operators.

*Other Revenues.* Other revenues mainly included revenues from the provision of technical services to customers.

Effective from January 1, 2018, we adopted ASC topic 606, a new accounting standard on the recognition of revenue, and applied the modified retrospective method to contracts that were not completed as of January 1, 2018 and we have applied such accounting standards to the year ended December 31, 2018. The adoption of ASC topic 606 did not have material impact on our financial results.

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

Before August 1, 2018, we recorded our IPTV revenue on a gross basis. As we became an agent in the operation of IPTV games since August 1, 2018, we started to record our IPTV revenues net of amounts we paid to third-party operators, and such amounts were no longer included in the cost of revenue.

*Operating Expenses.* Our operating expenses consist primarily of product development expenses, sales and marketing expenses, general and administrative expenses and gain on disposal of subsidiaries.

*Product Development Expenses.* Our product development expenses consist primarily of compensation to our product development personnel, outsourced research and development expenses, equipment and software depreciation charges and other overhead expenses for the development of our proprietary games. Our product development expenses amounted to RMB78.0 million, RMB45.1 million and RMB24.6 million (US\$3.6 million) for the year ended December 31, 2016, 2017 and 2018, respectively. Most of our proprietary online games have entered into their final stages of development and we have the ability to control the level of discretionary spending on product development in the near future.

*Sales and Marketing Expenses.* Our sales and marketing expenses consist primarily of advertising and marketing expenses incurred to promote our games and compensation expenses relating to our sales and marketing personnel.

Our sales and marketing expenses amounted to RMB21.3 million, RMB9.1 million and RMB2.3 million (US\$0.3 million) for the year ended December 31, 2016, 2017 and 2018, respectively.

*General and Administrative Expenses.* Our general and administrative expenses consist primarily of compensation and travel expenses for our administrative staff, depreciation of property and equipment, entertainment expenses, administrative office expenses, as well as fees paid to professional service providers for auditing, legal services and equity transactions. General and administration expenses amounted to RMB129.0 million, RMB108.8 million and RMB89.6 million (US\$13.0 million) for the year ended December 31, 2016, 2017 and 2018, respectively. General and administrative expenses continued to decrease from 2016 to 2018, which reflects our cost cutting efforts.

*Impairment on Intangible Assets.* We had impairment charges on certain intangible assets of RMB68.0 million for the year ended December 31, 2016. We did not have such impairment charges for the year ended December 31, 2017 and 2018.

*Impairment Loss on Goodwill.* We had no impairment charges of goodwill for the year ended December 31, 2017 and 2018. We had impairment charges on goodwill of RMB10.6 million for the year ended December 31, 2016, which represented the impairment of goodwill in connection with our acquisition of Red 5 in 2010. In 2016, due to the weaker-than-expected operating performance of Red 5, we concluded that the goodwill was fully impaired.

*Gain on disposal of subsidiaries.* We had gain on disposal of subsidiaries of RMB10.5 million (US\$1.5 million) for the year ended December 31, 2018, including gain on disposal of The9 Education of RMB10.0 million (US\$1.5 million). We had no gain on disposal of subsidiaries for the year ended December 31, 2016 and 2017.

*Other Operating Income.* We had other operating income of RMB0.3 million and RMB0.2 million (US\$0.03 million) for the year ended December 31, 2017 and 2018, respectively, both primarily attributable to office rental income. We had other operating income of RMB3.6 million for the year ended December 31, 2016, including primarily IDC rental income and office rental income of RMB4.2 million, which were partially offset by the disposal of property, equipment and software of RMB0.6 million.

## Holding Company Structure

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

## Income and Sales Taxes

The National People’s Congress of the PRC adopted and promulgated the EIT Law on March 16, 2007. The EIT Law went into effect as of January 1, 2008 and revised on February 24, 2017 and December 29, 2018, and unified the tax rate generally applicable to both domestic and foreign-invested enterprises in the PRC. Our company’s subsidiaries and affiliated entities in the PRC are generally subject to EIT at a statutory rate of 25%. Our subsidiaries and affiliated entities in the PRC that hold a HNTE qualification are entitled to enjoy a 15% preferential EIT rate.

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



In February 2018, the SAT issued the Announcement of the State Administration of Taxation on Issues Relating to “Beneficial Owner” in Tax Treaties on issues relating to “beneficial owner” in tax treaties, or Circular No. 9, which took effect on April 1, 2018. Circular No. 9 provides a more elastic guidance to determine whether the applicant engages in substantive business activities to constitute a “beneficial owner.” When determining the applicant’s status of the “beneficial owner” regarding tax treatments in connection with dividends, interests or royalties in the tax treaties, several factors, including without limitation, whether the applicant is obligated to pay more than 50% of his or her income in the past twelve months to residents in third country or region, whether the business operated by the applicant constitutes the actual business activities, and whether the other country or region to the tax treaties does not levy any tax or grant tax exemption on relevant incomes at all or levy tax at an extremely low rate, will be taken into account, and it will be analyzed according to the actual circumstances of the specific cases. This circular further provides that applicants who intend to prove his or her status of the “beneficial owner” shall submit the relevant documents to the relevant tax bureau according to the Administrative Measures for Non-Resident Enterprises to Enjoy Treatments under Tax Treaties, pursuant to which non-resident taxpayers which satisfy the criteria to be entitled to tax treaty benefits may, at the time of tax declaration or withholding declaration through a withholding agent, enjoy the tax treaty benefits, and be subject to follow-up administration by the tax authorities. If the non-resident taxpayer does not apply to the withholding agent for the tax treaty benefits, or such taxpayer does not satisfy the criteria to be entitled to tax treaty benefits, the withholding agent should withhold tax pursuant to the provisions of PRC tax laws. We cannot assure you that any dividends to be distributed by us or by our subsidiaries to our non-PRC shareholders and ADS holders whose jurisdiction of incorporation has a tax treaty with China providing a different withholding arrangement will be entitled to the benefits under the relevant withholding arrangement.

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

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

our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to decrease.”

With respect to sales taxes, before December 31, 2011, all the services provided by our PRC subsidiaries were subject to business taxes at the rate of 5%. On March 23, 2016, the Ministry of Finance and the SAT jointly issued the Circular on the Pilot Program for Overall Implementation of the Collection of Value Added Tax Instead of Business Tax, or Circular 36, which took effect on May 1, 2016. Pursuant to Circular 36, all companies operating in construction, real estate, finance, modern service or other sectors which were required to pay business tax are required to pay VAT in lieu of business tax. As a result of Circular 36, the services provided by Shanghai IT, The9 Computer and C9I Shanghai as general VAT payers will be subject to VAT at the rate of 6%, and the services provided by our other PRC subsidiaries or affiliated PRC entities as small-scale VAT payers will be subject to VAT at the rate of 3%.

Our subsidiaries in the United States are registered in California and are subject to U.S. federal corporate marginal income tax at a rate of 21% for the taxable year ending December 31, 2018 and subsequent taxable years and state income tax at a rate of 8.84%, respectively.

## Inflation

Since our inception, inflation in China has not materially affected our results of operations. According to the National Bureau of Statistics of China, the year-over-year percent changes in the consumer price index for December 2016, 2017 and 2018 increases of 2.1%, 1.8% and 1.9%, respectively. Although we have not been materially affected by inflation, we may be affected if China experiences higher rates of inflation in the future.

## Critical Accounting Policies

We prepare financial statements in conformity with U.S. Generally Accepted Accounting Principles, or U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities on the date of the financial statements, and the reported amounts of revenue and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements as their application assists management in making their business decisions.

## Consolidation of Variable Interest Entities, or VIEs

PRC laws and regulations, including the GAPP Circular and the Network Publication Measures, currently prohibit or restrict foreign ownership of Internet-related businesses. We believe, consistent with the view of our PRC legal counsel, that our current structure complies with these foreign ownership restrictions, subject to the interpretation and implementation of the GAPP Circular and the Network Publication Measures. Specifically, we operate our business through Shanghai IT and have entered into a series of contractual arrangements with Shanghai IT and its equity owners. See the contractual arrangements set forth in “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions.” As a result of these contractual arrangements, we are entitled to receive service fees for services provided to Shanghai IT for an amount determined at our discretion, up to 90% of PRC entities’ profits. In addition, the equity owners of record for these entities have pledged all their equity interests in the VIEs to us as collateral for all of their payments due to the wholly-owned foreign enterprise, or WOFE, and to secure performance of all obligations of the VIEs and their shareholders under various agreements. In addition, the agreements provide that any dividend distributions made by the VIEs, if any, are required to be deposited in an escrow account over which we have exclusive control. Moreover, through the Call Option Agreements and Shareholder Voting Proxy Agreements, each shareholder of the VIEs granted WOFE or any third parties designated by the WOFE an irrevocable

power of attorney to act on all matters pertaining to the VIEs. We believe that the terms of the Call Option Agreements are currently exercisable and legally enforceable under the PRC laws and regulations. We also believe that the minimum amount of consideration permitted by the applicable PRC law to exercise the options does not represent a financial barrier or disincentive for us to exercise our rights under the Call Option Agreements. A simple majority vote of our board of directors is required to pass a resolution to exercise our rights under the Call Option Agreements, for which consent of the shareholder of the VIEs is not required. As a result of the totality of these arrangements, we have both the power to direct activities that most significantly impact the VIEs economic performance and the obligation to absorb losses of or right to receive benefits from the VIEs that are significant to Shanghai IT. As a result, we concluded we are the primary beneficiary of Shanghai IT and as such Shanghai IT is consolidated VIE of our company.

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

## Revenue Recognition

We recognize revenues when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration expected to be entitled to in exchange for those goods or services. Depending on the terms of the contract and the laws that apply to the contract, control of the goods or services may be transferred over time or at a point in time. We do not believe that significant management judgments are involved in revenue recognition. We adopted ASC topic 606 using the modified retrospective transition approach method, reflecting the cumulative effect of initially applying the new standard to revenue recognition in 2018. We evaluated all revenue streams to assess the impact of implementing ASC topic 606 on revenue contracts. The adoption of ASC topic 606 did not change our consolidated balance sheets, consolidated statement of cash flows, or consolidated statement of changes in equity as of, or for the year ended, December 31, 2018.

### Online game services

We earn revenue from provision of online game operation services to players on the game servers and third-party platforms and overseas licensing of the online game to other operators. We grant operation right on authorized games, together with associated services which are rendered to the customers over time. We adopt virtual item / service consumption model for the online game services. Players can access certain games free of charge, but many of them purchase game points to acquire in-game premium features. We may act as principal or agent through the various transaction arrangements we entered into.

The determination on whether to record the revenue gross or net is based on an assessment of various factors, including but not limited to whether we (i) are the primary obligor in the arrangement; (ii) have general inventory risk; (iii) change the product or perform part of the services; (iv) have latitude in establishing the selling price; and (v) have involvement in the determination of product or service specifications. The assessment is performed for all of the licensed online games.

### When acting as principal

Revenues from online game operation operated through telecom carriers and certain online games operators are recognized upon consumption of the in-game premium features based on the gross of revenue sharing-payments to third-party operators, but net of VAT. We obtain revenue from the sale of in-game virtual items. Revenues are recognized when the virtual items are consumed or over the estimated lives of the virtual items, which are estimated by considering the average period that active players and players' behavior patterns derived from operating data. Accordingly, commission fees paid to third-party operators are recorded as cost of revenues.

When acting as agent

With respect to games license arrangements we entered into with third-party operators, if the terms provide that (i) third-party operators are responsible for providing game desired by the game players; (ii) the hosting and maintenance of game servers for running the games are the responsibility of third-party operators; (iii) third-party operators have the right to review and approve the pricing of in-game virtual items and the specification, modification or update of the game made by us; and (iv) publishing, providing payment solution and market promotion services are the responsibilities of third-party operators and we are responsible to provide the license of intellectual property and subsequent technical services, then we consider ourselves as an agent of the third-party operators in such arrangement with game players. Accordingly, we record the game revenues from these licensed games, net of amounts paid to the third-party operators.

Licensing revenue

We license our proprietary online games to other game operators and receive license fees and royalty income in connection with their operation of the games. License fee revenue is recognized evenly throughout the license period after commencement of the game, given that our intellectual property rights subject to the license are considered to be symbolic and the licensee has the right to access such intellectual property rights as they exist over time when the license is granted. Monthly revenue-based royalty payments are recognized when the relevant services are delivered, provided that collectability is reasonably assured. We view the third-party licensee operators as our customers and recognize revenues on a net basis, as we do not have the primary responsibility for fulfillment and acceptability of the game services.

### Technical services

Technical services mainly include blockchain-related consulting services where we provide services related to the designing, programming and other related services to our customers.

These revenues are recognized when delivery of the service has occurred or when services have been rendered and the collection of the related fees are reasonably assured.

### Contract balances

Timing of revenue recognition may differ from the timing of invoicing to customers. Accounts receivable represent amounts invoiced and revenue recognized prior to invoicing, when we satisfy its performance obligations and have the unconditional right to payment.

Deferred revenue relates to unsatisfied performance obligations at the end of the period and primarily consists of fees received from game players in the online game services and technical services. For deferred revenue, due to the generally short-term duration of the contracts, the majority of the performance obligations are satisfied in the following reporting period. The amount of revenue recognized that was included in deferred revenue balance at the beginning of the period was RMB5.4 million (US\$0.8 million) for the year ended December 31, 2018.

### Income Taxes

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

A valuation allowance is provided on deferred tax assets to the extent that it is more likely than not that such deferred tax assets will not be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred tax assets and liabilities. Realization of the future tax benefits related to the deferred tax assets is dependent on many factors, including our ability to generate taxable income within

the period during which the temporary differences reverse or our tax loss carry forwards expire, the outlook for the PRC economic environment, and the overall future industry outlook. We consider these factors in reaching our conclusion on the recoverability of the deferred tax assets and determine the valuation allowances necessary at each balance sheet date.

We recognize the impact of an uncertain income tax position at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. Income tax related interest is classified as interest expenses and penalties as income tax expense. As of December 31, 2016, 2017 and 2018, we did not have any material liability for uncertain tax positions. Our policy is to recognize, if any, tax-related interest as interest expenses and penalties as income tax expenses. For the year ended December 31, 2016, 2017 and 2018, we did not have any material interest and penalties associated with tax positions.

### Intangible Assets

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

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



## Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of our business acquisition. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. In September 2011, the Financial Accounting Standards Board, or FASB, issued an authoritative pronouncement related to testing goodwill for impairment. The guidance permits us to first assess qualitative factors to determine whether it is “more likely than not” that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. We have adopted this pronouncement since 2012. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we complete a two-step goodwill impairment test in December of each year. The first step is to compare the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step is to compare the implied fair value of goodwill to the carrying value of a reporting unit’s goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. After completing our annual impairment reviews during the fourth quarter of 2015, the reporting unit that was subject to the annual impairment testing had a fair value which exceeded its respective carrying value by a significant margin with no risk of failing the first step of the impairment test. In 2016, due to the weaker-than-expected operating performance of Red 5, we concluded that goodwill was fully impaired as of December 31, 2016. There was no goodwill as of December 31, 2017 or December 31, 2018.

## Share-Based Compensation

Under the 2004 Stock Option Plan, or the Option Plan, we granted options to purchase a total of 355,000 and 10,110,000 ordinary shares of our company to our employees and directors in 2013 and 2015, respectively. We did not grant any options under the Option Plan in 2014. We granted options to purchase a total of 6,000,000, nil and 8,250,000 ordinary shares of our company in 2016, 2017 and 2018, respectively.

We measure the cost of employee services received in exchange for stock-based compensation measured at the grant date fair value of the award. For the awards that are modified, we determine the incremental cost as the excess of the fair value of the modified award over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. We recognize the compensation costs, net of the estimated forfeiture, on a straight-line basis over the vesting period of the award, which generally ranges from one to four years. Forfeiture rates are estimated based on historical forfeiture patterns and adjusted to reflect future

changes in circumstances and facts, if any. If actual forfeitures differ from those estimates, the estimates may be revised in subsequent periods. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

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

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

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

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

In January 2018, we granted 8,250,000 options to directors, officers and consultants, of which 5,750,000 shares would vest based on their services period with our company and 2,500,000 shares granted would vest subject to their performance condition. We measured the fair value of the options using the Black-Scholes option-pricing model. In September 2018, we canceled a total of 6,200,000 shares granted in January 2018.

Share-based compensation expenses of RMB28.1 million, RMB38.0 million and RMB3.9 million (US\$0.6 million) were recognized for the year ended December 31, 2016, 2017 and 2018, respectively, for options and warrants granted to our company's and its subsidiaries' employees and directors, including compensation cost due to the acceleration vesting and exercise of options in June 2017.

#### Impairment Loss of Investments

We assess our equity investments for impairment on a periodic basis by considering factors including, but not limited to, current economic and market conditions, the operating performance of the investees including current earnings trends, the technological feasibility of the investee's products and technologies, the general market conditions in the investee's industry or geographic area, factors related to the investee's ability to remain in business, such as the investee's liquidity, debt ratios, and cash burn rate and other company-specific information including recent financing rounds. If it has been determined that the carrying amount of investment is higher than related fair value and that this decline is other-than-temporary, the carrying value of the investment is adjusted downward to reflect these declines in value. Impairment loss on investments of RMB2.8 million, RMB9.1 million and RMB9.2 million (US\$1.3 million) was recognized in 2016, 2017 and 2018, respectively.

## Impairment on Long-lived Assets

We review long-lived assets and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. We assess the recoverability of long-lived assets and intangible assets (other than goodwill) by comparing the carrying amount to the estimated future undiscounted cash flow associated with the related assets. We recognize impairment of long-lived assets and intangible assets in the event that the net book value of such assets exceeds the estimated future undiscounted cash flow attributable to such assets. We use estimates and judgment in our impairment tests, and if different estimates or judgments had been utilized, the timing or the amount of the impairment charges could be different. Impairment charges relating to intangible assets and other assets amounting to RMB68.0 million, nil and nil were recognized in 2016, 2017 and 2018, respectively.

## Refund of WoW Game Points

As a result of non-renewal of WoW license on June 7, 2009, we announced a refund plan in connection with inactivated WoW game point cards. According to the plan, inactivated WoW game point card holders are eligible to receive a cash refund from us. We recorded a liability in connection with both inactivated points cards and activated but unconsumed point cards of approximately RMB200.4 million, of which RMB4.0 million was refunded in 2009. Upon the loss of the WoW license, we concluded that the nature of the obligation substantively changed from deferred revenue, for which we had the ability to satisfy the underlying performance obligation, to an obligation to refund players for their unconsumed points. Thus, we have accounted for this refund liability by applying the relevant de-recognition guidance when determining the proper accounting treatment. In accordance with this guidance, the refund liability associated with these WoW game points, to the extent not refunded, will be recorded as other operating income after we are legally released from the obligation to refund amounts under the applicable laws. As we announced the refund plan on September 7, 2009, the statute of limitations of the creditors (in this case the game players with claims for refund of inactivated WoW game point cards) to assert their claims for refund is two years from such date under applicable laws and thus our legal liability relating to the inactivated WoW game point cards was extinguished on September 7, 2011 and the associated liability amounting to RMB26.0 million was recognized as other operating income for the year ended December 31, 2011. With respect to the remaining refund liability, based on current PRC laws, to the extent not refunded, we, in consultation with legal counsel, have determined that we will be legally released from this liability in 2029, which represents 20 years from the date of discontinuation of WoW in 2009. However, if management were to publicly announce a refund policy, we would be legally released from any remaining liability for these activated, but unconsumed points, sooner than 20 years. To date, we have determined not to publicly announce any refund policy with respect to this remaining liability, and no refunds have been claimed. The remaining refund liability relating to the activated, but unconsumed WoW game points was RMB170.0 million (US\$24.7 million) as of December 31, 2018.

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

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

## Warrants

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

## Redeemable Noncontrolling Interests

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

## Recent Accounting Pronouncements

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

## Results of Operations

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

	For the Year Ended December 31,			
	2016	2017	2018	US\$( <sup>1</sup> )
	RMB	RMB	RMB	
Consolidated Statement of Operation Data				
Revenues( <sup>2</sup> ):				
Online game services	48,565,620	71,564,023	16,552,080	2,407,255
Other revenues	7,719,902	1,644,143	941,335	136,911
Sales taxes	(86,236 )	(59,610 )	(60,557 )	(8,808 )
Net revenues	56,199,286	73,148,556	17,431,858	2,535,358
Cost of revenue	(48,518,779 )	(23,782,054 )	(16,435,590 )	(2,390,457 )
Gross profit	7,680,507	49,366,502	996,268	144,901
Operating (expenses)/income:				
Product development	(77,991,408 )	(45,112,396 )	(24,555,308 )	(3,571,421 )
Sales and marketing	(21,286,647 )	(9,089,969 )	(2,325,818 )	(338,276 )
General and administrative	(129,047,846 )	(108,824,680 )	(89,853,331 )	(13,029,355 )
Impairment on intangible assets	(68,003,805 )	—	—	—
Impairment loss on goodwill	(10,561,857 )	—	—	—
Gain on disposal of subsidiaries	—	—	10,473,159	1,523,258
Total operating expenses	(306,891,563 )	(163,027,045 )	(105,991,298 )	(15,415,794 )
Other operating income	3,604,749	349,954	229,538	33,385
Loss from operations	(295,606,307 )	(113,310,589 )	(104,765,492 )	(15,237,508 )
Impairment on equity investment and available-for-sale investment	(244,798,058 )	—	(1,386,174 )	(201,611 )
Impairment on other investments	(2,806,439 )	(9,109,312 )	(7,776,157 )	(1,130,995 )
Interest income	161,144	30,525	193,928	28,206
Interest expenses	(56,471,609 )	(83,922,200 )	(104,776,674 )	(15,239,135 )
Fair value change on warrants	48,057,204	12,615,466	2,251,427	327,456
(Loss)/gain on disposal of equity investee and available-for-sale investment	(1,217,405 )	115,349	—	—
Foreign exchange (loss)/gain	(13,131,779 )	19,206,747	(20,331,430 )	(2,957,084 )

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Other income, net	3,179,508	4,669,587	1,598,663	232,516
Loss before income tax expense and share of loss in equity method investments	(562,633,741)	(169,704,427)	(234,991,909)	(34,178,155)
Income tax benefit	6,079,282	—	—	—
Recovery of equity investment in excess of cost	—	60,548,651	—	—
Share of loss in equity investments	(110,535,486)	(2,937,131 )	(4,292,887 )	(624,375 )
Net loss	(667,089,945)	(112,092,907)	(239,284,796)	(34,802,530)
Net (loss)/gain attributable to noncontrolling interest	(58,584,204 )	3,955,640	(16,332,968 )	(2,375,532 )
Net (loss)/gain attributable to redeemable noncontrolling interest	(14,724,152 )	2,117,303	(5,858,902 )	(852,142 )
Net loss attributable to The9 Limited	(593,781,589)	(118,165,850)	(217,092,926)	(31,574,856)
Accretion on redeemable noncontrolling interest	(82,890,188 )	(57,126,233 )	(40,918,773 )	(5,951,389 )
Net loss attributable to holders of ordinary shares	(676,671,777)	(175,292,083)	(258,011,699)	(37,526,245)

Notes:

Translation from Renminbi amounts into U.S. dollars was made at a rate of RMB6.8755 to US\$1.00 for the (1) convenience of the reader only. See “Item 3. Key Information—A. Selected Financial Information—Exchange Rate Information.”

Effective from January 1, 2018, we adopted ASC topic 606, a new accounting standard on the recognition of revenue, and have applied such accounting standards to the year ended December 31, 2018. The financial data for (2) the year ended December 31, 2016 and 2017 have not been recast and as such are not comparable with the financial data for the year ended December 31, 2018. The adoption of ASC topic 606 did not have material impact on our financial results.



Year 2018 Compared to Year 2017

**Revenues.** Our revenues decreased by 76.1%, from RMB73.2 million in 2017 to RMB17.5 million (US\$2.5 million) in 2018, primarily due to the decreases in (i) Firefall license revenue from System Link by RMB37.9 million (US\$5.5 million) as Firefall ceased operations and all revenue had been recognized in 2017, (ii) IPTV revenue by RMB5.3 million (US\$0.8 million) in 2018 as we started to record revenues net of amounts we paid to third-party operators of IPTV games since August 1, 2018, and (iii) revenue from Song of Knight by RMB1.3 million (US\$0.2 million) as Song of Knight ceased operations in 2018.

**Online Game Services.** Our revenues from our online game services decreased by 76.8%, from RMB71.6 million in 2017 to RMB16.6 million (US\$2.4 million) in 2018. The decrease was primarily attributable to the decreases in (i) Firefall license revenue from System Link by RMB37.9 million (US\$5.5 million) as Firefall ceased operations and all revenue had been recognized in 2017, (ii) IPTV revenue by RMB5.3 million (US\$0.8 million) in 2018 as described below, and (iii) revenue generated from Song of Knight by RMB1.3 million (US\$0.2 million) as Song of Knight ceased operations in 2018.

Our revenues from TV games decreased by 30.8% from RMB17.2 million in 2017 to RMB11.9 million (US\$1.7 million) in 2018. The decrease was partly attributable to the change of the revenue recognition policy of the revenue from TV games. Previously, we recorded our IPTV revenue on a gross basis. As we became an agent in the operation of IPTV games since August 1, 2018, we started to record revenues net of amounts we paid to third-party operators, and such amount of fees were no longer included in our cost of revenue. As a result, we did not record any revenues from TV games after August 1, 2018.

**Other Revenues.** Revenues generated from other products and services decreased from RMB1.6 million in 2017 to RMB0.9 million (US\$0.1 million) in 2018, primarily due to a decrease in revenue generated by our education business conducted by The9 Education as we disposed The9 Education in January 2018.

**Cost of Revenue.** Cost of revenue decreased by 31.1% from RMB23.8 million in 2017 to RMB16.4 million (US\$2.4 million) in 2018, primarily due to (i) the decrease in payroll as a result of the optimization of our organizational structure in 2018, and (ii) the change of revenue recognition policy of IPTV revenues.

**Operating Expenses.** Operating expenses decreased by 35.0% from RMB163.0 million in 2017 to RMB106.0 million (US\$15.4 million) in 2018.

*Product Development Expenses.* Product development expenses decreased by 45.5% from RMB45.1 million in 2017 to RMB24.6 million (US\$3.6 million) in 2018. The decrease was primarily due to a decrease in salaries for the product development personnel as the headcount of product development personnel decreased.

*Sales and Marketing Expenses.* Sales and marketing expenses decreased by 74.6% from RMB9.1 million in 2017 to RMB2.3 million (US\$0.3 million) in 2018. The decrease in sales and marketing expenses was primarily due to a decrease in the salaries for the sales and marketing personnel and a decrease of marketing expenses.

*General and Administrative Expenses.* General and administrative expenses decreased by 17.6% from RMB108.8 million in 2017 to RMB89.6 million (US\$13.0 million) in 2018. The decrease was primarily due to a decrease in payroll-related expenses as a result of our cost control measures and a decrease in share-based compensation expenses.

*Gain on Disposal of Subsidiaries.* We recorded gain on disposal of subsidiaries of RMB10.5 million (US\$1.5 million) in 2018. The increase is mainly due to a gain from disposal of The9 Education completed in January 2018.

**Other Operating Income.** We had an other operating income of RMB0.2 million (US\$0.03 million) in 2018, including primarily office rental income. We had an other operating income of RMB0.3 million in 2017, including primarily office rental income.

**Impairment on Other Investment.** We recorded an impairment of other investment amounting of RMB7.8 million (US\$1.1 million) in 2018, primarily due to the decrease in the market value of our investments in Shanghai Ronglei, Plutux, Smartposting and Beijing Ti Knight. We recorded an impairment of other investment amounting to RMB9.1 million in 2017, primarily due to the decrease in the market value of our investment in Smartposting and Beijing Ti Knight.

**Interest Income.** Interest income increased from RMB0.03 million in 2017 to RMB0.2 million (US\$0.03 million) in 2018.

**Interest Expenses.** Interest expenses increased from RMB83.9 million in 2017 to RMB104.8 million (US\$15.2 million) in 2018, primarily due to the increase in accrued interest expenses on the Convertible Notes. The interest expenses of the Convertible Notes were calculated by using effective interest rate method.

**Fair Value of Change on Warrants.** We had a fair value of change on convertible bonds and warrants of RMB2.3 million (US\$0.3 million) in 2018, primarily due to a decrease in our share price as of December 31, 2018 compared to December 31, 2017.

**Gain (loss) on disposal of equity investee and available-for-sale investment.** We had no gain or loss on disposal of equity investee and available-for-sale investment in 2018. We recorded a gain on disposal of equity investee and available-for-sale investment of RMB0.1 million in 2017 in connection with the disposal our partial shareholding in L&A.

**Foreign exchange gain (loss).** We recorded foreign exchange loss of RMB20.3 million (US\$3.0 million) in 2018, as compared to foreign exchange gain of RMB19.2 million in 2017, primarily due to the appreciation of U.S. dollar against Renminbi in 2018.

**Other Income, Net.** We recorded other net income of RMB1.6 million (US\$0.2 million) in 2018, as compared to other net income of RMB4.7 million in 2017, primarily due to a decrease in government subsidies received in 2018.

***Recovery of equity investment in excess of cost.*** We did not record any recovery of equity investment in excess of cost in 2018, while we recorded recovery of equity investment in excess of cost of RMB60.5 million in 2017, which was non-recurring in nature.

***Net Loss Attributable to Holders of Ordinary Shares.*** Primarily as a result of the cumulative effect of the above factors, net loss attributable to our holders of ordinary shares increased from RMB175.3 million in 2017 to RMB258.0 million (US\$37.5 million) in 2018.

#### Year 2017 Compared to Year 2016

***Revenues.*** Our revenues increased by 30.1%, from RMB56.3 million in 2016 to RMB73.2 million in 2017, primarily due to the increase in revenues from the recognition of remaining unamortized Firefall licensing fees from System Link.

***Online Game Services.*** Our revenues from our online game services increased by 47.4%, from RMB48.6 million in 2016 to RMB71.6 million in 2017. The increase was primarily due to an increase in revenues from the recognition of remaining unamortized Firefall licensing fees from System Link of RMB33.4 million in 2017. Such increase was partially offset by the decrease in revenues due to the cease of operations of Firefall in the United States and Europe and Song of Knights in China in July 2017.

Our revenues from TV games decreased from RMB24.0 million in 2016 to RMB17.2 million in 2017. Unlike PC online games, our TV games are operated through telecommunication carriers and we do not maintain information relating to active users pursuant to our cooperation agreements with the telecom carriers.

**Other Revenues.** Revenues generated from other products and services decreased by 78.7% from RMB7.7 million in 2016 to RMB1.6 million in 2017, primarily due to a decrease in our revenues from providing technical training to college students on mobile application programming.

**Cost of Revenue.** Cost of revenue decreased by 51.0% from RMB48.5 million in 2016 to RMB23.8 million in 2017, primarily due to a decrease in amortization of intangible assets following an impairment of intangible assets and a decrease in IPTV cost in 2017.

**Operating Expenses.** Operating expenses decreased by 46.9% from RMB306.9 million in 2016 to RMB163.0 million in 2017.

**Product Development Expenses.** Product development expenses decreased by 42.2% from RMB78.0 million in 2016 to RMB45.1 million in 2017. The decrease was primarily due to a decrease in staff cost relating to research and a decrease in depreciation expenses of fixed assets and rental fees of Red 5 as Red 5 ceased the operation of Firefall in 2017 and had no business operations since then.

**Sales and Marketing Expenses.** Sales and marketing expenses decreased by 57.3% from RMB21.3 million in 2016 to RMB9.1 million in 2017. The decrease in sales and marketing expenses was primarily due to a decrease in expenses incurred for Firefall.

**General and Administrative Expenses.** General and administrative expenses decreased by 15.7% from RMB129.0 million in 2016 to RMB108.8 million in 2017. The decrease was primary due to a decrease in payroll-related expenses under our cost control measures and a decrease in agency fees and related charges for the pledge of L&A shares.

**Impairment on Intangible Assets.** We had impairment charges on certain intangible assets of RMB68.0 million and nil for the year ended December 31, 2016 and 2017, respectively.

**Impairment Loss on Goodwill.** We recorded impairment of goodwill of RMB10.6 million and nil for the year ended December 31, 2016 and 2017, respectively.

***Other Operating (Expenses) Income.*** We had an operating income of RMB0.3 million in 2017, including primarily office rental fee. We had an operating income of RMB3.6 million in 2016, including primarily IDC rental fee and office rental fee of RMB4.2 million, which were partially offset by the disposal of property, equipment and software of RMB0.6 million.

***Impairment on Available-for-sale Investment.*** We did not record impairment on available-for-sale investments in 2017. We recorded an impairment on available-for-sale investment of RMB244.8 million in 2016, primarily due to a decrease in the share price of L&A, which we classify as available-for-sale investment.

***Impairment on Other Investment.*** We recorded an impairment of other investment amounting to RMB9.1 million in 2017, primarily due to the decrease in the market value of our investment in Smartposting and Beijing Ti Knight. We recognized the impairment of RMB5.1 million and RMB4.0 million for Smartposting and Beijing Ti Knight, respectively, in 2017. We recorded an impairment of other investment amounting of RMB2.8 million in 2016, primarily due to a decrease in the market value of our investment in Tandem Fund II, L.P., or the Tandem Fund.

***Interest Income.*** Interest income decreased from RMB0.2 million in 2016 to RMB0.03 million in 2017, primarily due to a decrease in our bank cash deposits during 2017.

***Interest Expenses.*** Interest expenses increased from RMB56.5 million in 2016 to RMB83.9 million in 2017, primarily due to the increase in accrued interest expenses on the Convertible Notes.

***Fair Value of Change on Warrants.*** We had a fair value of change on convertible bonds and warrants of RMB12.6 million in 2017, primarily due to a decrease in our share price as of December 31, 2017 compared to December 31, 2016.

***Gain (loss) on disposal of equity investee and available-for-sale investment.*** We have disposed partial shareholding in L&A and recorded a gain on disposal of equity investee and available-for-sale investment of RMB0.1 million in 2017. We recorded a loss on disposal of equity investee and available for sale investment of RMB1.2 million in November 2016 in connection with the disposal of all of our equity interest in Crowdstar Inc., our equity investee, to a third-party investor.

***Foreign exchange gain (loss).*** We recorded foreign exchange gain of RMB19.2 million in 2017, as compared to foreign exchange loss of RMB13.1 million in 2016, primarily due to the depreciation of U.S. dollars against Renminbi in 2017.

***Other Income (Expenses), Net.*** We recorded other net income of RMB4.7 million in 2017, as compared to other net expenses of RMB3.2 million in 2016, primarily due to the government subsidies received in 2017.

***Recovery of equity investment in excess of cost.*** We recorded recovery of equity investment in excess of cost of RMB60.5 million in 2017, primarily related to the settlement payment of US\$25.0 million received due to the termination of the CrossFire 2 license agreement related to and the joint venture agreement entered into by and between Oriental Shiny and Smilegate. Oriental Shiny and Smilegate agreed to terminate the CrossFire 2 license agreement in October 2017, and a settlement agreement was entered into by and among Qihoo 360, Smilegate and us. Pursuant to the settlement agreement, the joint venture agreement between Oriental Shiny and Smilegate would be terminated subsequent to the settlement payments of an aggregate amount of US\$50.0 million by Smilegate. Smilegate later made settlement payments of US\$25.0 million to Qihoo 360 and us, respectively. During 2017, we offset our share of losses in System Link for 2017 against the compensation of US\$25.0 million from Smilegate and reduced our investment in System Link to nil. The remaining portion of the compensation, i.e. RMB60.5 million, was recorded as a gain as we have no further funding obligation to System Link or Oriental Shiny.

***Net Loss Attributable to Holders of Ordinary Shares.*** Primarily as a result of the cumulative effect of the above factors, net loss attributable to our holders of ordinary shares decreased from RMB676.7 million in 2016 to RMB175.3 million in 2017.

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

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

is entitled to determine the amount of payment.

We acknowledge that the PRC government imposes controls on the convertibility of the RMB into foreign currencies, and in certain cases, the remittance of currency out of China. However, under existing PRC foreign exchange regulations, payments of current account items, including profit distributions and trade and service-related foreign exchange transactions, can be made in foreign currencies without prior approval from SAFE, by complying with certain procedural requirements. Therefore, we are able to pay dividends in foreign currencies without prior approval from SAFE or designated banks. Approval from or registration with appropriate government authorities and authorized banks is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies.

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

Current PRC regulations restrict our affiliated entities and subsidiaries from paying dividends in the following two principal aspects: (i) our affiliated entities and subsidiaries in China are only permitted to pay dividends out of their respective accumulated profits, if any, determined in accordance with PRC accounting standards and regulations; and (ii) these entities are required to allocate at least 10% of their respective accumulated profits each year, if any, to fund certain capital reserves until the cumulative total of the allocated reserves reaches 50% of registered capital, and a portion of their respective after-tax profits to their staff welfare and bonus reserve funds as determined by their respective boards of directors. Although the statutory reserves can be used, among other ways, to increase the registered capital and eliminate future losses in excess of retained earnings of the respective companies, companies may not distribute the reserve funds as cash dividends except upon a liquidation of these subsidiaries. In addition, dividend payments from our PRC subsidiaries could be delayed as we may only distribute such dividends upon completion of annual statutory audits of the subsidiaries. As of December 31, 2018, such restricted portion was RMB8.2 million (US\$1.2 million). We have not directed our PRC subsidiaries or affiliated entities to distribute any dividends to-date.



The aggregate net assets as of December 31, 2016, 2017 and 2018, as reflected on our statutory accounts, including registered capital and statutory reserves, were approximately RMB76.1 million, RMB52.0 million and RMB42.4 million (US\$6.2 million) higher than the amounts determined under U.S. GAAP, respectively.

## Cash Flows and Working Capital

We fund our operations primarily through our available cash in hand as well as cash generated from our operating, financing and investing activities. As of December 31, 2016, 2017 and 2018, we had RMB38.9 million, RMB142.6 million and RMB4.3 million (US\$0.6 million), respectively, in cash and cash equivalents. The decrease in cash and cash equivalents from 2017 to 2018 was primarily due to the cash outflows from operating activities associated with our product development and sales and marketing efforts for our new games. The increase in cash and cash equivalents from 2016 to 2017 was primarily because we received US\$25.0 million settlement payment from one of our investees in 2017.

We have an accumulated deficit of approximately RMB3,233.1 million (US\$470.2 million) and total current liabilities exceeded total assets by approximately RMB743.7 million (US\$108.2 million) as of December 31, 2018. We also had a net loss of approximately RMB239.3 million (US\$34.8 million) for the year ended December 31, 2018, and have not generated significant revenues or positive cash flows from operations since 2009. We expect to continue to incur product development and sales and marketing expenses for licensed and proprietary new games in order to achieve revenue growth. To meet our capital needs, we have engaged and are considering multiple alternatives, including but not limited to debt financings, other financing transactions, launch new games and cost control, as discussed below. We may continue to incur losses, negative cash flows from operating activities and net current liabilities in the future. If we are not able to return to profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—We may continue to incur losses, negative cash flows from operating activities and net current liabilities in the future. If we are not able to return to profitability or raise sufficient capital to cover our capital needs, we may not continue as a going concern.”

## Launch of New Games

We have launched and plan to launch our proprietary mobile online games, including the CrossFire New Mobile Game, Audition, Q Jiang San Guo and Pop Fashion. In November 2017, we entered into an exclusive publishing agreement with a third-party company, pursuant to which this third-party company was granted an exclusive right to publish the CrossFire New Mobile Game and Audition in China. We have invested significant financial and personnel resources in development of our proprietary CrossFire New Mobile Game and we expect to launch this game in 2019.

## Issue of Tokens

In 2018, we stepped into the blockchain-related service market. We invested in several blockchain-related companies to conduct related services and development of blockchain-technology-enabled products. In January 2018, we have subscribed a total of 5,297,257 tokens at a consideration of US\$2.0 million from a third-party company and the tokens are expected to be issued in 2019.

## Other External Financing

We intend to obtain financial support from related parties in the future.

## Cost Control

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

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

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

Pursuant to the Convertible Note and Warrant Purchase Agreement dated November 24, 2015, on December 11, 2015, we issued and sold the Convertible Notes in the aggregate principal amount of US\$40,050,000 to Splendid Days Limited, or Splendid Days. We received net proceeds of US\$36,850,000 from the sale of the Convertible Notes. The Convertible Notes are divided into three tranches in principal amounts of US\$22,250,000, US\$13,350,000 and US\$4,450,000, respectively, which will be convertible at the option of the holder at any time into our ADSs at initial conversion prices of US\$7.8, US\$15.6 and US\$23.4 per ADS, each representing three ordinary shares, respectively, provided that at no time shall the holder convert any portion of the Convertible Notes if subsequent to such conversion such holder will hold more than 20% of the total outstanding and issued shares of our company. The Convertible Notes bear interest at a rate of 12% per year, payable when the principal amount of the Convertible Notes becomes due, and have initial terms of three years, subject to an extension for two years at the discretion of the holder. The initial conversion prices are subject to adjustments for share splits, reverse splits, share dividends and distributions, and certain issuances (or deemed issuances) of ordinary shares or ADSs for consideration less than the conversion price then in effect. In addition, the holder of the Convertible Notes is entitled to any extraordinary cash dividend (to the extent that it exceeds the accrued interest amount per share) and dividend in kind that we distribute based on the number of shares into which the Convertible Notes are then convertible. Following a “change of control,” as such term is defined in the Convertible Notes, the holder of the Convertible Notes will be entitled to require us to redeem all or part of the Convertible Notes, at a price payable in cash equal to 100% of the outstanding principal amount of the Convertible Notes, plus all accrued and unpaid interest thereon, if any. In addition, pursuant to the terms of the Convertible Notes, if there is a continuing event of default, the holder will be entitled to declare any of the Convertible Notes immediately due and payable, and request redemption by us at a price equal to the outstanding principal amount plus all accrued and unpaid interest thereon, if any. “Events of default” as defined in the Convertible Notes include, among other things, an event of default under any indebtedness in the amount exceeding US\$500,000.

Pursuant to the same agreement, on December 11, 2015, we issued to Splendid Days four tranches of warrants in an aggregate principal amount of US\$9,950,000. The Warrants are divided into four tranches in principal amounts of US\$5,000,000, US\$2,750,000, US\$1,650,000 and US\$550,000, respectively, which will be exercisable for our ADSs at the option of the holder at any time at initial exercise prices of US\$4.5, US\$7.8, US\$15.6 and US\$23.4 per ADS, each representing three ordinary shares, respectively. The initial exercise prices are subject to adjustments for share splits, reverse splits, share dividends and distributions, distribution of assets, certain issuances (or deemed issuances) of ordinary shares or ADSs for consideration less than the exercise price then in effect, as applicable for each warrant. In addition, the holder of the Warrants with initial exercise prices of US\$7.8, US\$15.6 and US\$23.4 per ADS, each representing three ordinary shares, is entitled to any cash dividend (to the extent that it exceeds the notional interest amount attributable to such Warrants) and dividend in kind that we distribute based on the number of shares into which the Warrants are then exercisable. The tranche of Warrants with an exercise price of US\$4.5 per ADS, each representing three ordinary shares, has a term of five years, while the remaining three tranches have initial terms of three years, which have expired as of the date of this annual report. We entered into a deed of settlement with Splendid Days, the holder of the Convertible Notes, in March 2019, pursuant to which the Convertible Notes should be repaid by May 31, 2019. The Convertible Notes are secured by a pledge of our 100% equity interests in two of our wholly-owned subsidiaries in China, including The9 Computer and C9I Shanghai, and a mortgage over our office building in Shanghai. We expect to repay the Convertible Notes by the proceeds from planned sale of the mortgaged properties. Pursuant to the agreement, we have registered the ordinary shares into which the Convertible Notes are convertible and the Warrants are exercisable on a registration statement on F-3, which was declared effective by the SEC on June 17, 2016.

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

	For the Year Ended December 31,			
	2016	2017	2018	
	RMB	RMB	RMB	US\$(1)
	(in thousands)			
Net cash used in operating activities	(179,768)	(86,652 )	(101,201)	(14,719)
Net cash (used in)/provided by investing activities	(9,985 )	161,923	(17,315 )	(2,518 )
Net cash provided by (used in) financing activities	190,092	44,073	(18,357 )	(2,670 )
Effect of foreign exchange rate changes on cash	(10,472 )	4,529	(1,495 )	(218 )
Cash reclassified as held for sale	—	(20,127 )	—	—
Net (decrease)/increase in cash and cash equivalents	(10,133 )	103,746	(138,368)	(20,125)
Cash and cash equivalents at beginning of year	49,011	38,878	142,624	20,744
Cash and cash equivalents at end of year	38,878	142,624	4,256	619

#### Operating Activities

Net cash used in operating activities was RMB101.2 million (US\$14.7 million) in 2018, compared to RMB86.7 million in 2017 and RMB179.8 million in 2016. The increase of net cash used in operating activities in 2018 was mainly due to an increase in cash outflow associated with blockchain business.

The net cash used in operating activities in 2018 primarily reflected a net loss of RMB239.3 million (US\$34.8 million), partially offset by the interest expense on Convertible Notes of RMB98.3 million (US\$14.3 million), provision for doubtful other receivables of RMB21.0 million (US\$3.1 million), impairment on equity and other investment of RMB9.2 million (US\$1.3 million), depreciation and amortization of property, equipment and software and land use right of RMB5.6 million (US\$0.8 million) and adjustments for share-based compensation expense of RMB3.9 million (US\$0.6 million).

The net cash used in operating activities in 2017 primarily reflected a net loss of RMB112.1 million, partially offset by the interest expense on convertible note of RMB77.0 million, recovery of equity investment in excess of cost of RMB60.5 million, adjustments for share-based compensation expense of RMB38.0 million, consulting fee paid by equity of RMB13.5 million, and depreciation and amortization of property, equipment and software and land use right of RMB7.2 million.

The net cash used in operating activities in 2016 primarily reflected a net loss of RMB667.1 million, partially offset by the impairment of available-for-sales investment of RMB244.8 million, adjustments for share-based compensation

expense of RMB28.1 million, impairment of intangible assets of RMB68.0 million, amortization of intangible assets of RMB10.2 million, and depreciation and amortization of property, equipment and software of RMB7.3 million.

#### Investing Activities

Net cash used in investing activities was RMB17.3 million (US\$2.5 million) in 2018, which primarily included (i) advance payment of US\$2.0 million to subscribe tokens of a third party, (ii) purchase of other investments of RMB5.3 million (US\$0.8 million), and (iii) proceeds from disposal of assets and liabilities held for sale of RMB2.8 million (US\$0.4 million).

Net cash provided by investing activities was RMB161.9 million in 2017, which primarily included (i) the settlement payment of US\$25.0 million from our investee in 2017, (ii) purchase of investment in Ti Knight Inc. of RMB4.0 million, (iii) loan receivable due from ZTE9 of RMB4.0 million, and (iv) proceeds from disposal of other investment in Tandem Fund of RMB1.2 million.

Net cash used in investing activities was RMB10.0 million in 2016, which primarily included (i) loan receivable due from ZTE9 of RMB2.8 million, (ii) capital expenditures including purchase of property, equipment, software and license of RMB8.3 million, partially offset by a dividend of RMB0.7 million from Tandem Fund.

## Financing Activities

Net cash used in financing activities in 2018 was RMB18.4 million (US\$2.7 million), primarily attributable to the repayment of RMB29.1 million (US\$4.2 million) of a loan from a related party, partially offset by a loan from a related party of RMB11.0 million (US\$1.6 million). Net cash provided by financing activities in 2017 was RMB44.1 million, primarily attributable to loans of RMB73.9 million, borrowed from related parties, contributions from noncontrolling interest of RMB20.0 million, partially offset by repayments on the bank loan of RMB25.5 million provided by Bank of Shanghai. Net cash provided by financing activities in 2016 was RMB190.1 million, primarily attributable to a loan of RMB79.2 million borrowed from a financial services company and secured by a pledge of shares of L&A, a bank loan of RMB25.0 million provided by Bank of Shanghai and loans of RMB60.0 million borrowed from related parties, partially offset by repayments on loans of RMB34.8 million from related parties. We also obtained funding for the development of CrossFire New Mobile Game through fund-raising on Inner Mongolia Culture Assets and Equity Exchange of RMB57.5 million in 2016.

As a result of non-renewal of WoW license on June 7, 2009, we announced a refund plan in connection with inactivated WoW game point cards. According to the plan, inactivated WoW game point card holders are eligible to receive a cash refund from us. We recorded a liability in connection with both inactivated points cards and activated but unconsumed point cards of approximately RMB200.4 million, of which RMB4.0 million was refunded in 2009. Upon the loss of the WoW license, we concluded that the nature of the obligation substantively changed from deferred revenue, for which we had the ability to satisfy the underlying performance obligation, to an obligation to refund players for their unconsumed points. Thus, we have accounted for this refund liability by applying the relevant de-recognition guidance when determining the proper accounting treatment. In accordance with this guidance, the refund liability associated with these WoW game points, to the extent not refunded, will be recorded as other operating income after we are legally released from the obligation to refund amounts under the applicable laws. As we announced the refund plan on September 7, 2009, the statute of limitations of the creditors (in this case the game players with claims for refund of inactivated WoW game point cards) to assert their claims for refund is two years from such date under applicable laws and thus our legal liability relating to the inactivated WoW game point cards was extinguished on September 7, 2011 and the associated liability amounting to RMB26.0 million was recognized as other operating income for the year ended December 31, 2011. With respect to the remaining refund liability, based on current PRC laws, to the extent not refunded, we, in consultation with legal counsel, have determined that we will be legally released from this liability in 2029, which represents 20 years from the date of discontinuation of WoW in 2009. However, if management were to publicly announce a refund policy, we would be legally released from any remaining liability for these activated, but unconsumed points, sooner than 20 years. To date, we have determined not to publicly announce any refund policy with respect to this remaining liability, and no refunds have been claimed. The remaining refund liability relating to the activated, but unconsumed WoW game points was RMB170.0 million (US\$24.7 million) as of December 31, 2018.

## Capital Expenditures

We incurred capital expenditures of RMB8.3 million, RMB0.5 million and RMB0.5 million in 2016, 2017 and 2018, respectively. The capital expenditures principally consisted of purchases of servers, computers and other items related to our network infrastructure. If we license new games or enter into strategic joint ventures or acquisitions, we may require additional funds for necessary capital expenditures.

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

Our research and development efforts are primarily focused on the development of our proprietary online games and the maintenance of our websites. Our research and development expenses were RMB78.0 million, RMB45.1 million and RMB24.6 million (US\$3.6 million) in 2016, 2017 and 2018, respectively.



D. Trend Information

Except as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from January 1, 2018 to December 31, 2018 that are reasonably likely to have a material adverse effect on our net sales or revenues, results of operations, profitability, liquidity or capital resources, or that would cause the reported financial information not necessarily to be indicative of future operating results or financial conditions.

E. Off-Balance Sheet Arrangements

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third-parties. We have not entered into any off-balance sheet derivative instruments. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

F. Tabular Disclosures of Contractual Obligations

The following table sets forth our contractual obligations and other commitments under as of December 31, 2018:

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(in thousands of RMB)				
Short-term borrowings <sup>(1)</sup>	112,461	112,461	—	—	—
Convertible notes payable <sup>(2)</sup>	274,871	274,871	—	—	—
Interest expense on short-term borrowings	118,872	118,872	—	—	—
Total	506,204	506,204	—	—	—

## Notes:

Short-term borrowings include (i) a pledged loan of RMB80.8 million (US\$11.8 million) from a financial services (1) company, (ii) loan of approximately RMB31.6 million (US\$4.6 million) obtained from a third party, all of which is due within one year and is reclassified to short-term bank borrowings.

Represents the Convertible Notes in an aggregate principal amount of US\$40,050,000 which bear interest at a rate of 12% per year, payable when the principal amount of the Convertible Notes becomes due. The Convertible Notes (2) have initial terms of three years, subject to an extension to five years at the discretion of the holder. In March 2019, we entered into a deed of settlement with Splendid Days, the holder of the Convertible Notes, pursuant to which the Convertible Notes should be repaid by May 31, 2019.

G. Safe Harbor

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

- our ability to return to profitability or raise sufficient capital to cover our capital needs;
- our ability to successfully launch and operate additional games in China and overseas;
- our ability to develop, license or acquire additional online games that are attractive to users;
- the maintenance and expansion of our relationships with game distributors and online game developers, including our existing licensors;

- our ability to maintain and expand our relationships with joint venture partners and other business partners;
- our ability to develop blockchain related service business;
- uncertainties in and the timeliness of obtaining necessary governmental approvals and licenses for operating any new online game;
- risks inherent in the online game business;
- risks associated with our future acquisitions and investments;
- our ability to compete effectively against our competitors;
- risks associated with our corporate structure and the regulatory environment in China; and
- other risks outlined in our filings with the SEC including this annual report on Form 20-F.

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

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

## Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. Directors and Senior Management

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

<b>Directors and Executive Officers</b>	<b>Age</b>	<b>Position/Title</b>
Jun Zhu	52	Director, Chairman of the Board and Chief Executive Officer
Davin A. Mackenzie <sup>(1)(2)</sup>	58	Independent Director
Kwok Keung Chau <sup>(1)(2)</sup>	42	Independent Director
Ka Keung Yeung <sup>(1)(2)</sup>	59	Independent Director
George Lai (Lai Kwok Ho)	42	Director and Chief Finance Officer
Arthur Lau	37	President
Chris Shen	50	Vice President

Notes:

(1) Member of Audit Committee.

(2) Member of Compensation Committee.

#### Biographical Information

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

**Davin A. Mackenzie** has served as our independent director since July 2005. Mr. Mackenzie is currently the General Manager of Greater China for Scape, a developer and operator of purpose-build student accommodation, and the Managing Director – Asia Pacific for the Madison Sports Group, the promoter of the Six Day series of track cycling events. Mr. Mackenzie was a consultant of Spencer Stuart Beijing Office, a renowned global executive search company, from 2012 to 2016. Currently, he serves as a director of Mountain Hazelnut Ventures, a private agricultural company. From 2009 to 2011, Mr. Mackenzie was the Beijing representative of Brocade Capital Limited, a private equity advisory firm that he founded in 2009. From 2008 to 2009, Mr. Mackenzie was the managing director and Beijing representative of Arctic Capital Limited, a pan-Asia private equity advisory firm. Between 2000 and 2008, Mr. Mackenzie held the same positions in Peak Capital LLC, another private equity investment and advisory firm that focuses on the China market. Prior to Peak Capital, Mr. Mackenzie worked with the International Finance Corporation, a private sector arm of The World Bank Group, for seven years, including four years as the resident representative for China and Mongolia. Mr. Mackenzie has also worked at Mercer Management Consultants in Washington, D.C., and at First National Bank of Boston in Taiwan. Mr. Mackenzie received a bachelor's degree in Government from Dartmouth College. He received a master's degree in international studies and an MBA degree from the Wharton School of Business at the University of Pennsylvania. Mr. Mackenzie has also completed the World Bank Executive Development Program at Harvard Business School.

**Kwok Keung Chau** has served as our independent director since October 2015. Mr. Chau is an executive director, the chief financial officer and the company secretary of Comtec Solar Systems Group Limited (HKEx: 00712), responsible for corporate financial and general management. Currently, he also serves as an independent non-executive director and the chairman of the audit committee of Qingdao Port International Co., Ltd. (HKEx: 06198) and an independent non-executive director and the chairman of the audit committee of China Xinhua Education Group Limited (HKEx: 02779). He acted as a member of supervisory board of RIB Software AG, a software company in Germany, which was listed in Frankfurt Stock Exchange, from May 2010 to June 2013. Prior to joining Comtec Solar in November 2007, Mr. Chau served in various positions at China.com Inc., a Hong Kong listed company (Stock Code: 8006) from October 2005 to October 2007, including vice president of the finance department, chief financial officer, company secretary and authorized representative. Prior to joining China.com Inc., Mr. Chau served as the deputy group financial controller of China South City Holdings Limited, a Hong Kong listed company (Stock Code: 1668) from August 2003 to April 2005. Before that, he served as the financial controller of Shanghai Hawei New Material and Technology co., Ltd. from June 2002 to August 2003. Mr. Chau has been a fellow member of the Association of Chartered Certified Accountants since June 2002, a member of the Hong Kong Institute of Certified Public Accountants since July 2005 and a Chartered Financial Analyst of the CFA Institute since September 2003. Mr. Chau received his bachelor's degree in business administration from the Chinese University of Hong Kong in May 1998.

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

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

**Arthur Lau** has served as our president since January 2018. Mr. Lau is currently the co-founder and partner of Ark Pacific Capital Management, a multi-strategy alternative asset manager focusing in Greater China, and also served as the directors of multiple portfolio companies. Prior to that, he was an investment director of Elliott Advisors, the Asian office of Elliott Associates, a global hedge fund managing over US\$30 billion of assets. Before that, Mr. Lau was a technology, media and telecom investment banker at Citigroup and an investment banker at JPMorgan. Mr. Lau graduated from The London School of Economics and Political Science with a Bachelor of Laws degree and holds a Master of Economics degree from The University of Hong Kong.

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

## **B. Compensation**

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

In 2018, the aggregate cash compensation paid to our executive officers was approximately RMB4.8 million (US\$0.7 million). We paid a total of RMB1.0 million (US\$0.1 million) in cash to our non-executive directors for their services in 2018. In addition, in September 2018, we issued 30,000,000 ordinary shares in the form of restricted shares to our directors, employees and consultant in accordance with our stock option plan. Simultaneous with the new grants, options to purchase 6,200,000 ordinary shares by certain grantees were cancelled. In January 2019, we forfeited and cancelled 15,000,000 ordinary shares in aggregate in the form of restricted shares held by relevant directors, employees and consultant. Those incentive shares are subject to a six-month lock-up period and will vest in installments upon the satisfaction of certain service period conditions of the grantees. No director or executive officer is entitled to any severance benefits upon termination of his or her employment with or appointment by our company.

### **Share Incentive Plan**

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

Our board of directors and our shareholders have adopted and approved the 2004 Stock Option Plan, as amended and restated, or the Option Plan, in order to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentives to employees, directors and consultants and to promote the success of our business. The Option Plan was amended and restated in December 2006, November 2008, August 2010, November 2010, November 2015, August 2016, June 2017 and December 2018. By the amendment to the Option Plan in December 2018, we increased the total number of ordinary shares reserved under the Option Plan from 34,449,614 to 100,000,000. As of February 28, 2019, options to purchase 1,050,000 ordinary shares under the Option Plan were outstanding and 15,000,000 restricted shares were issued. In September 2018 our board granted an aggregate amount of 30,000,000 restricted shares to our directors, officers and consultant. In exchange for such restricted shares grant, we forfeited and cancelled the stock options in the total amount of 6,200,000 shares previously

granted to our directors in January 2018. In January 2019, our board of directors approved to forfeited and cancel 15,000,000 out of 30,000,000 restricted shares previously granted. The following table provides a summary of the options and restricted shares granted to our directors, executive officers and other individuals as a group under the Option Plan as of February 28, 2019 and that remained outstanding.

	Restricted Shares Outstanding	Total Number of Ordinary Shares Underlying Options	Exercise Price (in US\$)	Expiration Date
Jun Zhu	7,500,000	—	—	March 4, 2021
Davin Alexander Mackenzie	*	—	—	—
Kwok Keung Chau	*	—	—	—
Ka Keung Yeung	*	—	—	—
George Lai	1,500,000	—	—	March 4, 2021
Arthur Lau	—	*	0.93	January 24, 2023
Chris Shen	—	—	—	—
All Directors and Senior Executive Officers as a Group				
Restricted Shares	9,900,000	—	—	March 4, 2021
Options	—	*	0.93	January 24, 2023
Other Individuals as a Group (other than those listed above)	5,100,000	*	0.93	January 24, 2023

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



*Types of Awards.* The Option Plan permits the awards of options, stock purchase rights, restricted shares and restricted share units.

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

*Award Agreement.* Awards granted under our Option Plan are evidenced by an award agreement that contains, among other things, terms, conditions and limitations for each award, which may include the term of the award, the provisions concerning exercisability and forfeiture upon termination of employment or consulting arrangements, as determined by our board.

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

*Vesting Schedule.* In general, the plan administrator determines the vesting schedule, which is specified in the relevant award agreement.

*Exercise of Options.* The plan administrator determines the exercise price for each award, which is stated in the award agreement. The vested portion of option will expire if not exercised prior to the time as the plan administrator determines at the time of its grant.

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

*Changes in Capitalization and Other Adjustments.* If we shall at any time increase or decrease the number of outstanding shares, or change in any way the rights and privileges of our outstanding shares, by means of a payment or a stock dividend or any other distribution upon such ordinary shares, or through a stock split, subdivision, consolidation, combination, reclassification or recapitalization involving such ordinary shares, then in relation to the

ordinary shares that are covered by the awards granted or available under the plan and are affected by one or more of the above events, the number, rights and privileges shall be increased, decreased or changed in like manner as if such ordinary shares had been issued and outstanding, fully paid and non-assessable at the time of such occurrence.

*Termination of Plan.* Unless terminated earlier, our Option Plan will expire in 2038. Our board of directors has the authority to amend, alter, suspend or terminate our Option Plan. However, no such action may (i) impair the rights of any grantee unless agreed by the grantee and the stock option plan administrator, or (ii) affect the stock option plan administrator's ability to exercise the powers granted to it under our Option Plan.

### C. Board Practices

#### Board of Directors

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

## Committees of the Board of Directors

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

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

- selecting the independent auditors and pre-approving all auditing and non-auditing services permitted to be performed by the independent auditors;
- reviewing and approving all proposed related party transactions;
- discussing the annual audited financial statements with management and the independent auditors;
- annually reviewing and reassessing the adequacy of our audit committee charter;
- meeting separately and periodically with management and the independent auditors;
- reporting regularly to the full board of directors; and
- such other matters that are specifically delegated to our audit committee by our board of directors from time to time.

**Compensation Committee.** Our compensation committee consists of Messrs. Kwok Keung Chau, Davin A. Mackenzie and Ka Keung Yeung, all of whom meet the “independence” standards for compensation committee members under the Nasdaq Rules. The compensation committee assists the board in reviewing and approving the compensation structure of our executive officers, including all forms of compensation to be provided to our executive officers. The compensation committee will be responsible for, among other things:

- reviewing and determining the compensation for our five most senior executives;

- reviewing the compensation of our other employees and recommending any proposed changes to the management;

- reviewing and approving director and officer indemnification and insurance matters;

- reviewing and approving any employee loans in an amount equal to or greater than US\$60,000 (or such amount as from time to time announced by the relevant regulatory bodies as requiring the approval of the Committee); and

- reviewing periodically and approving any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pensions and welfare benefits plans.

#### Duties of Directors

Under Cayman Islands law, our directors owe to our company have fiduciary duties, including a duty of loyalty, a duty to act honestly and a duty to act in what they consider in good faith to be in our best interests. Our directors must also exercise their powers only for a proper purpose. Our directors also owe to our company a duty to act with care and diligence that a reasonably prudent person would exercise in comparable circumstances and a duty to exercise the skill they actually possess. It was previously considered that a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. However, English and Commonwealth courts have moved towards an objective standard with regard to the required skill and care and these authorities are likely to be followed in the Cayman Islands. In fulfilling their duty of care to us, our directors must ensure compliance with our memorandum and articles of association, as amended and restated from time to time. We have the right to seek damages if a duty owed by our directors is breached.

## Terms of Directors

Our board of directors is currently divided into three classes with different terms. This provision would delay the replacement of a majority of our directors and would make changes to the board of directors more difficult than if such provision were not in place. Our independent directors, namely Kwok Keung Chau, Davin A. Mackenzie and Ka Keung Yeung, were re-elected (elected in the case of Kwok Keung Chau) at our 2018 annual general meeting and each of them is serving a three-year term until the 2021 annual general meeting or until his successor is duly elected and qualified, whichever is earlier. Jun Zhu, our chairman and chief executive officer, was re-elected as a director at our 2016 annual general meeting and is serving a three-year term until the 2019 annual general meeting or until his successor is duly elected and qualified, whichever is earlier. George Lai, our chief financial officer and director, was re-elected as a director at our 2018 annual general meeting and is serving a three-year term until the 2021 annual general meeting or until his successor is duly elected and qualified, whichever is earlier. Upon expiration of the term of office of each class, succeeding directors in each class will be elected for a term of three years. Directors may be removed from office by ordinary resolution of shareholders at any time before the expiration of his/her term. Pursuant to the natural expiration of the directorial terms, elections for directors would be held on the date of the annual general meeting of shareholders.

## D. Employees

As of December 31, 2018, we had 105 employees, of which 103 were based in China, including 42 in management and administration, 4 in our customer service centers, 13 in game operations, sales and marketing, and 44 in product development, including supplier management personnel and technical support personnel, and two were based in the United States. We had 354 and 236 employees as of December 31, 2016 and 2017, respectively. The decrease in the number of employees as of December 31, 2018 as compared to that of December 31, 2017 was primarily due to our business restructuring. We consider our relations with our employees to be good.

## E. Share Ownership

As of February 28, 2019, there were 133,355,358 ordinary shares outstanding.

The following table sets forth information with respect to the beneficial ownership of our ordinary shares as of February 28, 2019 by:

- each of our directors and executive officers who are also our shareholders; and

each person known to us to own beneficially more than 5% of our ordinary shares.

	Ordinary Shares Beneficially Owned	
	Amount <sup>(1)</sup>	% <sup>(2)</sup>
Directors and Executive Officers:		
Jun Zhu <sup>(3)</sup>	21,483,530	16.1
Davin A. Mackenzie	*	*
Kwok Keung Chau	*	*
Ka Keung Yeung	*	*
George Lai (Lai Kwok Ho) <sup>(4)</sup>	1,500,000	1.1
Arthur Lau	—	—
Chris Shen	*	*
All Directors and Senior Executive Officers as a Group <sup>(5)</sup>	24,257,990	18.2
Principal Shareholders:		
Plutux Labs Limited <sup>(6)</sup>	21,000,000	15.7
Leading Choice Holdings Limited <sup>(7)</sup>	21,000,000	15.7
Splendid Days Limited <sup>(8)</sup>	15,028,844	10.1
IE Limited <sup>(9)</sup>	12,500,000	9.4
Incsight Limited <sup>(3)(10)</sup>	7,019,428	5.3

Notes:

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

Beneficial ownership is determined in accordance with the rules of the SEC, and includes voting or investment power with respect to the securities. In computing the number of shares beneficially owned by a person and the (1) percentage ownership of that person, we have included shares that the person has the right to acquire within 60 days of February 28, 2019, including through the exercise of any option, warrant or other right or the conversion of any other security.

Percentage of beneficial ownership is based on 133,355,358 ordinary shares outstanding as of February 28, 2019, (2) as well as the shares underlying share options and warrants exercisable by such person or group within 60 days from February 28, 2019.

Includes (i) 6,107,334 ordinary shares and 912,094 ordinary shares represented by ADSs held by Incisight Limited, (3) a British Virgin Islands company wholly owned and controlled by Jun Zhu, and (ii) 7,500,000 ordinary shares in the form of restricted shares and 6,964,102 ordinary shares represented by ADSs held by Jun Zhu.

(4) Includes 1,500,000 ordinary shares in the form of restricted shares held by George Lai.

(5) Includes ordinary shares, ordinary shares represented by ADSs, restricted shares and ordinary shares issuable upon exercise of options held by all of our directors and executive officers as a group.

Includes 21,000,000 ordinary shares held by Plutux Labs Limited, as reported by Plutux Labs Limited on the (6) Schedule 13G filed with the SEC on September 13, 2018. The address for Plutux Labs Limited is 4<sup>th</sup> Floor, Harbour Place, 103 South Church Street, Grand Cayman KY1-1002, Cayman Islands.

Includes 21,000,000 ordinary shares held by Leading Choice Holdings Limited. The address for Leading Choice (7) Holdings Limited is Unit 1005, 10/F, tower A, New Mandarin Plaza, 14 Science Museum Road, Tsim Sha Tsui, Hong Kong.

Includes an aggregate 11,695,511 ordinary shares issuable upon conversion of the Convertible Notes and an aggregate 3,333,333 ordinary shares issuable upon exercise of the Warrants within 60 days of February 28, 2019 that are beneficially owned by Splendid Days Limited, or Splendid Days. Splendid Days currently holds all of the (8) Convertible Notes and the Warrants that we issued in December 2015, and it may not convert any portion of the Convertible Notes if subsequent to such conversion it will hold more than 20% of our total outstanding and issued ordinary shares. Splendid Days Limited is controlled by Truth Beauty Limited, a British Virgin Islands company, which is in turn controlled by Cyrus Jun-Ming Wen. The address for Splendid Days Limited is Sea Meadow House, Blackburne Highway, (P.O. Box 116), Road Town, Tortola, British Virgin Islands.

Includes 12,500,000 ordinary shares held by IE Limited, as reported by IE Limited on the Schedule 13G filed with (9) the SEC on February 9, 2018. The address for IE Limited is 7th Floor, Revesant Building, 6 Bongeunsa-ro 86-gil, Gangnam-gu, Seoul, Korea.

Includes 6,107,334 ordinary shares and 912,094 ordinary shares represented by ADSs held by Incisight Limited, a British Virgin Islands company wholly owned and controlled by Jun Zhu, reported by Incisight Limited on the (10) Schedule 13D/A filed with the SEC on February 4, 2019. The business address for Incisight Limited is Building No. 3, 690 Bibo Road, Zhangjiang Hi-Tech Park, Pudong New Area, Shanghai 201203, People's Republic of China.

To our knowledge, as of February 28, 2019, 52,916,595 ordinary shares, or approximately 39.7% of the issued and outstanding shares, were held by one record shareholder in the United States, namely, The Bank of New York Mellon, our ADS depository. The number of beneficial owners of our ADSs in the United States is likely to be much larger than the number of record holders of our ordinary shares in the United States.

None of our shareholders has different voting rights from other shareholders as of the date of this annual report. We are currently not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

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

B. Related Party Transactions

Arrangements with Affiliated PRC Entities

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

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



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

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

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

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

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

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

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

In February 2013, we established a new joint venture, namely ZTE9, in cooperation with Shanghai Zhongxing Communication Technology Enterprise Co., Ltd. and Shanghai Ruigao Information Technology Co., Ltd., in Wuxi, Jiangsu province of China, to develop and operate home entertainment set top box business. In February 2014, Guangdong Hongtu Guangdian Investment Limited Company made a capital investment of RMB12.5 million to acquire 10% equity interests in ZTE9. As of December 31, 2018, we held 26.0% equity interest in ZTE9. ZTE9 charged net royalty and other service fee related to IPTV business to us in an amount of RMB13.0 million, RMB7.1 million and RMB5.2 million (US\$0.8 million) in 2016, 2017 and 2018, respectively. We provided IPTV related advertising service to ZTE9 in an amount of RMB0.5 million, nil and nil in 2016, 2017 and 2018, respectively. Total amount due to ZTE9 for IPTV business was RMB16.8 million, RMB2.7 million and RMB5.1 million (US\$0.7 million) as of December 31, 2016, 2017 and 2018, respectively.

In 2016, 2017 and 2018, we lent RMB2.8 million, RMB4.0 million and RMB0.6 million (US\$0.1 million) to ZTE9 to fund its operations, respectively. The loans are interest-free. As of December 31, 2016, 2017 and 2018, total outstanding amount for loan due from ZTE9 was RMB12.7 million, RMB2.1 million and RMB1.0 million (US\$1.0 million), respectively.

In 2014, we entered into a license agreement with System Link, a 50% joint venture of us, for publishing and operating Firefall for a five-year term in China. Under this license agreement, System Link should pay to Red 5 and Red 5 Singapore licensing fees and royalties in an aggregate amount of at least US\$160.0 million during the term of the agreement. In 2015, System Link paid US\$10.0 million to us as licensing fees. We recorded the US\$10.0 million as amount due to the related party and was to amortize the amount over the five-year period. System Link has become

dormant since the cessation of Firefall in March 2016 and the termination of the licensing arrangement of CrossFire 2 in November 2017. As Red 5 is no longer required to render any services to System Link in relation to Firefall, Red 5 recognized the remaining unamortized licensing fees for Firefall as revenues in 2017. The balance due to System Link was nil as of December 31, 2017 and 2018, respectively. We recognized licensing revenue of RMB13.6 million and RMB51.1 million for the years ended December 31, 2016 and 2017, respectively.

In 2016, we charged service fee, including IDC rental fee, office rental fee and etc., to Big Data (previously known as Jiucheng Advertisement) amounted to RMB4.5 million and the service fee was paid in 2016. In 2017, the service fee amounted to RMB0.1 million.

In 2016, Asian Way entered into a license agreement with T3, an equity investee of us, for developing a game using augmented reality (AR) technologies based on the intellectual property relating to the game Audition. Upon commercial launch, Asian Way will share certain percentages of revenues of the game to T3. The game is still under development as of December 31, 2018.

In 2017, we entered into a share purchase agreement with IncSight Limited, which is controlled by Mr. Jun Zhu, our chairman and chief executive officer. Pursuant to this agreement, Mr. Jun Zhu will acquire 12,500,000 newly issued shares of us for a total cash consideration of US\$15.0 million. The transaction was terminated in February 2019 and the previously issued shares were surrendered and cancelled.

In 2017, we entered into a share purchase agreement with Ark Pacific Special Opportunities Fund I, L.P., which beneficially owns more than 10% of share capital in our company. Pursuant to this agreement, Ark Pacific Special Opportunities Fund I, L.P. will acquire 12,500,000 newly issued shares of us for a total cash consideration of US\$15.0 million. The transaction was terminated in February 2019 and the previously issued shares were surrendered and cancelled.

#### Loan from Related Parties

Mr. Jun Zhu, the chairman and chief executive officer, extended aggregate of RMB60.0 million, RMB73.9 million and RMB11.0 million (US\$1.6 million) in loan to us in 2016, 2017 and 2018, respectively. The loans are interest-free. As of December 31, 2016, 2017 and 2018, RMB25.2 million, RMB75.2 million and RMB57.1 million (US\$8.3 million) of such loan remained outstanding, respectively.

#### Stock Option Grants

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

#### C. Interests of Experts and Counsel

Not applicable.

### Item 8.

### FINANCIAL INFORMATION

#### A. Consolidated Statements and Other Financial Information

We have appended consolidated financial statements filed as part of this annual report.

#### Legal Proceedings

Red 5 and its affiliates are currently in dispute with Qihoo 360 and its affiliates regarding System Link and Firefall and various legal proceedings have been initiated and are ongoing in connection with such dispute. See “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—Our equity investments or establishment of joint ventures and any material disputes with our investment or joint venture partners may have an adverse effect on our financial results, business prospects and our ability to manage our business.” Other than the foregoing, we are not currently a party to any material litigation or other legal proceeding.

#### Dividend Policy

We currently intend to retain most, if not all, of our available funds and any future earnings for use in the operation of our business. Our board of directors has discretion as to whether we will distribute dividends in the future, subject to applicable laws. In addition, our shareholders may by ordinary resolution declare a dividend, but no dividend may exceed the amount recommended by our board of directors. Even if our board of directors determines to distribute dividends, the form, frequency and amount of our dividends will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions, legal restrictions and other factors as the board of directors may deem relevant. Any dividend we declare will be paid to the holders of ADSs, subject to the terms of the deposit agreement, to the same extent as holders of our ordinary shares, less the fees and expenses payable under the deposit agreement. Any dividend we declare will be distributed by the depositary bank to the holders of our ADSs. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

#### B. Significant Changes

Except as otherwise disclosed in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

Item 9.

THE OFFER AND LISTING

A. Offer and Listing Details

Our ADSs, each currently representing three ordinary shares, are listed on the Nasdaq Capital Market. Our ADSs are traded under the symbol “NCTY.” Our ADSs had been listed on the Nasdaq Global Market from December 15, 2004 to October 2018. Effective May 9, 2018, we effected a change of the ratio of the ADSs to ordinary shares from one ADS representing one ordinary share to three ordinary shares. In October 2018, we transferred our listing venue to the Nasdaq Capital Market.

B. Plan of Distribution

Not applicable.

C. Markets

Our ADSs, each representing three ordinary shares, have been listed on the Nasdaq Capital Market since October 2018 and previously Nasdaq Global Market since December 15, 2004 under the symbol “NCTY.”

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

Item 10.

ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We are an exempted company incorporated in the Cayman Islands and our affairs are governed by our memorandum and articles of association and the Companies Law (2018 Revision) of the Cayman Islands, which is referred to as the Companies Law below.

As of the date of this annual report, our authorized share capital is US\$3,500,000, consisting of 350,000,000 ordinary shares, par value of US\$0.01 each. The following are summaries of material provisions of our currently effective amended and restated memorandum and articles of association and the Companies Law insofar as they relate to the material terms of our ordinary shares.

Ordinary Shares

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

**Dividends.** The holders of our ordinary shares are entitled to such dividends as may be declared by our board of directors. In addition, our shareholders may declare dividends by ordinary resolution, but no dividend shall exceed the amount recommended by our directors. Under the laws of the Cayman Islands, our company may pay a dividend out of either profit or share premium account, provided that in no circumstances may a dividend be paid if this would result in our company being unable to pay its debts as they fall due in the ordinary course of business.



***Voting Rights.*** Each ordinary share is entitled to one vote on all matters upon which the ordinary shares are entitled to vote. Voting at any meeting of shareholders is by show of hands unless a poll is demanded. A poll may be demanded by one or more shareholders together holding not less than ten percent of the paid up voting share capital, present in person or by proxy.

A quorum required for a meeting of shareholders consists of holders of not less than one-third of all issued and outstanding shares entitled to vote. The Company shall, if required by the Companies Law, in each year hold a general meeting as its annual general meeting and shall specify the meeting as such in the notices calling it. The Company may hold an annual general meeting but shall not (unless required by the Companies Law) be obliged to hold an annual general meeting. Annual general meetings and extraordinary general meetings may be convened by our board of directors on its own initiative. Extraordinary general meetings shall be convened by our board of directors upon a request to the directors by shareholders holding in aggregate not less than 33% of our voting share capital. Advance notice of at least seven business days is required for the convening of our annual general meeting and extraordinary general meetings.

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

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

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

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

to forfeiture.

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

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

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

#### Differences in Corporate Law

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

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

a “merger” means the merging of two or more constituent companies and the vesting of their undertaking, property and liabilities in one of such companies as the surviving company; and

a “consolidation” means the combination of two or more constituent companies into a consolidated company and the vesting of the undertaking, property and liabilities of such companies to the consolidated company.

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

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

The plan of merger or consolidation must be filed with the Registrar of Companies together with a declaration as to the solvency of the consolidated or surviving company, a declaration as to the assets and liabilities of each constituent company and an undertaking that a copy of the certificate of merger or consolidation will be given to the members and creditors of each constituent company that notification of the merger or consolidation will be published in the Cayman Islands Gazette. Save in certain limited circumstances, a shareholder of a Cayman constituent company who dissents from the merger or consolidation is entitled to payment of the fair value of his shares (which, if not agreed between

the parties, will be determined by the Cayman Islands court) upon dissenting to the merger or consolidation, provided the dissenting shareholder complies strictly with the procedures set out in the Companies Law. The exercise of dissenter rights will preclude the exercise by the dissenting shareholder of any other rights to which he or she might otherwise be entitled by virtue of holding shares, save for the right to seek relief on the grounds that the merger or consolidation is void or unlawful. The fair value of the shares will be determined by the Cayman Islands court if it cannot be agreed among the parties. Court approval is not required for a merger or consolidation which is effected in compliance with these statutory procedures.

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

the statutory provisions as to majority vote have been met;

the shareholders have been fairly represented at the meeting in question and the statutory majority are acting bona fide without coercion of the minority to promote interests adverse to those of the class;

the arrangement is such that may be reasonably approved by an intelligent and honest man of that class acting in respect of his interest; and

the arrangement is not one that would more properly be sanctioned under some other provision of the Companies Law.

The Companies Law also contains a statutory power of compulsory acquisition which may facilitate the “squeeze out” of dissentient minority shareholder upon a tender offer. When a tender offer is made and accepted by holders of 90% of the shares affected within four months, the offeror may, within a two month period commencing on the expiration of such four month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the Grand Court of the Cayman Islands but this is unlikely to succeed in the case of an offer which has been so approved unless there is evidence of fraud, bad faith or collusion.

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

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

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

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

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

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

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

**Removal of Directors.** Under the Delaware General Corporation Law, a director of a corporation may be removed with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. Under our articles of association, directors can be removed with or without cause, by an ordinary resolution of our shareholders. In addition, a director's office shall be vacated if the director (i) becomes bankrupt or makes any arrangement or composition with his creditors; (ii) is found to be or becomes of unsound mind; (iii) resigns his office by notice in writing to the company; (iv) without special leave of absence from our board of directors, is absent from meetings of the board for six consecutive months and the board resolves that his office be vacated or; (v) is removed from office pursuant to any other provisions of our memorandum and articles of association or the Companies Law.

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

Cayman Islands law has no comparable statute. As a result, we cannot avail ourselves of the types of protections afforded by the Delaware business combination statute. However, although Cayman Islands law does not regulate transactions between a company and its significant shareholders, it does provide that such transactions must be entered

into bona fide in the best interests of the company and for a proper corporate purpose and not with the effect of constituting a fraud on the minority shareholders.

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

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



***Amendment of Governing Documents.*** Under the Delaware General Corporation Law, a corporation's governing documents may be amended with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. As permitted by Cayman Islands law, our memorandum and articles of association may be amended by a special resolution of our shareholders.

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

- authorize our board of directors to issue preference shares in one or more series and to designate the price, rights, preferences, privileges and restrictions of such preference shares without any further vote or action by our shareholders; and

- create a classified board of directors pursuant to which our directors are elected for staggered terms, which means that shareholders can only elect, or remove, a limited number of directors in any given year.

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

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

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

#### C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in “Item 4. Information on the Company” or elsewhere in this annual report.

D. Exchange Controls

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

E. Taxation

Cayman Islands Taxation

In the opinion of our Cayman Islands counsel, Maples and Calder (Hong Kong) LLP, the Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. No Cayman Islands stamp duty will be payable unless an instrument is executed in, or after execution, brought into, or produced before a court of the Cayman Islands. The Cayman Islands is not party to any double tax treaties which are applicable to payments made to or by our company. There are no exchange control regulations or currency restrictions in the Cayman Islands.

Payments of dividends and capital in respect of the shares will not be subject to taxation in the Cayman Islands and no withholding will be required on the payment of a dividend or capital to any holder of the Shares, nor will gains derived from the disposal of the shares be subject to Cayman Islands income or corporation tax.

## People's Republic of China Taxation

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

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

## U. S. Federal Income Taxation

The following discussion is a summary of U.S. federal income tax considerations to U.S. Holders (as defined below) relating to the ownership and disposition of the ADSs or ordinary shares. This discussion applies only to U.S. Holders of the ADSs or ordinary shares as “capital assets” (generally, property held for investment). This discussion is based on the tax laws of the United States in effect as of the date of this annual report and on U.S. Treasury regulations in effect or, in some cases, proposed as of the date of this annual report, as well as judicial and administrative interpretations thereof available on or before such date. All of the foregoing authorities are subject to change, which change could apply retroactively and could affect the tax consequences described below.

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

banks and other financial institutions;

- insurance companies;
- pension plans;
- cooperatives;
- regulated investment companies;
- real estate investment trusts;
- broker-dealers;
- traders that elect to use a mark-to-market method of accounting;
- U.S. expatriates or entities subject to the U.S. anti-inversion rules;
- tax-exempt entities (including private foundations);
- persons liable for alternative minimum tax;
- persons whose functional currency is not the U.S. dollar;

persons holding ADSs or ordinary shares as part of a straddle, hedging, conversion or integrated transaction for U.S. federal income tax purposes;

persons holding ADSs or ordinary shares through a bank, financial institution or other entity, or a branch thereof, located, organized or resident outside the United States;

- persons that directly, indirectly or constructively own 10% or more of our stock (by vote or value);

investors required to accelerate the recognition of any item of gross income with respect to our ADSs or ordinary shares as a result of such income being recognized on an applicable financial statement;

- partnerships or other pass-through entities, or persons holding ADSs or ordinary shares through such entities; or

persons who acquired ADSs or ordinary shares pursuant to the exercise of any employee share option or otherwise as compensation.

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

**U.S. HOLDERS ARE URGED TO CONSULT THEIR TAX ADVISORS REGARDING THE APPLICATION OF THE U.S. FEDERAL TAX RULES TO THEIR PARTICULAR CIRCUMSTANCES AS WELL AS THE STATE, LOCAL, NON-U.S. AND OTHER TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF ADSs OR ORDINARY SHARES.**

For the purpose of this discussion, a “U.S. Holder” is a beneficial owner of ADSs or ordinary shares that is, for U.S. federal income tax purposes:

- an individual who is a citizen or resident of the United States;

a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) organized under the laws of the United States, any state thereof or the District of Columbia;

- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust that (1) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons for all substantial decisions or (2) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

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

It is generally expected that a U.S. Holder of ADSs should be treated, for U.S. federal income tax purposes, as the beneficial owner of the underlying shares represented by the ADSs. The remainder of this discussion assumes that a U.S. Holder of ADSs will be treated in this manner. Predicated upon such treatment, deposits or withdrawals of our ordinary shares for our ADSs will not be subject to U.S. federal income tax.

#### Passive Foreign Investment Company Considerations

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

- at least 75% of its gross income for such year consists of certain types of passive income (the “income test”); or

at least 50% of the average quarterly value of its assets (as generally determined on the basis of fair market value) produce or are held for the production of passive income (the “asset test”).

For this purpose, cash and assets readily convertible into cash are generally classified as passive assets and goodwill and other unbooked intangibles associated with active business activities may generally be classified as non-passive assets. Passive income generally includes, among other things, dividends, interest, royalties and rents (other than certain royalties and rents derived in the active conduct of a trade or business and not derived from a related person), and gains from the disposition of passive assets.

We will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, at least 25% (by value) of the stock.

Although the law in this regard is not clear, we treat our VIEs as being owned by us for U.S. federal income tax purposes because we exercise effective control over them and are entitled to substantially all of their economic benefits. As a result, we consolidate the VIEs’ results of operations in our consolidated U.S. GAAP financial statements. If it were determined that we are not the owner of our VIEs for U.S. federal income tax purposes, the composition of our income and assets would change and we may be more likely to be treated as a PFIC for the taxable year ended December 31, 2018 and any subsequent taxable year. Assuming that we are the owner of our VIEs and based on the market price of our ADSs and the value and composition of our assets and liabilities, we believe that we were not a PFIC for U.S. federal income tax purposes for the taxable year ended December 31, 2018 and do not anticipate becoming a PFIC in the foreseeable future. However, as previously disclosed, although not free from doubt, we believed that we were a PFIC for U.S. federal income tax purposes for prior years.

While we do not anticipate being a PFIC in the current taxable year or the foreseeable future, there can be no assurance in this regard because the determination of whether we will be or become a PFIC is a factual determination made after the close of each taxable year that will depend, in part, on the composition of our income and assets.. Fluctuations in the market price of our ADSs may cause us to become a PFIC for the current or subsequent taxable years because the value of our assets for purposes of the asset test generally will be determined by reference to the market price of our ADSs or ordinary shares from time to time (which may be volatile).

Furthermore, because there are uncertainties in the application of the relevant rules, it is possible that the Internal Revenue Service, or IRS, may challenge our classification of certain income or assets as non-passive, or our valuation of our goodwill and other unbooked intangibles, each of which may result in our company becoming classified as a PFIC for the current or subsequent taxable years. If we are a PFIC for any taxable year during which you hold ADSs or ordinary shares, we generally will continue to be treated as a PFIC with respect to you for all succeeding years during which you hold ADSs or ordinary shares. However, if we cease to be a PFIC, provided that you have not made a mark-to-market election, as described below, you may avoid some of the adverse effects of the PFIC regime by making a “deemed sale” election with respect to the ADSs or ordinary shares, as applicable. If such election is made,

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

#### Passive Foreign Investment Company Rules

For each taxable year that we are treated as a PFIC with respect to you, you will be subject to special tax rules with respect to any “excess distribution” you receive and any gain you recognize from a sale or other disposition (including a pledge) of the ADSs or ordinary shares, unless you make a “mark-to-market” election as discussed below. Distributions you receive in a taxable year that are greater than 125% of the average annual distributions you received during the shorter of the three preceding taxable years or your holding period for the ADSs or ordinary shares will be treated as an excess distribution. Under the PFIC rules, if you receive any excess distribution or recognize any gain from a sale or other disposition of the ADSs or ordinary shares:



the excess distribution or recognized gain will be allocated ratably over your holding period for the ADSs or ordinary shares;

the amount allocated to the current taxable year, and any taxable years in your holding period prior to the first taxable year in which we became a PFIC (a “pre-PFIC year”), will be taxable as ordinary income;

the amount allocated to each prior taxable year, other than a pre-PFIC year, will be subject to the highest tax rate in effect for individuals or corporations, as applicable to the U.S. Holder for each such year; and

the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each prior taxable year other than a pre-PFIC year.

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

If we are a PFIC for any taxable year and any of non-U.S. subsidiaries is also a PFIC, a U.S. Holder would be treated as owning a proportionate amount (by value) of the shares of the lower-tier PFIC for purposes of the application of these rules, and could incur liability for the deferred tax and interest charge described below if either (1) we receive a distribution from, or dispose of all or part of our interest in, the lower-tier PFICs or (2) you dispose of all or part of your ADSs or ordinary shares. It is possible that one or more of our subsidiaries were PFICs for the taxable year ending December 31, 2018. You should consult your tax advisors regarding the application of the PFIC rules to any of our subsidiaries.

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

Alternatively, a U.S. Holder of “marketable stock” (as defined below) of a PFIC may make a mark-to-market election for such stock to elect out of the PFIC rules described above regarding excess distributions and recognized gains. If you make a valid mark-to-market election for the ADSs or ordinary shares, you will include in income for each year that we are a PFIC an amount equal to the excess, if any, of the fair market value of the ADSs or ordinary shares as of the close of your taxable year over your adjusted basis in such ADSs or ordinary shares. You will be allowed a deduction for the excess, if any, of the adjusted basis of the ADSs or ordinary shares over their fair market value as of the close of the taxable year. However, deductions will be allowable only to the extent of any net mark-to-market gains on the ADSs or ordinary shares included in your income for prior taxable years. Amounts included in your income under a mark-to-market election, as well as gain on the actual sale or other disposition of the ADSs or

ordinary shares, will be treated as ordinary income. Ordinary loss treatment will apply to the deductible portion of any mark-to-market loss on the ADSs or ordinary shares, as well as to any loss from the actual sale or other disposition of the ADSs or ordinary shares, to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included for such ADSs or ordinary shares. Your basis in the ADSs or ordinary shares will be adjusted to reflect any such income or loss amounts. If you make a mark-to-market election, any distributions that we make generally would be subject to the tax rules discussed below under “—Taxation of Dividends and Other Distributions on the ADSs or Ordinary Shares,” except that the lower tax rate applicable to qualified dividend income would not apply.

The mark-to-market election is available only for “marketable stock,” which is stock that is traded in greater than *de minimis* quantities on at least 15 days during each calendar quarter (“regularly traded”) on a qualified exchange or other market, as defined in applicable U.S. Treasury regulations. Although our ADSs are currently listed on, and historically regularly traded on, Nasdaq, which is a qualified exchange or other market for these purposes, no assurance can be given that the ADSs will be regularly traded on an established securities market in the United States for any taxable year. Moreover, if our ADSs are delisted (as described in “Item 3. Key Information—D. Risk Factors—Risks Related to Our Shares and ADSs— Our ADSs may be delisted from the Nasdaq Capital Market as a result of our not meeting the Nasdaq Capital Market continued listing requirements.”), then the mark-to-market election generally would be unavailable to U.S. Holders. If any of our subsidiaries are or become PFICs, the mark-to-market election will likely not be available with respect to the shares of such subsidiaries that are treated as owned by you. Consequently, you could be subject to the PFIC rules with respect to income of the lower-tier PFICs the value of which already had been taken into account indirectly via mark-to-market adjustments. You should consult your tax advisors as to the availability and desirability of a mark-to-market election, as well as the impact of such election on interests in any lower-tier PFICs.

We do not intend to provide information necessary for U.S. Holders to make qualified electing fund elections which, if available, would result in tax treatment different from the general tax treatment for PFICs described above.

Unless otherwise provided by the U.S. Treasury, each U.S. shareholder of a PFIC is required to file an annual report containing such information as the U.S. Treasury may require. In addition, if you hold ADSs or ordinary shares in any year in which we are a PFIC, you will be required to file IRS Form 8621 regarding distributions received on the ADSs or ordinary shares and any gain realized on the disposition of the ADSs or ordinary shares. You should consult your tax advisors regarding any reporting requirements that may apply to you.

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

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

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

With respect to certain non-corporate U.S. Holders, including individual U.S. Holders, dividends will be taxed at the lower capital gains rate applicable to “qualified dividend income,” provided that (1) the ADSs or ordinary shares, as applicable, are readily tradable on an established securities market in the United States, or we are eligible for the benefits of a qualifying income tax treaty with the United States that includes an exchange of information program, (2) we are neither a PFIC nor treated as such with respect to you for the taxable year in which the dividend was paid and the preceding taxable year, and (3) certain holding period requirements are met. Under IRS authority, common or ordinary shares, or ADSs representing such shares, are considered for the purpose of clause (1) above to be readily tradable on an established securities market in the United States if they are listed on Nasdaq, as are our ADSs (but not our ordinary shares). There can be no assurance that our ADSs will be considered readily tradable on an established

securities market in the United States in later years. Moreover, if our ADSs are delisted and not readily tradable on an established securities market in the United States (as described in “Item 3. Key Information—D. Risk Factors—Risks Related to Our Shares and ADSs— Our ADSs may be delisted from the Nasdaq Capital Market as a result of our not meeting the Nasdaq Capital Market continued listing requirements.”), clause (1) above would not be satisfied, and dividends would not qualify for the preferential rate applicable to qualified dividend income. Since we do not expect that our ordinary shares will be listed on an established securities market in the United States, it is unclear if the dividends that we pay on our ordinary shares which are not backed by ADSs currently meet the conditions required for the reduced tax rate. Furthermore, as previously disclosed, although not free from doubt, we believe that we were a PFIC for U.S. federal income tax purposes for prior years. If we are treated as a “resident enterprise” for PRC tax purposes under the EIT Law (see “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to suffer”), we may be eligible for the benefits of the income tax treaty between the United States and the PRC. You should consult your tax advisors regarding the availability of the lower capital gains rate applicable to qualified dividend income for dividends paid with respect to our ADSs or ordinary shares.

Dividends will constitute foreign source income for foreign tax credit limitation purposes. If the dividends are taxed as qualified dividend income (as discussed above), the amount of the dividend taken into account for purposes of calculating the foreign tax credit limitation in general will be limited to the gross amount of the dividend, multiplied by the reduced tax rate applicable to qualified dividend income and divided by the highest tax rate normally applicable to dividends. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends distributed by us with respect to the ADSs or ordinary shares generally will constitute “passive category income” but could, in the case of certain U.S. Holders, constitute “general category income.”

If PRC withholding taxes apply to dividends paid to you with respect to our ADSs or ordinary shares (see “Item 3. Key Information—D. Risk Factors—Risks Related to Our Company and Our Industry—The PRC income tax laws may increase our tax burden or the tax burden on the holders of our shares or ADSs, and tax benefits available to us may be reduced or repealed, causing the value of your investment in us to decrease”), subject to certain conditions and limitations, such PRC withholding taxes may be treated as foreign taxes eligible for credit against your U.S. federal income tax liability. The rules relating to the determination of the foreign tax credit are complex, and you should consult your tax advisors regarding the availability of a foreign tax credit in your particular circumstances, including the effects of any applicable income tax treaties.

#### Taxation of Disposition of the ADSs or Ordinary Shares

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

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

in us to decrease”), a U.S. Holder that is eligible for the benefits of the income tax treaty between the United States and the PRC may elect to treat the gain as PRC source income for foreign tax credit purposes. You should consult your tax advisors regarding the proper treatment of gain or loss in your particular circumstances, including the effect of any applicable income tax treaties.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

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

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

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

I. Subsidiary Information

Not applicable.

Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

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

Foreign Exchange Risk

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

A hypothetical 10% increase or decrease in the exchange rate of the U.S. dollar against the RMB would have resulted in an increase or decrease of RMB27.5 million (US\$4.0 million) in the aggregate principal amount of our U.S. dollar-denominated convertible notes outstanding as of December 31, 2018.

Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.



## D. American Depositary Shares

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

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

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

US\$0.02 (or less) per ADS

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

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

Registration or transfer fees

Expenses of the depositary

Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example,

### *For:*

- Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property
- Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
- Any cash distribution to ADS registered holders
- Distribution of securities distributed to holders of deposited securities that are distributed by the depositary to ADS registered holders
- Depositary services
- Transfer and registration of shares on our share register to or from the name of the depositary or its agent when you deposit or withdraw shares
- Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)
- Converting foreign currency to U.S. dollars
- As necessary

stock transfer taxes, stamp duty or withholding taxes

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

The depositary has agreed to reimburse us for expenses we incur that are related to the administration and maintenance of our ADS facility including, but not limited to, investor relations expenses, the annual Nasdaq Stock Market continued listing fees or any other program related expenses every year. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not related to the amounts of fees the depositary collects from investors. As of December 31, 2018, we had US\$0.2 million reimbursement receivable for the year 2018, after deducting withholding tax, from the depositary as reimbursement for legal fees and administrative expenses.

## PART II

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

None.

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

Use of Proceeds

Not Applicable.

Item 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, has performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15I under the Exchange Act) as of the end of the period covered by this report, as required by Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that, as of December 31, 2018, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such item is defined in Rules 13a-15(f) under the Exchange Act, for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with U.S. GAAP and includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that a company's receipts and expenditures are being made only in accordance with authorizations of a company's management and directors, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of a company's assets that could have a material effect on the consolidated financial statements.

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

As required by Section 404 of the Sarbanes-Oxley Act and related rules as promulgated by the SEC, our management assessed the effectiveness of the internal control over financial reporting as of December 31, 2018 using criteria established in “Internal Control—Integrated Framework (2013)” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management concluded that our internal control over financial reporting was effective as of December 31, 2018.

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

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

## Changes in Internal Control over Financial Reporting

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

### Item 16A.

### AUDIT COMMITTEE FINANCIAL EXPERT

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

### Item 16B.

### CODE OF ETHICS

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

### Item 16C.

### PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Grant Thornton, our principal external auditors for the periods indicated below.

	2017	2018	
	RMB	RMB	US\$
Audit fees(1)	2,640,000	2,510,000	365,064
Tax fees(2)	—	—	—

(1)

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

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

The policy of our audit committee is to pre-approve all audit and non-audit services provided by our independent registered public accounting firm, including audit services, audit-related services, tax services and other services as described above, other than those for de minimus services which are approved by our audit committee prior to the completion of the audit.

Item 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

Item 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

Item 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

Not applicable.

Item 16G. CORPORATE GOVERNANCE

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

Item 16H.

MINE SAFETY DISCLOSURE

Not applicable.

PART III

Item 17.

FINANCIAL STATEMENTS

We have elected to provide financial statements pursuant to Item 18.

Item 18.

FINANCIAL STATEMENTS

The consolidated financial statements for The9 Limited and its subsidiaries are included at the end of this annual report.

Item 19.

EXHIBITS

Exhibit Number	Description of Document
<u>1.1*</u>	<u>Amended and Restated Memorandum and Articles of Association of the Registrant as currently in effect</u>
<u>2.1</u>	<u>Specimen American Depositary Receipt (incorporated by reference to Exhibit A (Form of American Depositary Receipt) of Exhibit 1 (Form of Deposit Agreement) of our Post-Effective Amendment No. 2 to the Registration Statement on Form F-6 (file no. 333-156635) filed with the Securities and Exchange Commission on December 3, 2010)</u>
<u>2.2</u>	<u>Specimen Certificate for Ordinary Shares of The Registrant (incorporated by reference to Exhibit 4.2 from our Registration Statement on Form F-1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 26, 2004)</u>
<u>2.3</u>	<u>Form of Deposit Agreement dated as of December 20, 2004, as amended and restated as of January 16, 2009, as further amended and restated as of March 20, 2009, and as further amended and restated as of December 3, 2010 among The Registrant, The Bank of New York Mellon, as Depositary, and all Owners and Beneficial Owners from time to time of American Depositary Shares issued thereunder (incorporated</u>

by reference to Exhibit 1 of our Post-Effective Amendment No. 2 to the Registration Statement on Form F-6 (file no. 333-156635) filed with the Securities and Exchange Commission on November 19, 2010)



Exhibit Number	Description of Document
<u>4.1*</u>	<u>Eighth Amended and Restated 2004 Stock Option Plan</u>
<u>4.2</u>	<u>Form of Indemnification Agreement with the Registrant's directors and executive officers (incorporated by reference to Exhibit 10.2 from our Registration Statement on Form F-1 Amendment No. 1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 30, 2004)</u>
<u>4.3</u>	<u>Form of Employment Agreement between the Registrant and a Senior Executive Officer of the Registrant (incorporated by reference to Exhibit 10.3 from our Registration Statement on Form F-1 Amendment No. 1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 30, 2004)</u>
<u>4.4</u>	<u>Translation of Exclusive Technical Support Service Agreement, dated January 14, 2004, between Shanghai IT and The9 Computer (incorporated by reference to Exhibit 10.4 from our Registration Statement on Form F-1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 26, 2004)</u>
<u>4.5</u>	<u>Translation of Form of Call Option Agreement among The9 Computer, Shanghai IT and other parties therein (incorporated by reference to Exhibit 10.6 from our Registration Statement on Form F-1 Amendment No.1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 30, 2004)</u>
<u>4.6</u>	<u>Translation of Domain Name License Agreement, dated January 1, 2004, between GameNow.net (Hong Kong) Limited and Shanghai IT (incorporated by reference to Exhibit 10.9 from our Registration Statement on Form F-1 (file no. 333-120810) filed with the Securities and Exchange Commission on November 26, 2004)</u>
<u>4.7</u>	<u>Translation of Form of Shareholder Voting Proxy Agreement among The9 Computer, Shanghai IT and its shareholders (incorporated by reference to Exhibit 4.31 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 7, 2011)</u>
<u>4.8</u>	<u>Translation of Equity Transfer Agreement dated October 25, 2011 between Jun Zhu and Wei Ji (incorporated by reference to Exhibit 4.37 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)</u>
<u>4.9</u>	<u>Translation of Equity Pledge Agreement dated November 24, 2011 between Yong Wang and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.38 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)</u>
<u>4.10</u>	<u>Translation of Equity Pledge Agreement dated November 24, 2011 between Wei Ji and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.39 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)</u>
<u>4.11</u>	<u>Translation of Exclusive Call Option Agreement dated November 24, 2011 among Yong Wang, Wei Ji and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.40 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)</u>

4.12 Translation of Loan Agreement dated November 24, 2011 among Yong Wang, Wei Ji and The9 Computer(incorporated by reference to Exhibit 4.41 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)

Exhibit Number	Description of Document
4.13	<u>Translation of Shareholder Voting Proxy Agreement dated November 24, 2011 among Yong Wang, Wei Ji, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.42 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)</u>
4.14	<u>Translation of Novation Agreement dated November 25, 2011 among Jun Zhu, Wei Ji, Yong Wang, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.43 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 22, 2012)</u>
4.15	<u>Translation of Exclusive Technical Service Agreement, dated December 15, 2010, between Shanghai IT and The9 Computer (incorporated by reference to Exhibit 4.44 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 18, 2013)</u>
4.16	<u>Translation of Equity Transfer Agreement dated April 23, 2014 between Yong Wang and Zhimin Lin (incorporated by reference to Exhibit 4.21 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)</u>
4.17	<u>Translation of Equity Pledge Agreement dated April 22, 2014 between Zhimin Lin and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.22 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)</u>
4.18	<u>Translation of Exclusive Call Option Agreement dated April 22, 2014 among Zhimin Lin, Wei Ji and The9 Computer with respect to Shanghai IT (incorporated by reference to Exhibit 4.23 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)</u>
4.19	<u>Translation of Loan Agreement dated April 22, 2014 among Zhimin Lin, Wei Ji and The9 Computer (incorporated by reference to Exhibit 4.24 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)</u>
4.20	<u>Translation of Shareholder Voting Proxy Agreement dated April 22, 2014 among Zhimin Lin, Wei Ji, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.25 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)</u>
4.21	<u>Translation of Novation Agreement dated April 22, 2014 among Yong Wang, Zhimin Lin, Wei Ji, The9 Computer and Shanghai IT (incorporated by reference to Exhibit 4.26 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on March 27, 2015)</u>
4.22	<u>Standstill Agreement dated January 8, 2009 among the Registrant, Jun Zhu and Incisight Limited (incorporated by reference to Exhibit 4.2 from our Report of Foreign Private Issuer on Form 6-K furnished to the Securities and Exchange Commission on January 8, 2009)</u>
4.23	<u>Convertible Note and Warrant Purchase Agreement dated November 24, 2015 among the Registrant, Splendid Days Limited and the security providers listed on Schedule 1 attached thereto (incorporated by reference to Exhibit 4.23 from our Annual Report on Form 20-F filed with the Securities and Exchange Commission on April 11, 2016)</u>

4.24      Share Purchase Agreement dated June 15, 2017 between IE Limited and the Registrant (incorporated by reference to Exhibit 4.1 from Schedule 13D filed by IE Limited with the Securities and Exchange Commission on July 12, 2017)

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<b>Exhibit Number</b>	<b>Description of Document</b>
<u>4.25</u>	<u>Share Purchase Agreement dated July 14, 2017 between 9City Asia Limited and the Registrant (incorporated by reference to Exhibit 4.27 from our Annual Report on Form 20-F filed with Securities and Exchange Commission on April 27, 2018)</u>
<u>4.26*</u>	<u>Share Purchase Agreement dated August 30, 2018 between Leading Choice Investment Holdings Limited, Leading Choice Holdings Limited, 1111 Limited and the Registrant</u>
<u>4.27*</u>	<u>Share Purchase Agreement dated August 31, 2018 between Plutux Labs Limited, Plutux Limited, 1111 Limited and the Registrant</u>
<u>4.28</u>	<u>Joint Venture Agreement dated March 24, 2019 between the Registrant and Faraday&amp;Future Inc. (incorporated by reference to Exhibit 99.2 from our Report of Foreign Private Issuer on Form 6-K furnished to the Securities and Exchange Commission on March 25, 2019)</u>
<u>8.1*</u>	<u>List of Significant and Other Principal Subsidiaries and Affiliated Entities of the Registrant</u>
<u>11.1</u>	<u>Amended Code of Business Conduct and Ethics of the Registrant (incorporated by reference to Exhibit 11.1 to our annual report on Form 20-F filed with the Securities and Exchange Commission on June 30, 2005)</u>
<u>12.1*</u>	<u>Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
<u>12.2*</u>	<u>Certification by Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
<u>13.1**</u>	<u>Certification by Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
<u>13.2**</u>	<u>Certification by Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
<u>15.1*</u>	<u>Consent of Maples and Calder (Hong Kong) LLP</u>
<u>15.2*</u>	<u>Consent of Zhong Lun Law Firm</u>
<u>15.3*</u>	<u>Consent of Grant Thornton, independent registered public accounting firm</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

\*Filed with this Form 20-F.

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

SIGNATURES

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

**The9 Limited**

By: /s/ Jun Zhu

Name: Jun Zhu

Title: Chairman and Chief Executive Officer

Date: April 29, 2019

**THE9 LIMITED**

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## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders of The9 Limited:

### **Opinion on the financial statements**

We have audited the accompanying consolidated balance sheets of The9 Limited, and its subsidiaries and its variable interest entities (the “Group”) as of December 31, 2018 and 2017, the related consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and the financial statement schedule (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2018 and 2017, and the results of its operations, changes in equity and cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

### **Going concern**

The accompanying consolidated financial statements have been prepared assuming that the Group will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Group has an accumulated deficit of approximately RMB3,233.1 million (US\$470.2 million) as of December 31, 2018, and incurred a net loss of approximately RMB239.3 million (US\$34.8 million) for the year ended December 31, 2018. These conditions, along with other matters set forth in Note 2, raise substantial doubt about the Group’s ability to continue as a going concern. Management’s plans in regard to these matters are also discussed in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### **Change in accounting principles**

As discussed in Note 2 to the consolidated financial statements, the Group has changed its method of accounting for revenue from contracts with customers in 2018 due to the adoption of ASC 606 “Revenue from Contracts with Customers”.

### **Basis for opinion**

These consolidated financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Group in accordance with the U.S. federal securities laws and the applicable rules and

regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ GRANT THORNTON

We have served as the Group's auditor since 2016.

Shanghai, China

April 29, 2019

**THE9 LIMITED****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS****FOR THE YEARS ENDED DECEMBER 31, 2016, 2017 AND 2018**

	2016 RMB	2017 RMB	2018 RMB	2018 US\$ (Note 3)
Revenues:				
Online game services	48,565,620	71,564,023	16,551,080	2,407,255
Other revenues	7,719,902	1,644,143	941,335	136,911
	56,285,522	73,208,166	17,492,415	2,544,166
Sales taxes	(86,236 )	(59,610 )	(60,557 )	(8,808 )
Total net revenues	56,199,286	73,148,556	17,431,858	2,535,358
Cost of revenues	(48,518,779 )	(23,782,054 )	(16,435,590 )	(2,390,457 )
Gross profit	7,680,507	49,366,502	996,268	144,901
Operating (expenses) income:				
Product development	(77,991,408 )	(45,112,396 )	(24,555,308 )	(3,571,421 )
Sales and marketing	(21,286,647 )	(9,089,969 )	(2,325,818 )	(338,276 )
General and administrative	(129,047,846 )	(108,824,680 )	(89,583,331 )	(13,029,355 )
Impairment on goodwill	(10,561,857 )	-	-	-
Impairment on intangible assets	(68,003,805 )	-	-	-
Gain on disposal of subsidiaries	-	-	10,473,159	1,523,258
Total operating expenses	(306,891,563 )	(163,027,045 )	(105,991,298 )	(15,415,794 )
Other operating income, net	3,604,749	349,954	229,538	33,385
Loss from operations	(295,606,307 )	(113,310,589 )	(104,765,492 )	(15,237,508 )
Impairment on equity investment and available-for-sale investment	(244,798,058 )	-	(1,386,174 )	(201,611 )
Impairment on other investments	(2,806,439 )	(9,109,312 )	(7,776,157 )	(1,130,995 )
Interest income	161,144	30,525	193,928	28,206
Interest expense	(56,471,609 )	(83,922,200 )	(104,776,674 )	(15,239,135 )
Fair value change on warrants liability	48,057,204	12,615,466	2,251,427	327,456
(Loss) gain on disposal of equity investee and available-for-sale investment	(1,217,405 )	115,349	-	-
Foreign exchange (loss) gain	(13,131,779 )	19,206,747	(20,331,430 )	(2,957,084 )
Other income, net	3,179,508	4,669,587	1,598,663	232,516
Loss before income tax expense and share of loss in equity method investments	(562,633,741 )	(169,704,427 )	(234,991,909 )	(34,178,155 )

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Income tax benefit	6,079,282	-	-	-
Recovery of equity investment in excess of cost	-	60,548,651	-	-
Share of loss in equity method investments	(110,535,486)	(2,937,131 )	(4,292,887 )	(624,375 )
Net loss	(667,089,945)	(112,092,907)	(239,284,796)	(34,802,530)
Net (loss) gain attributable to noncontrolling interest	(58,584,204 )	3,955,640	(16,332,968 )	(2,375,532 )
Net (loss) gain attributable to redeemable noncontrolling interest	(14,724,152 )	2,117,303	(5,858,902 )	(852,142 )
Net loss attributable to The9 Limited	(593,781,589)	(118,165,850)	(217,092,926)	(31,574,856)
Change in redemption value of redeemable noncontrolling interest	(82,890,188 )	(57,126,233 )	(40,918,773 )	(5,951,389 )
Net loss attributable to holders of ordinary shares	(676,671,777)	(175,292,083)	(258,011,699)	(37,526,245)
Other comprehensive loss, net of tax:				
Currency translation adjustments	(1,754,639 )	(9,525,761 )	(1,314,265 )	(191,153 )
Total comprehensive loss	(668,844,584)	(121,618,668)	(240,599,061)	(34,993,683)

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**THE9 LIMITED****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS****FOR THE YEARS ENDED DECEMBER 31, 2016, 2017 AND 2018**

	2016 RMB	2017 RMB	2018 RMB	2018 US\$ (Note 3)
Comprehensive (loss) gain attributable to:				
Noncontrolling interest	(66,293,454 )	13,457,650	(24,888,425 )	(3,619,871 )
Redeemable noncontrolling interest	(14,724,152 )	2,117,303	(5,858,902 )	(852,142 )
The9 Limited	(587,826,978)	(137,193,621)	(209,851,734)	(30,521,670)
Net loss attributable to holders of ordinary shares per share:				
- Basic and diluted	(28.34 )	(5.24 )	(4.15 )	(0.60 )
Weighted average number of shares outstanding:				
- Basic and diluted	23,874,102	33,426,448	62,114,760	62,114,760

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

**THE9 LIMITED****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2017 AND 2018**

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2018</b>
	<b>RMB</b>	<b>RMB</b>	<b>US\$</b>
			<b>(Note 3)</b>
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	142,624,020	4,256,449	619,075
Accounts receivable, net of allowance for doubtful accounts of RMB1,039,958 and RMB1,149,864 as of December 31, 2017 and 2018, respectively	2,607,568	592,897	86,233
Advances to suppliers	8,102,278	15,808,042	2,299,184
Prepayments and other current assets	6,616,297	6,148,787	894,304
Amounts due from related parties	2,492,842	6,207,846	902,894
Assets held for sale	20,669,377	-	-
Total current assets	183,112,382	33,014,021	4,801,690
Investments	48,243,558	45,216,118	6,576,412
Property, equipment and software, net	20,721,252	17,352,445	2,523,808
Land use right, net	64,510,566	62,589,656	9,103,288
Other long-lived assets, net	6,521,420	6,515,200	947,597
<b>TOTAL ASSETS</b>	<b>323,109,178</b>	<b>164,687,440</b>	<b>23,952,795</b>
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS' EQUITY (DEFICIT)</b>			
Current liabilities:			
Short-term borrowings (including short-term borrowings of the consolidated VIEs without recourse to the Group of nil as of both December 31, 2017 and 2018)	108,743,369	112,461,383	16,356,830
Accounts payable (including accounts payable of the consolidated VIEs without recourse to the Group of RMB6,706,484 and RMB 5,920,126 as of December 31, 2017 and 2018, respectively)	37,129,671	38,035,661	5,532,057
Other taxes payable (including other taxes payable of the consolidated VIEs without recourse to the Group of RMB169,300 and RMB1,398,996 as of December 31, 2017 and 2018, respectively)	1,714,992	2,949,082	428,926
Advances from customers (including advances from customers of the consolidated VIEs without recourse to the Group of	47,558,542	39,631,950	5,764,228

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RMB24,558,422 and RMB23,976,676 as of December 31, 2017 and 2018, respectively)			
Amounts due to related parties (including amounts due to related parties of the consolidated VIEs without recourse to the Group of RMB55,361,287 and RMB62,268,751 as of December 31, 2017 and 2018, respectively)	88,939,108	71,849,633	10,450,096
Deferred revenue (including deferred revenue of the consolidated VIEs without recourse to the Group of RMB4,568,595 and nil as of December 31, 2017 and 2018, respectively)	5,576,269	159,125	23,144
Refund of game points (including refund of game points of the consolidated VIEs without recourse to the Group of RMB169,998,682 as of both December 31, 2017 and 2018)	169,998,682	169,998,682	24,725,283
Warrants (including warrants of consolidated VIEs without recourse to the Group of nil as of both December 31, 2017 and 2018)	3,742,271	1,490,844	216,834
Convertible notes (including convertible notes of consolidated VIEs without recourse to the Group of nil as of both December 31, 2017 and 2018)	260,563,020	375,257,140	54,578,887
Interest payable (including interest payable of consolidated VIEs without recourse to the Group of nil as of both December 31, 2017 and 2018)	9,505,843	15,298,961	2,225,142
Accrued expenses and other current liabilities (including accrued expenses and other current liabilities of the consolidated VIEs without recourse to the Group of RMB69,543,098 and RMB67,862,435 as of December 31, 2017 and 2018, respectively)	83,700,051	81,291,306	11,823,330
Liabilities directly associated with assets held for sale	2,273,532	-	-
Total current liabilities	819,445,350	908,423,767	132,124,757
TOTAL LIABILITIES	819,445,350	908,423,767	132,124,757
Commitments and contingencies (Note 30)			
Redeemable noncontrolling interest (Note 28)	306,014,668	341,074,539	49,607,234
SHAREHOLDERS' EQUITY (DEFICIT):			
Ordinary shares (US\$0.01 par value; 44,544,036 and 91,315,465 shares issued and outstanding as of December 31, 2017 and 2018, respectively)	3,328,852	6,502,658	945,772
Additional paid-in capital	2,527,215,315	2,496,069,065	363,038,188
Statutory reserves	28,071,982	28,071,982	4,082,900
Accumulated other comprehensive loss	(16,445,748 )	(9,204,556 )	(1,338,746 )
Accumulated deficit	(3,015,968,137)	(3,233,061,063)	(470,229,228)
The9 Limited shareholders' deficit	(473,797,736 )	(711,621,914 )	(103,501,114)
Noncontrolling interest	(328,553,104 )	(373,188,952 )	(54,278,082 )
Total shareholders' deficit	(802,350,840 )	(1,084,810,866)	(157,779,196)
TOTAL LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS' EQUITY	323,109,178	164,687,440	23,952,795

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

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**THE9 LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****FOR THE YEAR ENDED DECEMBER 31, 2016**

	Ordinary shares		Additional paid-in capital	Statutory reserves	Accumulated other comprehensive income (loss)	Accumulated deficit	Equity (deficit) attributable to The9 Limited	Non inter
	(US\$0.01 par value) Number of shares	Par value RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2016	23,701,601	1,917,620	2,080,041,288	28,071,982	(3,372,588)	(2,304,020,698)	(197,362,396)	(43)
Net loss	-	-	-	-	-	(593,781,589)	(593,781,589)	(58)
Currency translation adjustments	-	-	-	-	5,954,611	-	5,954,611	(7,7)
Minority interest change in redemption value	-	-	(82,890,188)	-	-	-	(82,890,188)	-
Exercise of options	213,900	14,022	2,128,532	-	-	-	2,142,554	-
Partial disposal of Red 5	-	-	244,798,058	-	-	-	244,798,058	-
Share-based compensation	-	-	27,689,259	-	-	-	27,689,259	362
Change in equity interest attributable to noncontrolling interest	-	-	253,396,755	-	-	-	253,396,755	(25)
Issuance of shares of Red 5 upon exercise of stock options	-	-	436,128	-	-	-	436,128	603
Balance as of December 31, 2016	23,915,501	1,931,642	2,525,599,832	28,071,982	2,582,023	(2,897,802,287)	(339,616,808)	(36)

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**THE9 LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****FOR THE YEAR ENDED DECEMBER 31, 2017**

	Ordinary shares		Additional paid-in capital	Statutory reserves	Accumulated other comprehensive income (loss)	Accumulated deficit	Equity (deficit) attributable to The9 Limited	No
	(US\$0.01 par value) Number of shares	Par value RMB	RMB	RMB	RMB	RMB	RMB	RM
Balance as of January 1, 2017	23,915,501	1,931,642	2,525,599,832	28,071,982	2,582,023	(2,897,802,287)	(339,616,808)	(3)
Net loss	-	-	-	-	-	(118,165,850)	(118,165,850)	3,
Currency translation adjustments	-	-	-	-	(19,027,771)	-	(19,027,771)	9,
Disposal of Yunmei Partnership	-	-	-	-	-	-	-	11
Contributions from noncontrolling interest	-	-	-	-	-	-	-	20
Exercise of options	6,328,535	425,483	(425,483)	-	-	-	-	-
Share-based compensation	-	-	37,727,861	-	-	-	37,727,861	30
Accretion in redemption value of redeemable noncontrolling interest	-	-	(57,126,233)	-	-	-	(57,126,233)	-
Change in equity interest attributable to noncontrolling interest	-	-	(7,060)	-	-	-	(7,060)	7,
	14,300,000	971,727	21,446,398	-	-	-	22,418,125	-

Issuance of  
shares

Balance as of  
December 31,  
2017

44,544,036	3,328,852	2,527,215,315	28,071,982	(16,445,748)	(3,015,968,137)	(473,797,736)	(3
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**THE9 LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****FOR THE YEAR ENDED DECEMBER 31, 2018**

	Ordinary shares		Additional paid-in capital	Statutory reserves	Accumulated other comprehensive (income) loss	Accumulated deficit	Equity (deficit) attributable to The9 Limited
	(US\$0.01 par value)						
	Number of shares	Par value					
		RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2018	44,544,036	3,328,852	2,527,215,315	28,071,982	(16,445,748)	(3,015,968,137)	(473,797,137)
Net loss	-	-	-	-	-	(217,092,926 )	(217,092,926)
Currency translation adjustments	-	-	-	-	7,241,192	-	7,241,192
Derecognition of noncontrolling interests	-	-	-	-	-	-	-
Share-based compensation	-	-	3,645,751	-	-	-	3,645,751
Accretion in redemption value of redeemable noncontrolling interest	-	-	(40,918,773 )	-	-	-	(40,918,773)
Issuance of shares	46,771,429	3,173,806	6,126,772	-	-	-	9,300,578
Balance as of December 31, 2018	91,315,465	6,502,658	2,496,069,065	28,071,982	(9,204,556 )	(3,233,061,063)	(711,621,063)
Balance as of December 31, 2018 (US\$ except share data, Note 3)	91,315,465	945,772	363,038,188	4,082,900	(1,338,746 )	(470,229,228 )	(103,501,063)

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

**THE9 LIMITED****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2016, 2017 AND 2018**

	2016 RMB	2017 RMB	2018 RMB	2018 US\$ (Note 3)
Cash flows from operating activities:				
Net loss	(667,089,945)	(112,092,907)	(239,284,796)	(34,802,530)
Adjustments for:				
Loss (gain) on disposal of property, equipment and software	1,765,367	18,460	(183,767 )	(26,728 )
Gain on disposal of subsidiaries	-	-	(10,473,159 )	(1,523,258 )
Share-based compensation expense	28,051,735	38,029,713	3,898,328	566,988
Impairment on equity investments	-	-	1,386,174	201,611
Impairment on other investments	2,806,439	9,109,312	7,776,157	1,130,995
Impairment on available-for-sale investment	244,798,058	-	-	-
Impairment of intangible assets	68,003,805	-	-	-
Provision for doubtful accounts receivable	-	47,948	109,939	15,990
Impairment on advances to suppliers	-	-	7,765,482	1,129,443
Provision for doubtful other receivables	-	-	21,042,700	3,060,534
Impairment of goodwill	10,561,857	-	-	-
Consulting fee paid by equity	-	13,454,692	4,172,800	606,909
Depreciation and amortization of property, equipment and software	7,317,920	5,299,059	3,650,261	530,908
Amortization of land use right	1,920,910	1,920,910	1,920,910	279,385
Amortization of intangible assets	10,151,356	-	-	-
Recovery of equity investment in excess of cost	-	(60,548,651 )	-	-
Share of loss in equity method investments	110,535,486	2,937,131	4,292,887	624,375
Loss (gain) on disposal of investment in equity investee and available-for-sales investment	1,217,405	(115,349 )	-	-
Foreign currency exchange loss (gain)	13,131,779	(19,206,747 )	20,331,430	2,957,084
Fair value change on warrant liability	(48,057,204 )	(12,615,466 )	(2,251,427 )	(327,456 )
Amortization of discount and interest on convertible note	50,409,270	76,990,826	98,308,205	14,298,335
Changes in operating assets and liabilities:				
Change in accounts receivable	(1,453,441 )	5,742,365	1,904,732	277,032
Change in advance to suppliers	(8,187,039 )	2,462,761	(1,400,665 )	(203,718 )
Change in prepayments and other current assets	(2,162,566 )	3,169,076	(20,575,190 )	(2,992,537 )
Change in other long-lived assets	1,879,021	-	6,220	905
Change in accounts payable	(4,200,259 )	2,073,797	905,990	131,771
Change in amounts due to related parties	(2,063,553 )	(53,060,754 )	(1,628,877 )	(236,910 )
Change in deferred tax liability	(6,079,282 )	-	-	-

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Change in other taxes payable	(267,451 )	1,430,998	1,234,090	179,491
Change in advances from customers	7,106,374	21,137,125	(2,336,252 )	(339,794 )
Change in deferred revenue	(2,630,344 )	(10,345,604 )	(5,417,144 )	(787,891 )
Change in interest payable	3,827,510	5,452,770	6,053,191	880,400
Change in accrued expenses and other current liabilities	(1,061,524 )	(7,943,127 )	(2,408,745 )	(350,338 )
Net cash used in operating activities	(179,768,316)	(86,651,662 )	(101,200,526)	(14,719,004)
Cash flows from investing activities				
Proceeds from disposal of other investment	409,694	1,158,040	-	-
Proceeds from disposal of equity investee and available-for-sale investment	-	115,349	-	-
Proceeds from disposal of cost method investee	737,894	-	-	-
Purchase of other investments	-	(4,000,000 )	(5,300,000 )	(770,853 )
Advances to subscribe tokens	-	-	(14,070,581 )	(2,046,481 )
Disbursement for loans receivable from a related party	(2,800,000 )	(4,000,000 )	(600,000 )	(87,266 )
Collection of loans receivable from related party	-	3,000,000	-	-
Proceeds from disposal of property, equipment and software	-	292,074	81,848	11,904
Proceeds from disposal of assets and liabilities classified as held for sale	-	-	2,800,000	407,243
Settlement payment from investee	-	165,812,500	-	-
Purchase of property, equipment and software	(1,714,075 )	(454,560 )	(226,717 )	(32,975 )
Purchase of intangible assets	(6,618,977 )	-	-	-
Net cash (used in) provided by investing activities	(9,985,464 )	161,923,403	(17,315,450 )	(2,518,428 )
Cash flows from financing activities:				
Proceeds from exercise of stock options	2,142,549	-	-	-
Proceeds from exercise of stock options of a subsidiary	1,039,832	-	-	-
Cash from pledged loan	79,190,933	-	-	-
Proceeds from bank borrowings	24,992,214	-	-	-
Repayments of bank borrowings	-	(25,528,388 )	-	-
Proceeds from Inner Mongolia Culture Assets and Equity Exchange	57,500,000	-	-	-
Loan from a related party	60,009,400	73,930,427	11,030,602	1,604,335
Repayment of a loan from a related party	(34,782,586 )	(23,950,421 )	(29,127,540 )	(4,236,425 )
Proceeds from other loans	-	19,881,900	-	-
Repayments of other loans	-	(20,260,085 )	(260,073 )	(37,826 )
Contribution from noncontrolling interest	-	20,000,000	-	-
Net cash provided by (used in) financing activities	190,092,342	44,073,433	(18,357,011 )	(2,669,916 )
Effect of foreign exchange rate changes on cash and cash equivalents	(10,471,027 )	4,527,918	(1,494,584 )	(217,379 )
Cash reclassified as held for sale	-	(20,127,148 )	-	-
Net change in cash and cash equivalents	(10,132,465 )	103,745,944	(138,367,571)	(20,124,727)
Cash and cash equivalents, beginning of year	49,010,541	38,878,076	142,624,020	20,743,802
Cash and cash equivalents, end of year	38,878,076	142,624,020	4,256,449	619,075

Supplemental disclosure of cash flow information:

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Interest paid	1,077,374	892,159	260,073	37,826
Income taxes paid	-	-	-	-
Non-cash investing and financing activities				
Accrued purchases of property, equipment and software	1,832,201	-	-	-
Receivable related to the disposition of a subsidiary	-	1,600,000	-	-
Shares issued for equity investments and other investments	-	-	3,091,986	449,711

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

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**THE9 LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED DECEMBER 31, 2016, 2017 AND 2018****1. ORGANIZATION AND NATURE OF OPERATIONS**

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

The Group is principally engaged in the development and operation of online games and internet related businesses, including massively multiplayer online games (“MMOGs”), mobile games, web games and TV games.

The Group's principal subsidiaries and VIE subsidiaries are as follows as of December 31, 2018:

Name of Entity	Date of Registration	Place of Registration	Legal Ownership	
Principal subsidiaries:				
GameNow.net (Hong Kong) Ltd. (“ <i>GameNow Hong Kong</i> ”)	January-2000	Hong Kong	100	%
The9 Computer Technology Consulting (Shanghai) Co., Ltd. (“ <i>The9 Computer</i> ”)	June-2000	People’s Republic of China (“PRC”)	100	%
China The9 Interactive Limited (“ <i>C9I</i> ”)	October-2003	Hong Kong	100	%
China The9 Interactive (Shanghai) Limited (“ <i>C9I Shanghai</i> ”)	February-2005	PRC	100	%
China The9 Interactive (Beijing) Ltd. (“ <i>C9I Beijing</i> ”)	March-2007	PRC	100	%
Jiu Jing Era Information Technology (Beijing) Ltd. (“ <i>Jiu Jing</i> ”)	April-2007	PRC	100	%
JiuTuo (Shanghai) Information Technology Ltd. (“ <i>Jiu Tuo</i> ”)	July-2007	PRC	100	%
China Crown Technology Ltd. (“ <i>China Crown Technology</i> ”)	November-2007	Hong Kong	100	%
Asian Development Ltd. (“ <i>Asian Development</i> ”)	January-2007	Hong Kong	100	%
Asian Way Development Ltd. (“ <i>Asian Way</i> ”)	November-2007	Hong Kong	100	%
New Star International Development Ltd. (“ <i>New Star</i> ”)	January-2008	Hong Kong	100	%

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Red 5 Studios, Inc. (“Red 5”)	June-2005	USA	34.71%	
			(Note 2)	
Red 5 Singapore Pte. Ltd. (“Red 5 Singapore”)	April-2010	Singapore	34.71%	
			(Note 2)	
The9 Interactive, Inc. (“The9 Interactive”)	June-2010	USA	100	%
Shanghai Jiu Chang Investment Co., Ltd. (“Jiu Chang”)	December-2014	PRC	100	%
City Channel Ltd. (“City Channel”)	June-2006	Hong Kong	100	%
The9 Singapore Pte. Ltd. (“The9 Singapore”)	April-2010	Singapore	100	%
Fast Supreme Development Limited (“Fast Supreme”)	July-2017	Hong Kong	99.99	%
Ninebit Inc. (“Ninebit”)	January -2018	Cayman Islands	100	%
1111 Limited (“1111”)	January -2018	Hong Kong	100	%
Supreme Exchange Limited (“Supreme”)	December-2018	Malta	90	%
Variable interest entity:				
Shanghai The9 Information Technology Co., Ltd. (“Shanghai IT”)	September-2000	PRC	N/A (Note 4)	

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**Subsidiaries and VIEs of Shanghai IT:**

Name of Entity	Date of Registration	Place of Registration	Legal Ownership Held by Shanghai IT	
Shanghai Jiushi Interactive Network Technology Co., Ltd. (“ <i>Jiushi</i> ”)	July-2011	PRC	80	%
Hangzhou Firerain Network Technology Co., Ltd.(“ <i>HZ Firerain</i> ”)	October- 2008	PRC	100	%
Shanghai ShencaiChengjiu Information Technology Co., Ltd. (“ <i>SH Shencai</i> ”)	May-2015	PRC	60	%
Wuxi Interest Dynamic Network Technology Co., Ltd. (“ <i>Wuxi Qudong</i> ”)	June-2016	PRC	100	%
Changsha Quxiang Network Technology Co., Ltd. (“ <i>Changsha Quxiang</i> ”)	July-2016	PRC	100	%
Silver Express Investments Ltd. (“ <i>Silver Express</i> ”)	November-2007	Hong Kong	100	%
Shanghai Morning Technology Co., Ltd. (“ <i>Morning Tech</i> ”)	May-2017	PRC	100	%

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## **2. PRINCIPAL ACCOUNTING POLICIES**

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

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). Significant accounting policies followed by the Group in the preparation of the accompanying consolidated financial statements are summarized below.

The accompanying consolidated financial statements have been prepared on a going concern basis. The Group has accumulated deficit of approximately RMB 3,233.1 million (US\$470.2 million) and total current liabilities exceeded total assets by approximately RMB743.7 million (US\$108.2 million) as of December 31, 2018. The Group also suffered a net loss of approximately RMB239.3 million (US\$34.8 million) for the year ended December 31, 2018. The Group expects to continue to incur product development and sales and marketing expenses for licensed and proprietary new games and blockchain-technology-enabled products in order to achieve overall revenue growth. These factors raise substantial doubt about the Group's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset amounts, or amounts of liabilities that might result from the outcome of this uncertainty.

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

#### *Additional Equity Financing*

On November 24, 2015, the Group entered into an agreement with a third-party investor for a private placement of secured convertible notes and warrants for gross proceeds of US\$40,050,000. This transaction closed on December 11, 2015. Pursuant to the terms of the agreement, the convertible notes shall mature in 2018, subject to a two-year extension at the discretion of the investor. Upon the maturity of convertible notes and warrants, if the third-party investor did not opt to extend or convert into ordinary shares, the Group may consider to sell certain assets to repay this obligation. In March 2019, the Group entered into a deed of settlement agreement relating to the settlement of convertible notes which expired in December 2018, pursuant to which the convertible notes should be repaid by May 31, 2019 through the proceeds from planned sale of the mortgaged properties.

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### *Launch of New Games and New Operation*

The Group plans to launch our proprietary online mobile games on different platforms, including the CrossFire New Mobile Game, Q Jiang San Guo, Audition and Pop Fashion, on different platforms. In November 2017, the Group entered into an exclusive publishing agreement with two third-party companies, pursuant to which these third-party companies were granted an exclusive right to publish the CrossFire New Mobile Game and Audition in China. The Group has invested significant financial and personnel resources in development of our proprietary CrossFire New Mobile Game and the Group expects to launch this game in 2019.

In 2018, the Group stepped into the blockchain-related service market. The Group has invested in several blockchain-related companies to conduct related services and development of blockchain-technology-enabled products. In January 2018, the Group subscribed a total of 5,297,257 tokens to be issued by Telegram Inc. at a consideration of US\$2.0 million with a third-party company and the tokens are expected to issue in 2019.

### *Other External Financing*

The Group intends to obtain financial support from related parties in 2019.

### *Cost Controls*

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

## **<2> Consolidation**

The consolidated financial statements include the financial statements of The9 Limited, its subsidiaries and VIEs in which it has a controlling financial interest. A subsidiary is consolidated from the date on which the Group obtained control and continues to be consolidated until the date that such control ceases. A controlling financial interest is typically determined when a company holds a majority of the voting equity interest in an entity. If the Group demonstrates its ability to control a VIE through its rights to all the residual benefits of the VIE and its obligation to

fund losses of the VIE, then the VIE is consolidated. All intercompany balances and transactions between The9 Limited, its subsidiaries and VIEs have been eliminated in consolidation.

In April 2010, the Group acquired a controlling interest in Red 5. In June 2016, the Group completed a share exchange transaction with L&A International Holding Limited (“L&A”) and certain other shareholders of Red 5 (see Note 8). After the transaction, the Group owned 34.71% shareholding in Red 5. As the Group controls a majority of Board of Director seats and has continuously funded the operation of Red 5, the Group still retained effective control over Red 5. Red 5 remained as a consolidated entity of the Group as of December 31, 2018.

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

### <3> Use of estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported revenues and expenses during the reported periods. Significant accounting estimates reflected in the Group's consolidated financial statements include the valuation of non-marketable equity investments and determination of other-than-temporary impairment, allowance for doubtful accounts and prepayments, revenue recognition, goodwill impairment, assessment of impairment of available-for-sale investments, assessment of impairment of other long-lived assets, fair value of redeemable noncontrolling interest, fair value of the warrants, share-based compensation expense, consolidation of VIEs, valuation allowances for deferred tax assets, and contingencies. Such accounting policies are affected significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements, and actual results could differ materially from these estimates.



#### **<4> Foreign currency translation**

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

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

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

Cash and cash equivalents represent cash on hand and highly-liquid investments with a maturity date when acquired of three months or less. As of December 31, 2017 and 2018, cash and cash equivalents were comprised primarily of bank deposits. Included in cash and cash equivalents as of December 31, 2017 and 2018 are amounts denominated in U.S. dollar totaling US\$21.0 million and US\$0.08 million, respectively.

The RMB is not a freely convertible currency. The PRC State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of RMB into foreign currencies. The value of the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in China's foreign exchange trading system market. The Group's aggregate amount of cash and cash equivalents denominated in RMB amounted to RMB5.2 million and RMB3.6 million (US\$0.5 million) as of December 31, 2017 and 2018, respectively.

**<6> Allowance for doubtful accounts**

Accounts receivable mainly consist of receivables from third-party game platforms, and other receivables, which are included in prepayments and other current assets, both of which are recorded net of allowance for doubtful accounts. The Group determines the allowances for doubtful accounts when facts and circumstances indicate that the receivable is unlikely to be collected. Allowances for doubtful accounts are charged to general and administrative expenses. If the financial condition of the Group's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company provided allowance for doubtful accounts of nil, RMB0.05 million and RMB21.2 million (US\$3.1 million) for the years ended December 2016, 2017 and 2018, respectively.

**<7> Investments in equity method investee and loan to equity method investee**

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

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

The Group assesses its equity investments and loans to equity investees for impairment on a periodic basis by considering factors including, but not limited to, current economic and market conditions, the operating performance of the investees including current earnings trends, the technological feasibility of the investee's products and technologies, the general market conditions in the investee's industry or geographic area, factors related to the investee's ability to remain in business, such as the investee's liquidity, debt ratios, cash burn rate, and other company-specific information including recent financing rounds. If it has been determined that the equity investment is less than its related fair value and that this decline is other-than-temporary, the carrying value of the investment and loan to equity investee is adjusted downward to reflect these declines in value.

**<8> Available-for-sale investments**

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

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

**<9> Property, equipment and software, net**

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

Leasehold improvements	Shorter of respective lease term or estimated useful life
Computer and equipment	3 to 4 years
Software	5 years
Office furniture and fixtures	3 years
Motor vehicles	5 years
Office buildings	10 to 20 years

**<10> Goodwill**

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



**<11> Assets held for sale**

Assets held for sale represent property, equipment and software for business operation that has met the criteria of held for sale accounting, as specified by Accounting Standards Codification (“ASC”) 360, *Property, Plant, and Equipment*. The effect of suspending depreciation on the property, equipment and software held for sale is immaterial to the results of operations for both 2017 and 2018. The sales of the assets held for sale as of December 31, 2017 have been completed in 2018.

**<12> Intangible assets, net**

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

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

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

**<13> Land use right, net**

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

**<14> Impairment of long-lived assets**

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

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

**<15> Revenue recognition**

On January 1, 2018, the Group adopted ASC 606, *Revenue from Contracts with Customers*, applying the modified retrospective method to contracts that were not completed as of January 1, 2018. The adoption of ASC 606 did not have a material impact on the Group's accumulated deficit as of January 1, 2018. Results for reporting periods beginning on or after January 1, 2018 are presented under ASC 606, while prior period results are not adjusted.

The adoption of ASC 606 did not change the Group's consolidated balance sheets, consolidated statement of cash flows, or consolidated statement of changes in equity as of, or for the year ended December 31, 2018.

Revenues are recognized when control of the promised goods or services is transferred to the Group's customers, in an amount that reflects the consideration of the Group expects to be entitled to in exchange for those goods or services. Depending on the terms of the contract and the laws that apply to the contract, control of the goods or services may be transferred over time or at a point in time.

*Online game services*

The Group earns revenue from provision of online game operation services to players on the Group's game servers and third-party platforms and overseas licensing of the online game to other operators. The Group grants operation right on authorized games, together with associated services which are rendered to the customers over time. The Group adopts virtual item / service consumption model for the online game services. Players can access certain games free of charge, but many purchase game points to acquire in-game premium features. The Group may act as principal or agent through the various transaction arrangements entered.



The determination on whether to record the revenue gross or net is based on an assessment of various factors, including but not limited to whether the Group (i) is the primary obligor in the arrangement; (ii) has general inventory risk; (iii) change the product or perform part of the services; (iv) has latitude in establishing the selling price; (v) has involvement in the determination of product or service specifications. The assessment is performed for all of licensed online games.

When acting as principal

Revenues from online game operation operated through telecom carriers and certain online games operators are recognized upon consumption of the in-game premium features based on the gross of revenue sharing-payments to third-party operators, but net of value-added tax (“VAT”). The Group obtains revenue from the sale of in-game virtual items. Revenues are recognized as the virtual items are consumed or over the estimated lives of the virtual items, which are estimated by considering the average period that active players and players' behavior patterns derived from operating data. Accordingly, commission fees paid to third-party operators are recorded as cost of revenues.

When acting as agent

With respect to games license arrangements entered into by third-party operators, if the terms provide that (i) third-party operators are responsible for providing game desired by the game players; (ii) the hosting and maintenance of game servers for running the games is the responsibility of third-party operators; (iii) third-party operators have the right to review and approve the pricing of in-game virtual items and the specification, modification or update of the game made by the Group; and (iv) publishing, providing payment solution and market promotion services are the responsibilities of third-party operators and the Group is responsible to provide intellectual property licensing and subsequent technical services, then the Group considers itself as an agent of the third-party operators in such arrangement with game players. Accordingly, the Group records the game revenues from these licensed games, net of amounts paid to the third-party operators.

*Licensing revenue*

The Group authorizes third parties to operate its online games where games licensed out mainly include online games developed in house. The Group receives monthly revenue-based royalty payments from the third-party licensee operators. The Group receives additional up-front license fees from certain third-party licensee operators who are entitled to an exclusive right to access the games where initial license fee is allocated solely on the license. The amount is recognized as revenue evenly throughout the license period after commencement of the game, given that the Group's intellectual property rights subject to the license are considered to be symbolic and the licensee has the right to access such intellectual property rights as they exist over time when the license is granted. Monthly revenue-based royalty payments are recognized when the relevant services are delivered, provided that collectability is reasonably assured. The Group views the third-party licensee operators as its customers and recognizes revenues on a net basis, as the Group does not have the primary responsibility for fulfillment and acceptability of the game services.

*Technical services*

Technical services are blockchain-related consulting services where the Group is to provide designing, programming, drafting of white paper, and related services to its customers. These revenues are recognized when delivery of the services has occurred or when services have been rendered and the collection of the related fees is reasonably assured.

*Contract balances*

Timing of revenue of revenue recognition may differ from the timing of invoicing to customers. Accounts receivable represent amounts invoiced and revenue recognized prior to invoicing, when the Group has satisfied its performance obligations and has the unconditional right to payment.

Deferred revenue related to unsatisfied performance obligations at the end of the period and primarily consists of fees received from game players in the online game services and technical services. For deferred revenue, due to the generally short-term duration of the contracts, the majority of the performance obligations are satisfied in the following reporting period. The amount of revenue recognized that was included in deferred revenue balance at the beginning of the period was RMB5.4 million (US\$0.8 million) for the year ended December 31, 2018.

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

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

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

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**<17> Convertible note and warrants**

**Convertible Notes and Beneficial Conversion Feature ("BCF")**

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

The Group has adopted Accounting Standards Update ("ASU") 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, to present the occurred debt issuance costs as a direct deduction from the convertible note rather than as an asset. Amortization of the costs is reported as interest expense.

**Warrants**

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

**<18> Cost of sales**

Cost of sales consists primarily of online game royalties, payroll, revenue sharing to third-party game platform, telecom carriers and other suppliers, depreciation, maintenance and rental of Internet data center sites, depreciation and amortization of computer equipment and software, and other overhead expenses directly attributable to the services provided.

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**<19> Product development costs**

For software development costs, including online games, to be sold or marketed to customers, the Group expenses software development costs incurred prior to reaching technological feasibility. Once a software product has reached technological feasibility, all subsequent software costs for that product are capitalized until that product is released for marketing. After an online game is released, the capitalized product development costs are amortized over the estimated product life. To date, the Group has essentially completed its software development concurrently with the establishment of technological feasibility, and, accordingly, no costs have been capitalized.

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

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

**<20> Sales and marketing expenses**

Sales and marketing expenses consist primarily of advertising and promotional expenses, payroll and other overhead expenses incurred by the Group's sales and marketing personnel. Advertising expenses in the amount of RMB2.5 million, RMB0.9 million and RMB0.3 million (US\$0.04 million) for the years ended December 31, 2016, 2017 and 2018, respectively, were expensed as incurred.

**<21> Government grants**

Unrestricted government subsidies from local government agencies allowing the Group full discretion to utilize the funds were RMB1.1 million, RMB2.3 million and RMB1.6 million (US\$0.2 million) for the years ended December 31, 2016, 2017 and 2018, respectively, which were recorded in other income, net in the consolidated statements of operations and comprehensive loss.

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**<22> Share-based compensation**

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

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

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

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

On June 6, 2017, the Board of Directors of the Group approved cancellation of a portion of the options and accelerated vesting of the remaining options in addition to the repricing of the exercise price which was US\$0.00. Pursuant to the option agreement entered with the optionees, options totaling 6,328,535 were exercised and options totaling 10,806,665 were canceled. An independent appraiser engaged by the Group prepared a valuation report assessing the fair value of the options. The cancellation and acceleration of the options shall be considered as an option modification. Subject to ASC 718-20-35, the remaining unrecognized compensation cost of unvested stock option measured at grant date shall be recognized at the date of modification. The incremental compensation cost which is the excess of the fair value of the replacement award over the fair value of the cancelled award shall be recognized at the date of cancellation.

#### **<23> Leases**

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

#### **<24> Income taxes**

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

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

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**<25> Redeemable noncontrolling interests**

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

**<26> Noncontrolling interest**

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

**<27> Loss per share**

Basic loss per share is computed by dividing net loss attributable to the holders of ordinary shares by the weighted average number of ordinary shares outstanding during the year. Diluted loss per share is calculated by dividing net income attributable to the holders of ordinary shares as adjusted for the effect of dilutive ordinary share equivalents, if any, by the weighted average number of ordinary shares and dilutive ordinary share equivalents outstanding during the period. Ordinary share equivalents of stock options and warrants are calculated using the treasury stock method, and are not included in the denominator of the diluted earnings per share calculation when inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded.

**<28> Segment reporting**

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

**<29> Certain risks and concentration**

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash and cash equivalents, accounts receivable and prepayments and other current assets. As of December 31, 2017 and 2018, substantially all of the Group's cash and cash equivalents were held by major financial institutions, which management believes are of high credit worthiness.

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**<30> Fair value measurements**

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

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

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

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

**<31> Financial instruments**

Financial instruments primarily consist of cash and cash equivalents, investments, accounts receivable, accounts payable, short-term borrowings, warrants and convertible notes. The carrying value of the Group's cash and cash equivalents, investments, accounts receivable, accounts payable and short-term borrowings approximate their market values due to the short-term nature of these instruments. Warrants are recorded in the consolidated balance sheets based on fair value. Both carrying value and fair value of convertible notes as of December 31, 2018 were RMB375.3 million (US\$54.6 million).

## <32> Recent accounting pronouncements

### *Leases*

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* which replaces existing lease guidance. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. The new guidance will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of income. The standard is effective for the Group beginning January 1, 2019, with early application permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented with various optional practical expedients. The adoption of this guidance is not expected to have a material effect on the Group's financial condition, results of operations and cash flows.

### *Financial Instruments – Credit Losses*

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, to provide financial statement users with more useful information about expected credit losses. ASU 2016-13 also changes how entities measure credit losses on financial instruments and the timing of when such losses are recorded. In November 2018, the FASB issued ASU No. 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*. The amendment clarifies that receivables arising from operating leases are not within the scope of Subtopic 326-20. Instead, impairment of receivables arising from operating leases should be accounted for in accordance with Topic 842, Leases. ASU 2016-13 and ASU 2018-19 are effective for fiscal years and interim periods within those years beginning after December 15, 2019, and early adoption is permitted for periods beginning after December 15, 2018. The adoption of this guidance is not expected to have a material effect on the Group's financial condition, results of operations and cash flows.

*Fair Value Measurements*

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820)*. The new guidance modifies disclosure requirements related to fair value measurement. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. Early adoption is permitted. The standard also allows for early adoption of any removed or modified disclosures upon issuance of this ASU while delaying adoption of the additional disclosures until their effective date. The adoption of this guidance is not expected to have a material effect on the Group's financial condition, results of operations and cash flows.



*Nonemployee Share-Based Payment*

In June 2018, the FASB issued ASU No. 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting*. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. This ASU intends to reduce cost and complexity and to improve financial reporting for share-based payments issued to nonemployees. The ASU expands the scope of Topic 718, Compensation—Stock Compensation, which currently only includes share-based payments issued to employees, to also include share-based payments issued to nonemployees for goods and services. The standard is effective for the Group beginning December 15, 2018, with early application permitted. The adoption of this guidance is not expected to have a material effect on the Group's financial condition, results of operations and cash flows.

**3. CONVENIENCE TRANSLATION**

The Group, with the exception of its subsidiaries, Red 5, The9 Interactive and Red 5 Singapore, maintains its accounting records and prepares its financial statements in RMB. The U.S. dollar amounts disclosed in the accompanying financial statements are presented solely for the convenience of the readers at the rate of US\$1.00 = RMB6.8755, representing the noon buying rate in the City of New York for cable transfers of RMB, as certified for customs purposes by the Federal Reserve Bank of New York, on December 31, 2018. Such translations should not be construed as representations that the RMB amounts represent, or have been or could be converted into, United States dollars at that or any other rate.

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

The Group is the primary beneficiary of its VIEs, including Shanghai IT which was designed by the Group to comply with PRC regulations that prohibit direct foreign ownership of businesses that operate online and TV games in the PRC.

##### *Shanghai IT and its VIE subsidiaries*

There are certain key contractual arrangements between the Group's subsidiary, The9 Computer (wholly-owned foreign enterprise, the "WOFE") and each of the VIEs that provide the Group with control over the VIEs. As a result of these contracts, the Group concluded that it is required to consolidate the VIEs pursuant to the guidance in ASC 810.

A summary of these contractual agreements is as follows:

Loan agreement. The WOFE entered into loan agreements with each shareholder of the relevant VIEs. Pursuant to the terms of these loan agreements, the WOFE granted an interest-free loan to each shareholder of the VIEs for the explicit purpose of making a capital contribution to the VIEs. These loans have an unspecified term and will remain 1) outstanding for the shorter of the duration of WOFE or that of the VIE, or until such time that the WOFE elects to terminate the agreement (which is at the WOFE's sole discretion), at which point the loans are payable on demand. The shareholders of the VIEs may not prepay all or any portion of the loans without the WOFE's prior written request.

Equity pledge agreement. The shareholders of the VIEs entered into equity pledge agreements with the WOFE. Under the equity pledge agreements, the shareholders of the VIEs pledged all of their equity interests in the VIEs to the WOFE as collateral for all of their payments due to the WOFE and to secure performance of all obligations of the VIEs and their shareholders under the above loan agreements. In addition, the dividend distributions to the shareholders of VIEs, if any, will be deposited in an escrow account over which the WOFE has exclusive control. The pledge shall remain effective until all 2) obligations under such agreements have been fully performed. The shareholders have the obligation to maintain ownership and effective control over the pledged equity. Under no circumstances, without the prior written consent of the WOFE, may the shareholder transfer or otherwise encumber any equity interests in the VIEs. If any event of default as provided for therein occurs, the WOFE, as the pledgee, will be entitled to dispose of the pledged equity interests through transfer or assignment and use the proceeds to repay the loans or make other payments due under the above loan agreements up to the loan amounts.

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Call option agreement. The VIEs and their shareholders entered into equity call option agreements with the WOFE. Pursuant to such agreements, the shareholders of the VIEs grant the WOFE an irrevocable and exclusive option to purchase the shares of VIEs at a purchase price equal to the amount of the registered capital of the VIE or the loan provided by the WOFE, permissible by the then-applicable PRC laws and regulations. WOFE may exercise such right at any time during the term of the agreement. Moreover, under the call option agreements, neither the VIEs nor 3) their shareholders may take actions that could materially affect the VIEs' assets, liabilities, operations, equity or other legal rights without the prior written approval of the WOFE, including, without limitation, declaration and distribution of dividends and profits; sale, assignment, mortgage or disposition of, or encumbrances on, the VIE's equity; merger or consolidation; acquisition of and investment in any third-party entities; creation, assumption, guarantee or incurrence of any indebtedness; entering into other materials contracts. The agreements shall not expire until such time as the WOFE acquires all equity interests of the relevant VIEs subject to applicable PRC laws.

Shareholder voting proxy agreement. Each of the VIE's shareholders executed an irrevocable power of proxy to appoint the WOFE as the attorney-in-fact to act on his or her behalf on all matters pertaining to the VIEs and to 4) exercise all of his or her rights as a shareholder of the VIEs, including the right to attend shareholders meetings, to exercise voting rights and to appoint directors, a general manager, and other senior management of the VIEs. The power of proxy is irrevocable and may only be terminated at the discretion of the WOFE.

Exclusive technical service agreement. Under the exclusive technical service agreement, the VIEs agreed to engage the WOFE as their exclusive provider of technology consulting and other services for a service fee equal to 90% of all operating profit generated by the VIEs. According to the relevant PRC rules and regulations, related party transactions should be negotiated at the arm's length basis and apply reasonable transfer pricing methods. The 5) determination of service fees, however, is under the sole discretion of the WOFE. These agreements do not have specific clauses on renewal but do have an initial term of 20 years (with the earliest expiration date being December 31, 2029). By virtue of the governance rights the WOFE maintains over the VIEs, through the terms of the other agreements noted above, the Group is able to unilaterally renew, extend or amend the service agreements at its discretion.

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The Group shall be deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

- a. The power to direct the activities of a VIE that most significantly impact the VIE's economic performance; and
- b. The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In determining that the Group has "the power to direct the activities of the VIE that most significantly impact the VIEs' economic performance," the Group looked to the specific provisions of the call option agreement and shareholder voting proxy agreement. These agreements, as summarized above, provide the WOFE effective control over all of the corporate and operating decisions of the VIEs, and as such, the Group's management concluded that the WOFE has the requisite power to direct the activities of the VIEs that most significantly impact the VIEs' economic performance. In assessing the Group's obligation to absorb losses, the Group notes that it has funded through the loan agreements all of the entities' share capital and also provides financial support as necessary to the entities through intercompany transactions. The Group's rights to receive economic benefits that are significant to the VIEs are embodied firstly in the equity pledge agreements that secure the equity owners' obligations under the relevant agreements, and ascribes to the WOFE all of the economic benefits of the equity interests including rights to any dividends declared. Secondly, the exclusive technical service agreement further secures the ability of WOFE to receive substantially all of the economic benefits from each of the VIEs on behalf of the Group.

In conclusion, because the Group, through its wholly owned subsidiary The9 Computer, has (1) the power to direct the activities of the VIEs that most significantly affect the VIE's economic performance, and (2) the right to receive benefits from the VIEs that could potentially be significant to the VIEs, the Group has been deemed to be the primary beneficiary of the VIEs and has consolidated the VIEs since the date of execution of such agreements.

Shareholders of the VIEs may potentially have conflicts of interest with the Company, and they may breach their contracts with the PRC subsidiaries or cause such contracts to be amended in a manner contrary to the interests of the Group. As a result, the Group may have to initiate legal proceedings, which involve significant uncertainty. Such disputes and proceedings may significantly disrupt the Groups business operations and adversely affect the Group's ability to control the VIEs. As most of the shareholders of the VIEs are directors, officers, shareholders or employees of the Group, management is of the view that the risk that misaligned interests may lead to deconsolidation in the foreseeable future is remote and insignificant.

PRC laws and regulations currently limit foreign ownership of companies that provide Internet content services, which include operating online games. In addition, foreign invested enterprises are currently not eligible to apply for the required licenses to operate online games in the PRC. The9 Limited is incorporated in the Cayman Islands and is considered a foreign entity under PRC laws. Due to restrictions on foreign ownership of companies that provide online games, the Group has entered into contractual arrangements with Shanghai IT to conduct its online games business through its VIEs in the PRC. Shanghai IT holds the necessary licenses and approvals that are essential for the online game business in China. Shanghai IT is principally owned by certain shareholder and employee of the Company. Pursuant to certain other agreements and undertakings, The9 Limited in substance controls Shanghai IT. The Group believes that its current ownership structures and contractual arrangements with Shanghai IT and its equity owners, as well as its operations, are in compliance with all existing PRC laws and regulations. There may, however, be changes and other developments in the PRC laws and regulations or their interpretation. Specifically, following the recent promulgation of the GAPP Circular, it is unclear whether the authorities will deem our VIE structure and contractual arrangements with Shanghai IT as an “indirect or disguised” way for foreign investors to gain control over or participate in domestic online game operators, and challenge our VIE structure accordingly.

If the Group is found to be in violation of any existing or future PRC laws or regulations, or fails to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including requiring the Group to undergo a costly and disruptive restructuring, such as forcing The9 Limited to transfer its equity interest in the VIEs to a domestic entity or invalidating the VIE agreements. If the PRC government authorities impose penalties which cause the Group to lose its rights to direct the activities of and receive economic benefits from the VIEs, the Group may lose the ability to consolidate and reflect in its financial statements the financial position, and results of operation of the VIEs. The Group, however, does not believe such actions would result in the liquidation or dissolution of the Group, the WOFEs or VIEs.

The aforementioned contractual arrangements with the VIEs and their respective shareholders are subject to risks and uncertainties:

The VIEs or their shareholders could fail to obtain the proper operating licenses or fail to comply with other regulatory requirements. As a result, the PRC government could impose fines, new requirements or other penalties on the VIEs or the Group mandate a change in ownership structure or operations for the VIEs or the Group, restrict the VIEs or the Group's use of financing sources, or otherwise restrict the VIEs or the Group's ability to conduct business.

The aforementioned contractual agreements may be unenforceable or difficult to enforce. The equity pledge agreements may be deemed improperly registered or the VIEs or the Group may fail to meet other requirements. Even if the agreements are enforceable, they may be difficult to enforce given the uncertainties in the PRC legal system.

The PRC government may declare the aforementioned contractual agreements invalid. They may modify the relevant regulation, have a different interpretation of such regulations, or otherwise determine that the Group or the VIEs have failed to comply with the legal obligations required to effectuate such contractual arrangements.

It may be difficult to finance the VIEs by means of loans or capital contributions. Loans from The9 Limited to the VIEs must be approved by the relevant PRC government body and such approval may be difficult or impossible to obtain. The VIEs are domestic PRC enterprises owned by nominee shareholders, thus the Group is not likely to finance activities of the VIEs by means of direct capital contributions.

Summary financial information of the VIE subsidiaries included in the accompanying consolidated financial statements with intercompany balances and transactions eliminated are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
Total assets	99,468,575	80,531,978	11,712,890
Total liabilities	335,667,587	335,980,249	48,866,300

	2016 RMB	2017 RMB	2018 RMB	2018 US\$ (Note 3)
Net revenues	38,445,435	19,995,118	16,567,372	2,409,624
Net loss	(80,050,853)	(71,839,112)	(49,024,050)	(7,130,252)

The VIEs contributed an aggregate of 68.4%, 27.3% and 95.0% of the consolidated net revenues for the years ended December 31, 2016, 2017 and 2018, respectively. As of the fiscal years ended December 31, 2017 and 2018, the VIEs accounted for an aggregate of 30.8% and 48.9%, respectively, of the consolidated total assets, and 41.0% and 37.0%, respectively, of the consolidated total liabilities.

The VIE's assets are not used as collateral for the VIE's obligations, and can only be used to settle the VIE's obligations.

Relevant PRC laws and regulations restrict the VIE subsidiaries from transferring a portion of their net assets, equivalent to the balance of its statutory reserve and share capital, to the Group in the form of loans and advances or cash dividends. See Note 26 for disclosure of restricted net assets.

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**5. ADVANCES TO SUPPLIERS**

Advances to suppliers are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
Advance to subscribe tokens	-	14,070,581	2,046,481
Company registration fee	-	1,383,962	201,289
Advertising fee	255,259	255,259	37,126
Financing fee	7,497,988	-	-
Others	349,031	98,240	14,288
	8,102,278	15,808,042	2,299,184

The Group has obtained financing for the early phase development of CrossFire New Mobile Game from the Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2018, the Group had paid RMB7.5 million (US\$1.1 million) as the financing fee of the total funds raised and to be raised amounting to RMB157.5 million (US\$22.9 million). According to the agreement, the Group paid the total financing fee of RMB7.5 million upon receipt of the first payment in October 2016 (see Note 17). Due to unforeseen circumstances, the Group is not planning to finance the remaining RMB100.0 million (US\$14.5 million) and due to non-recovery of the advance financing fee, the Group has fully impaired the advance financing fee as of December 31, 2018.

On February 6, 2018, the Group entered into an agreement with a third-party company to subscribe a total of 5,297,257 tokens at a consideration of US\$2.0 million and the tokens are expected to issue in 2019.

**6. PREPAYMENTS AND OTHER CURRENT ASSETS**

Prepayments and other current assets are as follows:

December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$
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(Note 3)

Employee advances	1,732,451	2,158,987	314,012
Input VAT recoverable	2,249,958	1,448,075	210,614
Prepayments and deposits	659,581	693,111	100,809
Other receivables	1,974,307	1,848,614	268,869
	6,616,297	6,148,787	894,304

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## 7. INVESTMENTS

The Group's investments comprise the following:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ ( Note 3)
Investments accounted for under equity method:			
ZTE9 Network Technology Co., Ltd., Wuxi ("ZTE9")	-	-	-
System Link Corporation Limited ("System Link") <1>	-	-	-
Shanghai Big Data Cultures & Media Co., Ltd. ("Big Data") <2>	9,496,519	6,146,104	893,914
Maxline Holdings Limited ("Maxline") <7>	-	1,367,285	198,863
Leading Choice Holdings Limited ("Leading Choice") <8>	-	-	-
Investments accounted for under cost method:			
Shanghai Institute of Visual Art of Fudan University ("SIVA")	10,000,000	10,000,000	1,454,440
T3 Entertainment Co., Ltd. ("T3") <3>	24,892,921	24,892,921	3,620,525
Smartposting Co, Ltd. ("Smartposting") <4>	3,854,118	2,809,808	408,670
Beijing Ti Knight Network Technology Co., Ltd. ("Beijing Ti Knight") <5>	-	-	-
Tandem Fund II, L.P. ("Tandem Fund") <6>	-	-	-
Shanghai The9 Education Technology Co., Ltd. ("The9 Education Technology") <9>	-	-	-
Shanghai Ronglei Culture Communication Co., Ltd. ("Shanghai Ronglei") <10>	-	-	-
Plutux Limited ("Plutux") <11>	-	-	-
Total	48,243,558	45,216,118	6,576,412

### <1> System Link

In August 2014, the Group formed a joint venture, System Link, with Qihoo 360 Technology Co., Ltd., ("Qihoo 360"). Pursuant to the joint venture agreement, Qihoo 360 and the Group will each own 50% equity interest in the joint venture and share profits based on the equity interest each party holds. In August 2014, Red 5 Singapore entered into a license agreement with System Link for publishing and operating Firefall in the PRC under a five-year term beginning from 2015. The Group received an upfront payment of US\$10.0 million related to the license in 2015 and the Group began amortizing the upfront license payment over the license term starting in 2015 at the launch of game by System Link. The licensing agreement also calls for the Group to receive a US\$150.0 million minimum royalty payment. The Group did not recognize any of this amount as the amount is unlikely to be received from System Link.

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In August 2015, System Link entered into an agreement with Smilegate Entertainment, Inc. (“Smilegate”) to form a joint venture company, Oriental Shiny Star Limited (“Oriental Shiny”), for the operation of CrossFire 2. In the event of a successful commercial launch of CrossFire 2, Smilegate will receive a 30% equity share of Oriental Shiny.

In November 2015, Oriental Shiny entered into a license and distribution agreement with Smilegate for publishing and operating CrossFire 2 on an exclusive basis for a five-year term in the PRC (the “License Agreement”). In consideration for the exclusive license, Oriental Shiny made an upfront payment of US\$50.0 million and was to make additional payments totaling US\$450.0 million based on certain development and operation milestones of CrossFire 2. The payment of license fees is guaranteed by the Group and Qihoo 360 proportional to their equity interest in System Link.

The Group made total capital contributions to System Link of US\$35.0 million as of both December 31, 2016 and 2017. The Group recorded losses of RMB111.1 million (US\$16.2 million) in System Link for the year ended December 31, 2016.

In October 2017, Oriental Shiny and Smilegate agreed to terminate the License Agreement. In November 2017, Smilegate made a settlement payment of US\$25.0 million to both the Group and Qihoo 360, total of US\$50.0 million. A settlement agreement was signed among the Group, Qihoo 360 and Smilegate whereby subsequent to the payment of US\$50.0 million, the joint venture agreement signed among Oriental Shiny and Smilegate has terminated. During 2017, the Group offset its 2017 share of losses in System Link against the US\$25 million recovery and reduced its investment in System Link to nil, with the remaining portion of the recovery, RMB60.5 million (US\$8.8 million), recorded as gain as the Group has no future funding obligation to System Link or Oriental Shiny.

As of December 31, 2016, System Link was a significant subsidiary but not consolidated, and separate financial statements were provided in accordance with Rule 3-09 of SEC Regulation S-X. As of December 31, 2017, System Link met the criteria as a significant subsidiary but the Group has applied for and received a waiver from the SEC to not provide separate financial statements because the Group reduced its investment in System Link to nil in 2017 and the disclosure of separate financial statements of System Link does not have a material effect on the Group’s financial statements.

Presented below is summarized financial information of System Link:

	Unaudited December 31, 2017 RMB	Unaudited December 31, 2018 RMB	Unaudited December 31, 2018 US\$ (Note 3)		
Balance sheet data:					
Current assets	11,472,721	6,653,280	967,679		
Noncurrent assets	20,005	2,092	304		
Current liabilities	(983,142,842)	(974,039,557)	(141,668,178)		
Noncurrent liabilities	-	-	-		
Noncontrolling interest	(479)	) (94	) (14	)	
		Audited For the year ended December 31, 2016 RMB	Unaudited For the year ended December 31, 2017 RMB	Unaudited For the year ended December 31, 2018 RMB	Unaudited For the year ended December 31, 2018 US\$ (Note 3)
Operating data:					
Revenue		173,897	-	-	-
Gross loss		(150,131,075)	(825,402,887)	-	-
Loss from operations		(218,841,017)	(825,746,051)	(35,243 )	(5,126 )
Net loss		(222,102,758)	(826,681,381)	4,219,931	613,764
Net loss attributable to equity holders		(222,102,760)	(826,681,380)	4,219,931	613,764

**<2> Big Data**

In June 2015, the Group granted 33.3% equity interest of Shanghai Jiucheng Advertisement Co., Ltd. (“Jiucheng Advertisement”) to two of its employees for nil consideration. The Group recorded shared based compensation of RMB2.7 million as a result of this transaction as the equity interest was considered a share-based award for their service. In October, 2015, the Group entered into an agreement with Fei Fan Information Technology Co., Ltd. (“Fei Fan”), whereby Jiucheng Advertisement acquired 100% equity interest in Fei Fan in exchange of 30% equity interest in Jiucheng Advertisement. Upon completion of the exchange, the Group's equity interest in Jiucheng Advertisement was diluted to 46.7%. The Group accounted for the exchange as a disposal of subsidiary with a gain of RMB3.3 million (US\$0.5 million) recognized upon disposal and an acquisition of an equity method investment in Jiucheng Advertisement at fair value. In November 2015, the Group's equity interest in Jiucheng Advertisement was further diluted to 42.0% as a result of capital injection by other shareholders. In August 2016, Jiucheng Advertisement raised capital from the Group and a third-party, the Group's equity interest in Jiucheng Advertisement became 43.7%. In October 2016, the Group's equity interest in Jiucheng Advertisement further increased to 44.5% after the execution of certain terms under the investment agreements among certain investors of Jiucheng Advertisement.

In December 2016, the Group entered into an agreement with third-party investors of Jiucheng Advertisement. According to the agreement, the Group would repurchase an additional 19.11% equity interest in Jiucheng Advertisement for RMB18.3 million (US\$2.7 million) from those third-party investors if Jiucheng Advertisement is not listed on the PRC's National Equities Exchange and Quotations (“NEEQ”), commonly known as the New Third Board, before December 31, 2017. In March 2017, Jiucheng Advertisement was renamed as Shanghai Big Data Cultures & Media Co., Ltd. (“Big Data”). In September 2017, Big Data listed its shares on NEEQ. As Big Data has listed its shares on NEEQ and has fulfilled its obligation, hence the Group was relieved of its obligation to repurchase 19.11% equity interest in Big Data from those third-party investors. After the listings, the Group holds a 44.46% equity interest in Big Data. In 2018, there was no change in the equity interest of Big Data.

### <3> T3

In April 2008, the Group, through China Crown Technology, invested US\$38.3 million in cash to subscribe to 3,031,232 preferred shares issued by G10 Incorporation (“G10”), an established Korean online game developer and operator, which accounted for less than 20% of the equity interest in G10 on an as converted basis. The preferred shares are convertible, non-redeemable and with a liquidation preference. Considering the liquidation preference is substantive and not available to common shares, the preferred shares are not in substance common shares and equity accounting is not applicable. Further, considering the rights and obligations of these shares, they are not considered debt securities. Accordingly, the Group accounted for the investment in G10 under the cost method. The initial investment was US\$39.5 million, including US\$1.2 million transaction cost. Pursuant to the Series B Preferred Share Subscription Agreement entered into between G10 and the Group, the purchase price would be reduced by up to US\$25.0 million if G10’s consolidated net income does not reach the predetermined target for the period from July 1, 2009 to June 30, 2010. The target was not met in the predetermined period, and both parties reached a settlement agreement in November 2010 whereby the purchase price was reduced by US\$10.0 million, payable in 26 equal monthly installments beginning in February 2011. The adjustment to the purchase price was accounted for as a reduction in the carrying value of the underlying investment at the time of the settlement. The Group also performed an impairment assessment and recognized an impairment loss of RMB184.9 million for the year ended December 31, 2010. All the refund of purchase price under the settlement agreement had been received.

In December 2011, pursuant to the agreements between the shareholders of G10 and T3, a wholly-owned subsidiary of G10, G10 was spun off and the shareholders of G10 became shareholders of T3 at the same shareholding percentage. In February 2012, the changes in shareholding structures of G10 and T3 was completed and the Group owned 32,290 ordinary shares of T3, which reflects the same percentage of equity the Group owned in G10 on an as converted basis.

The Group performed an impairment assessment and determined that there is no impairment in the investment as of December 31, 2017 and 2018, respectively.

### <4> Smartposting

In June 2017, the Group completed a share exchange transaction with IE Limited (“IE”), which was a listed company on Korean Securities Dealers Automated Quotations of Korea Exchange (“KOSDAQ”) for issuance and sale of 12,500,000 ordinary shares of the Group with a 10 year lock-up period. In exchange, IE transferred 14.55% equity interest in Smartposting, a wholly-owned subsidiary of IE. The fair value of 14.55% equity interest in Smartposting was considered to be the value of the assets surrendered to the Group in this non-monetary exchange transaction. Due to weaker than expected operating performance of Smartposting, the Group recorded an impairment of RMB5.1 million and RMB1.1 million (US\$0.2 million) for the years ended December 31, 2017 and 2018.



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**<5> Beijing Ti Knight**

In June 2017, the Group entered into an investment agreement with shareholders of Beijing Ti Knight where the Group will invest a total of RMB9.0 million (US\$1.3 million) in Beijing Ti Knight. As of December 31, 2018, the Group has invested RMB4.9 million (US\$0.7 million). Due to weaker than expected operating performance, the investment in Beijing Ti Knight was fully impaired and the impairment of RMB4.0 million and RMB0.9 million (US\$0.1 million) was recorded for the years ended December 31, 2017 and 2018, respectively (see Note 30).

**<6> Tandem Fund**

In December 2016, the Group recorded an impairment loss on Tandem Fund of RMB2.8 million (US\$0.4 million) based on the fair market value of Tandem Fund. In January 2017, the Group disposed its entire interest in Tandem Fund to a third-party for a consideration of RMB1.2 million (US\$0.2 million) which was equivalent to the carrying amount of the investment. No gain or loss was recognized on the disposal in 2017.

**<7> Maxline**

In January 2018, the Group completed a share exchange transaction with Red Ace Limited (“Red Ace”), which was a private company incorporated under the laws of the British Virgin Islands for issuance and sale of 3,571,429 ordinary shares of the Group with a specific lock-up period. In exchange, Red Ace transferred 29% equity interest in Maxline, an associate of Red Ace. The fair value of 29% equity interest in Maxline was considered to be the value of the assets surrendered to the Group in this non-monetary exchange transaction.

**<8> Leading Choice**

In September 2018, the Group completed a share exchange transaction with Leading Choice Investment Holdings Limited (“Leading Choice Investment”), which was a private company incorporated under the laws of Hong Kong for issuance and sale of 21,000,000 ordinary shares of the Group with a specific lock-up period. In exchange, Leading Choice Investment transferred 20% equity interest in Leading Choice, a wholly-owned subsidiary of Leading Choice Investment. The fair value of 20% equity interest in Leading Choice was considered to be the nominal value of ordinary shares of the Group in the non-monetary exchange transaction. In 2018, due to weaker than expected operating performance of Leading Choice, the Group recorded an impairment of RMB1.4 million (US\$0.2 million) for the year ended December 31, 2018.

**<9> The9 Education Technology**

In April 2018, the Group has invested RMB0.4 million (US\$0.1 million) in The9 Education Technology. But due to weaker than expected operating performance, the investment in The9 Education Technology was fully impaired and the impairment of RMB0.4 million (US\$0.1 million) was recorded for the year ended December 31, 2018.

**<10> Shanghai Ronglei**

In December 2017, the Group has entered into an investment agreement with shareholders of Shanghai Ronglei where the Group will invest a total of RMB5.0 million (US\$0.7 million) in Shanghai Ronglei. As of December 31, 2018, the Group has invested RMB4.0 million (US\$0.6 million) but due to weaker than expected operating performance, the investment in Shanghai Ronglei was fully impaired and the impairment of RMB4.0 million (US\$0.6 million) was recorded for the year ended December 31, 2018.

**<11> Plutux**

In September 2018, the Group completed a share exchange transaction with Plutux Labs Limited (“Plutux Labs”), which was a private company incorporated under the laws of Cayman Islands for issuance and sale of 21,000,000 ordinary shares of the Group with a specific lock-up period. In exchange, Plutux Labs transferred 8% equity interest in Plutux, a wholly-owned subsidiary of Plutux Labs. The fair value of 8% equity interest in Plutux was considered to be the nominal value of ordinary shares of the Group in the non-monetary exchange transaction. In 2018, due to weaker than expected operating performance of Plutux, the Group recorded an impairment of RMB1.4 million (US\$0.2 million) for the year ended December 31, 2018.

The Group recorded impairment charges relating to its investment in equity and others of RMB2.8 million, RMB9.1 million and RMB9.2 million (US\$1.3 million) for the years ended December 31, 2016, 2017 and 2018, respectively.

## **8. AVAILABLE-FOR-SALE INVESTMENTS**

### **Investment in L&A**

In June 2016, the Group along with certain other shareholders of Red 5 completed a share exchange transaction with L&A, a Cayman Islands company with shares publicly listed on the Growth Enterprise Market of the Hong Kong Stock Exchange (Stock Code: 8195). The Group exchanged approximately 30.6% equity interest (on a fully-diluted basis) in Red 5 for a total of 723,313,020 (after a one-to-five stock split) newly issued shares of L&A, after deducting 6% of shares received (46,168,920 shares) as payment of a service fee to a third-party consultant.

In June 2016, Asian Development, a wholly-owned subsidiary incorporated in Hong Kong, borrowed a total of HK\$92.3 million from a financial services company, which was secured by a pledge of 417,440,000 shares of L&A (see Note 16). In 2016, Asian Development was in default on the loan due to a sharp decline in share price of L&A. The lender is entitled to foreclose on the pledged shares and become the legal and beneficial owner of the pledged shares (see Note 30.3). In 2016, the Group provided a full impairment allowance of RMB244.8 million (US\$35.6 million) on the investment in L&A. In 2018, the loan remained in default and the lender did not make any claim against Asian Development to recover any outstanding amounts under the agreement.

In 2017, the Group sold 18,360,000 shares in L&A for a consideration of RMB0.1 million (US\$0.01 million). In an extraordinary general meeting in October 2017, Board of Directors of L&A passed a resolution to consolidate every twenty issued and unissued shares into one share. After the share consolidation and as of both December 31, 2017 and 2018, the Group owned 14,375,651 shares in L&A.

**9. PROPERTY, EQUIPMENT AND SOFTWARE, NET**

Property, equipment and software and related accumulated depreciation and amortization are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
Office buildings	69,341,652	69,341,652	10,085,325
Computers and equipment	85,311,170	84,134,612	12,236,872
Leasehold improvements	11,503,400	10,365,904	1,507,658
Office furniture and fixtures	6,472,915	6,194,658	900,976
Motor vehicles	8,487,925	7,038,397	1,023,692
Software	15,833,764	15,832,264	2,302,707
Less: accumulated depreciation and amortization	(176,115,819)	(175,555,042)	(25,533,422 )
Property, equipment and software, net, held for sale	(113,755 )	-	-
Net book value	20,721,252	17,352,445	2,523,808

Depreciation and amortization charges for the years ended December 31, 2016, 2017 and 2018 amounted to RMB7.3 million, RMB5.3 million and RMB3.7 million (US\$0.5 million), respectively. The office building was mortgaged as collateral for the convertible notes and bank borrowing in 2015 (see Note 19 and Note 16).

**10. GOODWILL**

Changes in the carrying amount of goodwill for the years ended December 31, 2016, 2017 and 2018 are as follows:

	Gross amount	Accumulated impairment loss	Net amount
	RMB	RMB	RMB
Balance at January 1, 2016	10,342,694	-	10,342,694
Impairment allowance	-	(10,561,857)	(10,561,857)
Translation difference	219,163	-	219,163
Balance at December 31, 2016	10,561,857	(10,561,857)	-
Translation difference	-	-	-
Balance at December 31, 2017 and 2018	-	-	-
Balance at December 31, 2017 and 2018 US\$ (Note 3)	-	-	-

In 2010, the Group recognized goodwill of US\$1.6 million in connection with the acquisition of Red 5. The Group measures the consideration it transfers at fair value, which may be calculated as the sum of the acquisition-date fair values of the assets transferred, liabilities incurred to former owners of the acquiree, and equity instruments issued. The costs directly attributable to the acquisition are expensed as incurred. Identifiable assets acquired and liabilities assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any noncontrolling interests. Contingent consideration is measured at fair value and recorded as a liability. The excess of (i) the total cost of acquisition, fair value of the noncontrolling interests and acquisition-date fair value of any previously held equity interest in the acquiree over (ii) the fair value of the identifiable net assets of the acquiree is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference would be recognized directly in the consolidated statements of operations and comprehensive loss.

In 2016, due to weaker than expected operating performance of Red 5, the Group determined that goodwill was fully impaired. Impairment loss of RMB10.6 million (US\$1.5 million) was recorded for the year ended December 31, 2016.

**11. INTANGIBLE ASSETS, NET**

Gross carrying amount, accumulated amortization and net book value of the intangible assets as of December 31, 2017 and 2018 are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
Acquired game licenses	146,925,649	146,925,649	21,369,449
Acquired game development cost	12,285,000	12,285,000	1,786,779
Less: accumulated amortization	(85,026,783 )	(85,026,783 )	(12,366,633 )
Less: impairment allowance	(72,398,186 )	(72,398,186 )	(10,529,879 )
Translation difference	(1,785,680 )	(1,785,680 )	(259,716 )
Net book value of intangible assets subject to amortization	-	-	-

In 2017 and 2018, none of acquired game licenses had expired or been written-off from cost basis and accumulated amortization.

Since its acquisition by the Group on April 6, 2010, Red 5 has been substantially devoted its operating activities to fulfill its obligations under a game development and license agreement executed in 2006 and amended in 2009 between Red 5 and a third-party game publisher to develop Firefall in exchange for cash consideration from the third-party publisher. Prior to the acquisition, Red 5 received a total of US\$24.7 million cash consideration as an advance recoupable against future royalties payable to Red 5. Red 5 retained the ownership of the game and granted the third-party publisher an exclusive, non-transferable term license to market and distribute the game and host the game for customers in specified regions after Red 5 completes the game development. Red 5 continues to perform its obligations under the agreement post-acquisition, including the provision of post-contract customer support for the hosted version of the game to the third-party publisher during the term of the license. The initial term of the agreement is from February 2006 through the fifth anniversary of the first commercial release of the initial game. Thereafter, the agreement can be renewed in two-year terms.



In September 2011, Red 5 Singapore and Red 5 entered into a series of agreements with the third-party game publisher. Pursuant to the agreement, Red 5 Singapore were substituted in full for the third-party publisher as a party under the game development and license agreement between Red 5 and the third-party game publisher, including the exclusive, non-transferable term license to market and distribute the game and host the game for customers in specified regions. Under the agreements, the Group paid US\$10.0 million and guaranteed an additional payment of US\$12.7 million to the third-party game publisher due within four years. In addition, the Group is subject to additional contingent payments to be calculated based on certain percentages of the proceeds received from future game licensing and royalties, if any. The total consideration paid, including the US\$10.0 million and the guaranteed amount of US\$12.7 million, was recorded as acquired game license. The contingent payments will be recorded as cost of services when incurred. The balance of accounts payable related to this game license fee was US\$3.1 million as of December 31, 2018.

The Group pledged intellectual property in relation to the game to secure the guaranteed amount. Following this license acquisition, the previously recognized backlog of US\$0.4 million in relation to the game development and license agreement acquired in the Red 5 acquisition was reclassified to acquired game licenses as it was considered to be additional cost to acquire the game license.

Amortization expense related to intangible assets was RMB10.2 million, nil and nil for the years ended December 31, 2016, 2017 and 2018, respectively.

The Group has been monitoring its licensed games that have not commercially launched, including but not limited to their market acceptance and operational performance in other regions where they are commercially launched and operated by other operators. The Group incorporates these factors into its continuous evaluation of the forecasted results of the respective games and takes into account the Group's expected commercial launch and cash flows in the evaluation of potential impairment of the carrying value of upfront licensing fees. Based on the Group's impairment tests, impairment allowance on upfront licensing fees of RMB68.0 million, nil and nil were provided in 2016, 2017 and 2018, respectively.

**12. LAND USE RIGHT, NET**

Gross carrying amount, accumulated amortization and net book value of land use right are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
Land use right	85,160,348	85,160,348	12,386,059
Less: accumulated amortization	(20,649,782 )	(22,570,692 )	(3,282,771 )
Net book value	64,510,566	62,589,656	9,103,288

Amortization charge for the years ended December 31, 2016, 2017 and 2018 amounted to RMB1.9 million, RMB1.9 million and RMB1.9 million (US\$0.3 million), respectively. The land use right was mortgaged for the convertible notes and bank borrowing in 2015 (see Note 19 and Note 16).

**13. OTHER LONG-LIVED ASSETS, NET**

Other long-lived assets are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31 2018 US\$ (Note 3)
Prepaid license fee	6,515,200	6,515,200	947,597
Other	6,220	-	-
Total	6,521,420	6,515,200	947,597

Prepaid license fee represents the payment made by the Group pursuant to an IP license agreement with an online game company in January 2016 to use its IP to develop a mobile game. The mobile game is expected to be launched in 2019.

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#### 14. FAIR VALUE MEASUREMENTS

##### *Assets and Liabilities Measured at Fair Value on a Recurring Basis*

The fair values of common stock warrants were measured using the Black-Scholes Model (see Note 23). Inputs used to determine estimated fair value of the warrant liabilities include the estimated fair value of the underlying stock at the valuation date, the estimated term of the warrants, risk-free interest rates, expected dividends and the expected volatility of the underlying stock. The significant unobservable inputs used in the fair value measurement of the warrant liability are the fair value of the underlying stock at the valuation date and the estimated term of the warrants. The fair value of convertible note is based on a discounted cash flow model with an unobservable input of discount rate. (Level 3)

In 2015, the Group issued warrants in connection with its convertible notes. The warrants are recorded at fair market value at the date of issuance and subsequently at each reporting date. The following table presents the change in the warrants liability that were measured at fair value on a recurring basis using significant Level 3 inputs during 2017 and 2018 (see Note 20).

	<b>December 31, 2017 RMB</b>	<b>December 31, 2018 RMB</b>	<b>December 31, 2018 US\$ (Note 3)</b>
Balance at issuance date/beginning of year	16,357,737	3,742,271	544,290
Fair value change on warrants liability recognized in other comprehensive income	(12,615,466 )	(2,251,427 )	(327,456 )
Balance at the end of the year	3,742,271	1,490,844	216,834

## **15. TAXATION**

### *Cayman Islands*

Under the current tax laws of the Cayman Islands, the Group is not subject to tax on its income or capital gains. In addition, upon payment of dividends by The9 Limited to its shareholders, no Cayman Islands withholding tax will be imposed.

### *Hong Kong*

The Group's subsidiaries incorporated in Hong Kong did not have assessable profits that were derived in Hong Kong during the years ended December 31, 2016, 2017 and 2018. Therefore, no Hong Kong income tax has been provided for in the years presented.

### *Singapore*

The Group's subsidiaries incorporated in Singapore did not have assessable profits that were derived in Singapore during the years ended December 31, 2016, 2017 and 2018. Therefore, no Singapore income tax has been provided for in the years presented.

### *PRC*

The Group's subsidiaries and VIE subsidiaries incorporated in the PRC are subject to Enterprise Income Tax ("EIT") on the taxable income as reported in their respective statutory financial statements adjusted in accordance with the PRC Enterprise Income Tax Law ("EIT Law"), which went into effect as of January 1, 2008. The Group's subsidiaries and VIE subsidiaries in the PRC are generally subject to EIT at a statutory rate of 25%. The subsidiaries that hold a "High and New Technology Enterprise" ("HNTE") qualification are subject to a 15% preferential EIT rate. The HNTE qualification is valid for three years and every qualified HNTE company is required to re-apply for it in the three years after receiving approval. In October 2017, Shanghai IT renewed its HNTE qualification and obtained approval in 2018, which entitles Shanghai IT to enjoy a preferential EIT rate of 15% during the period from 2018 to 2020. Total tax savings of Shanghai IT were nil for the years ended December 31, 2016, 2017 and 2018.

*United States*

The Group's subsidiaries incorporated in the U.S. are registered in the state of California and are subject to U.S. federal corporate marginal income tax rate of 21% and state income tax rate of 0.28%, respectively. The Group has assessed the recently enacted tax reform in the United States and concluded that there is no material effect to the financial statements.

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On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act includes significant changes to the U.S. corporate income tax system including a federal corporate rate reduction from 34% to 21%; limitations on the deductibility of interest expense and executive compensation; creation of the base erosion anti-abuse tax (“BEAT”), a new minimum tax; and the transition of U.S. international taxation from a worldwide tax system to a modified territorial tax system. A majority of the provisions in the Tax Act are effective January 1, 2018.

The Tax Act creates a new requirement that certain income such as Global Intangible Low-Taxed Income (“GILTI”) earned by a controlled foreign corporation (“CFC”) must be included in the gross income of the CFC U.S. shareholder. The Group has evaluated these provisions of the Tax Act and whether taxes due on future U.S. inclusions related to GILTI be recorded as current-period expense when incurred, or factored into measurement of deferred taxes. The Group concluded that there is no material effect to the financial statements.

#### *Composition of income tax expense*

The current and deferred portions of income tax expense included in the consolidated statements of operations and comprehensive loss are as follows:

	For the year ended December 31,			
	2016	2017	2018	2018
	RMB	RMB	RMB	US\$
				(Note 3)
Current income tax expense				
China	-	-	-	-
Other jurisdictions	-	-	-	-
Deferred taxation				
China	(22,553,453)	(84,042,632 )	(39,763,083)	(5,783,301)
Other jurisdictions	46,848,751	(124,313,755)	(19,816,235)	(2,882,151)
Subtotal	24,295,298	(208,356,387)	(59,579,318)	(8,665,452)
Change in valuation allowance				
China	22,553,453	84,042,632	39,763,083	5,783,301
Other jurisdictions	(52,928,033)	124,313,755	19,816,235	2,882,151
Subtotal	(30,374,580)	208,356,387	59,579,318	8,665,452
Income tax benefit	(6,079,282 )	-	-	-

#### *Reconciliation of the differences between statutory tax rate and the effective tax rate*

Reconciliation between the statutory EIT rate and the Group's effective tax rate is as follows:

	For the year ended December 31,		For the year ended December 31,		For the year ended December 31,	
	2016		2017		2018	
PRC statutory EIT rate	25	%	25	%	25	%
Effect of different tax rates in other jurisdictions	(4	)%	(2	)%	2	%
Effect of future tax rate change	(1	)%	(22	)%	1	%
Change of prior year deferred tax assets	(1	)%	(8	)%	(11	)%
Change of valuation allowance	(13	)%	61	%	(2	)%
Income not subject to tax and non-deductible expenses, net	0	%	(1	)%	0	%
Effect of expired net operating loss	(6	)%	(53	)%	(15	)%
Effective EIT rate	0	%	0	%	0	%



*Significant components of deferred tax assets*

	<b>For the year ended December 31,</b>	<b>For the year ended December 31,</b>	<b>For the year ended December 31,</b>
	<b>2017 RMB</b>	<b>2018 RMB</b>	<b>2018 US\$ (Note 3)</b>
Temporary differences related to expenses and accruals	1,858,263	1,087,421	158,159
Temporary differences related to impairment on advances to suppliers	533,377	2,451,767	356,595
Temporary differences related to provision for doubtful accounts	1,604,986	3,077,784	447,645
Others	6,859,651	7,152,217	1,040,247
Temporary differences related to depreciation, amortization, and impairment of equipment and intangible assets	23,180,705	23,165,631	3,369,301
Startup expenses and advertising fees	12,156,135	608,399	88,488
Temporary differences related to research and development credits	1,047,514	1,106,956	161,000
Temporary differences related to equity investments	2,599,887	3,978,269	578,615
Foreign tax credits	16,070,561	-	-
Temporary differences related to provision for prepayment for equipment	5,000,000	5,000,000	727,220
Tax loss carry forwards	330,832,639	294,535,956	42,838,478
Total deferred tax assets	401,743,718	342,164,400	49,765,748
Less: Valuation allowance	(401,743,718)	(342,164,400)	(49,765,748)
Total deferred tax assets	-	-	-

*Movement of valuation allowance on deferred tax assets*

	<b>For the year ended December 31,</b>	<b>For the year ended December 31,</b>	<b>For the year ended December 31,</b>
	<b>2017 RMB</b>	<b>2018 RMB</b>	<b>2018 US\$ (Note 3)</b>
Beginning balance	610,100,105	401,743,718	58,431,200
Decrease in valuation allowance	(208,356,387)	(59,579,318)	(8,665,452)
Ending balance	401,743,718	342,164,400	49,765,748

For the years ended December 31, 2017 and 2018, the Group recorded a reversal of valuation allowance of approximately RMB208.4 million and RMB59.6 million (US\$8.7 million), respectively. The Group considers positive and negative evidence to determine whether some portion or all of the deferred tax assets will more likely than not be realized. This assessment considers, among other matters, the nature, frequency and severity of recent losses, forecasts of future profitability, the duration of statutory carry forward periods, the Group's experience with tax attributes expiring as unused and tax planning alternatives. Valuation allowances have been established for deferred tax assets based on a more-likely-than-not threshold. The Group's ability to realize deferred tax assets depends on its ability to generate sufficient taxable income within the carry forward periods provided for in the tax law.

As of December 31, 2018, the Group's PRC subsidiaries had net operating loss carry forwards of RMB392.1 million, of which RMB41.0 million, RMB113.6 million, RMB99.5 million, RMB71.1 million and RMB66.9 million will expire in 2019, 2020, 2021, 2022 and 2023, respectively. The Group has provided a full valuation allowance as it is not more likely than not that the net operating losses can be utilized before expiry. According to Caishui [2018] No. 76, with effect from January 1, 2018, losses of qualified HNTE in the current year occurred five years before the year in which the entity qualified for HNTE and have not been made up shall be allowed to be carried forward to subsequent years to be made up, and the maximum carry-forward period shall be extended from five years to ten years.

As of December 31, 2018, Red 5 had net operating loss carry forwards for federal and state income tax purposes of approximately US\$125.5 million and US\$64.7 million, respectively, which will begin to expire in 2026 and 2028, respectively. Red 5 also had credits for increasing research activities available to offset future federal and state taxes payable of approximately US\$0.1 million and US\$0.1 million, respectively, that will begin to expire in 2026 for federal purposes and which have no expiration for state purposes. Red 5 had foreign tax credits for federal purposes of approximately US\$2.5 million, which has expired in 2018. Pursuant to US tax laws and regulations, the utilization of an acquired entity's net operating losses and credits are subject to annual limitation computed based on the fair value of the acquired entity. As a result of the limitation, the Group provided a full valuation allowance as it is not more likely than no not that the net operating losses and credits carried forward can be utilized before expiration.

In accordance with the EIT Law, dividends, which arise from profits of foreign invested enterprises ("FIEs") earned after January 1, 2008, are subject to a 10% withholding income tax. In addition, under tax treaty between the PRC and Hong Kong, if the foreign investor is incorporated in Hong Kong and qualifies as the beneficial owner, the applicable withholding tax rate is reduced to 5%, if the investor holds at least 25% in the FIE, or 10%, if the investor holds less than 25% in the FIE. A deferred tax liability should be recognized for the undistributed profits of PRC companies unless the Group has sufficient evidence to demonstrate that the undistributed dividends will be reinvested and the remittance of the dividends will be postponed indefinitely. The Group plans to indefinitely reinvest undistributed profits earned after December 31, 2007 from its China subsidiaries in its operations in the PRC. Therefore, no withholding income taxes for undistributed profits of the Company's subsidiaries incorporated in PRC have been provided as of December 31, 2017 and 2018.

Under applicable accounting principles, a deferred tax liability should be recorded for taxable temporary differences attributable to the excess of financial reporting basis over tax basis in a domestic subsidiary. However, recognition is not required in situations where the tax law provides a means by which the reported amount of that investment can be recovered tax-free and the enterprise expects that it will ultimately use that means. The Group has not recorded any such deferred tax liability attributable to the undistributed earnings of its financial interests in VIEs because these entities do not have any accumulated earnings as of December 31, 2017 and 2018.

The Group made its assessment of the level of authority for each tax position (including the potential application of interests and penalties) based on the tax positions' technical merits, and measured the unrecognized benefits associated with the tax positions. The Group did not have any unrecognized tax benefits as of December 31, 2017 and 2018. The Group does not anticipate that unrecognized tax benefits will significantly increase or decrease within the next twelve months. For the years ended December 31, 2016, 2017 and 2018, the Group did not have any material interest and penalties associated with its tax positions.

According to PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or withholding agent. The statute of limitations will be extended five years under special circumstances, which are not clearly defined (but an underpayment of tax liability exceeding RMB 0.1 million is specifically listed as a special circumstance). In the case of a related party transaction, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. From inception to 2018, the Group is subject to examination of the PRC tax authorities. Red 5's federal income tax returns and state income tax returns for 2006 through 2018 are open tax years, subject to examination by the relevant tax authorities.

## 16. SHORT-TERM BORROWINGS

Short-term borrowings are as follows:

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
Pledged loan	77,118,809	80,836,823	11,757,228
Long-term borrowing due within one year	31,624,560	31,624,560	4,599,602
Total	108,743,369	112,461,383	16,356,830

In June 2016, the Group completed a share exchange transaction with L&A for a total of 769,481,940 (after a 1 to 5 stock split) newly issued shares of L&A. In June 2016, Asian Development borrowed a total of HK\$92.3 million from a financial services company at an annual interest rate of 2% for a term of 24 months, which is secured by a pledge of 417,440,000 shares of L&A. The outstanding balance as of December 31, 2018 is RMB84.5 million (US\$12.3 million), which includes RMB3.6 million (US\$0.5 million) of interest payable, and the pledged loan was due in June 2018. Asian Development has defaulted the loan in June 2016 due to a sharp decline in share price of L&A (see Note 30.3)

In December 2015, the Group entered an entrusted bank borrowing agreement, amounted to RMB31.6 million (US\$4.6 million), with a subsidiary of the convertible notes investor (see Note 19) and China Merchants Bank as entrustment bank. The borrowing agreement has matured in December 2018, with an annual interest rate of 12% due on maturity of the loan. The loan is secured by the Group's office buildings. The outstanding balance as of December 31, 2018 is RMB43.3 million (US\$6.3 million), including RMB11.7 million (US\$1.7 million) of interest payable. The entrusted bank borrowing was due in December 2018 but has not repaid as of December 31, 2018. The Group has entered into a deed of settlement with the investor of convertible notes on March 12, 2019 where the Group will proceed to the disposal of office buildings and to repay both convertible notes and entrusted bank borrowing. Annual

interest rate of the loan remained at 12% up to settlement date.

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**17. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities are as follows:

	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2017</b>	<b>2018</b>	<b>2018</b>
	<b>RMB</b>	<b>RMB</b>	<b>US\$</b>
			(Note 3)
Staff cost related payables	7,461,738	4,245,967	617,550
Professional services	7,250,470	6,879,775	1,000,622
Utility fee	2,013,127	1,547,898	225,132
Product development services	849,446	892,216	129,767
Funds raised for CrossFire New Mobile Game (see below)	57,499,910	57,499,910	8,363,015
Others	8,625,360	10,225,540	1,487,244
Total	83,700,051	81,291,306	11,823,330

The Group has financed the early phase development of CrossFire New Mobile Game through fund raising from the Inner Mongolia Culture Assets and Equity Exchange. As of December 31, 2018, the Group had raised RMB57.5 million (US\$8.4 million). Under this fund raising arrangement, the Group will share certain percentages of the revenues from CrossFire new mobile game to the investors providing funding to the Group. Due to unforeseen circumstances, the Group is not planning to finance the remaining RMB100.0 million (US\$14.5 million) and due to non-recovery of the advance financing fee, the Group has fully impaired the advance financing fee as of December 31, 2018. In November 2017, the Group entered into an exclusive publishing agreement with a third-party company, pursuant to which this third-party company was granted with an exclusive right to publish the CrossFire New Mobile Game in China and the game is expected to be launched in the second half of 2019.

**18. Refund of WoW game points**

As a result of the loss of the World of Warcraft (“WoW”) license on June 7, 2009, the Group announced a refund plan in connection with inactivated WoW game point cards, which the Group recorded as advance from customers. According to the plan, inactivated WoW game point card holders are eligible to receive a cash refund from the Group. The Group recorded a liability in connection with both inactivated points cards and activated but unconsumed point cards of approximately RMB200.4 million.

Upon the loss of the WoW license, the Group concluded the nature of the obligation substantively changed from deferred revenue, for which the Group had the responsibility to satisfy the underlying performance obligation, to an obligation to refund players for their unconsumed points. The Group has accounted for this refund liability by applying the derecognition guidance specified in ASC 405-20. In accordance with this guidance, the refund liability associated with these WoW game points, to the extent not refunded, will be recorded as other operating income after the Group is legally released from the obligation to refund amounts under the applicable laws. In consultation with its legal counsel, the Group concluded the legal liability relating to the inactivated WoW game point cards was extinguished in September 2011 on the basis that the legal liability lapsed two years from the date the Group publicly announced the refund policy that applied to these cards. Accordingly, the associated liability amounting to RMB26.0 million (US\$3.8 million) was recognized as other operating income for the year ended December 31, 2011. With respect to the remaining refund liability, based on current PRC laws, to the extent not refunded, the Company, in consultation with legal counsel has determined that it will be legally released from this liability in September 2029, which represents 20 years from the discontinuation of WoW in 2009. However, if the Group were to publicly announce a refund policy, the Group would be legally released from any remaining liability for these activated, but unconsumed points that remained two years from the date of such announcement. To date, the Group has determined not to publicly announce any refund policy with respect to this remaining liability, and no refunds have been claimed. The remaining refund liability relating to the activated, but unconsumed WoW game points is RMB170.0 million (US\$24.7 million) as of both December 31, 2017 and 2018.

## ***19. CONVERTIBLE NOTES***

On November 24, 2015, the Group entered into an agreement with a third-party investor for a private placement of secured convertible notes and warrants for a gross proceeds of US\$40,050,000. The transaction closed on December 11, 2015. Pursuant to the terms of the agreement, the convertible notes shall mature in December 2018, subject to an extension for two years at the discretion of the investor. The convertible notes accrue interest at a rate of 12% per annum and are payable upon maturity of the notes. The notes are secured by the equity interest of the Group's subsidiaries (The9 Computer and C9I Shanghai), and the Group's office buildings with a total net book value of RMB16.0 million as of December 31, 2018. The third-party investor is entitled to put the convertible notes to the Group upon a change in control and upon an event of default. The Group has entered into a deed of settlement with the investor of convertible notes on March 12, 2019 where the Group will proceed to the disposal of office buildings and to repay both convertible notes and entrusted bank borrowing. Annual interest rate of the loan remained at 12% up to settlement date.

The notes are divided into three tranches and can be converted into a total of 11,695,513 shares of the Group's ADS at any time as follows:

Convertible Notes	Principal Amount	Conversion Price
Tranche A	US\$ 22,250,000	US\$ 2.60
Tranche B	US\$ 13,350,000	US\$ 5.20
Tranche C	US\$ 4,450,000	US\$ 7.80

The conversion prices are subject to anti-dilution adjustments in the event the Group issues ordinary shares at a price per share lower than the applicable conversion price in effect immediately prior to the issuance. As of December 31, 2018, no adjustments to the conversion prices had occurred.

The Group has determined that there was BCF attributable to the Tranche A convertible loan as the conversion price is lower than market value at the date of issuance of the convertible note. The value of the BCF is determined to be US\$8.1 million, which is equal to the intrinsic value of the conversion feature. The convertible notes are recorded at net carrying value at the date of issuance as follows:

	US\$
Principal Amount	40,050,000
Less:	
Fair value allocated to warrants (Note 20)	8,821,883
Beneficial conversion feature	8,112,556
Issuance cost	3,200,000
Net carrying value	19,915,561

The fair value of warrants, BCF and issuance costs are recorded as debt discount and accreted to interest expense over three years using the effective interest method. The convertible notes should be repaid with principal and interest based on the agreement. As of December 31, 2017 and 2018, the total carrying amount of the convertible notes principal and interest payable is RMB260.6 million and RMB375.3 million (US\$54.6 million), respectively. Interest expenses recognized related to the convertible notes are RMB50.4 million, RMB77.0 million and RMB98.3 million (US\$14.3 million) for the years ended December 31, 2016, 2017 and 2018, respectively.



**20. WARRANTS**

The warrants are exercisable at any time after the commitment date to purchase up to 4,778,846 shares of the Group's ADS as follows:

<b>Warrants</b>	<b>Principal Amount</b>	<b>Exercise Price</b>
Tranche I	US\$ 5,000,000	US\$ 1.50
Tranche A	US\$ 2,750,000	US\$ 2.60
Tranche B	US\$ 1,650,000	US\$ 5.20
Tranche C	US\$ 550,000	US\$ 7.80

For the tranches A, B and C, the expiration date is the third anniversary of the issuance date or if the holder has exercised its option to extend the maturity date of all or any portion of the convertible notes in accordance with the terms and conditions thereof, the fifth anniversary of the issuance date. Tranches A, B and C expired on December 20, 2018. Tranche I will expire in December 2020.

The exercise prices of the warrants are subject to anti-dilution adjustments in the event the Company issue ordinary shares at a price per share lower than the applicable exercise price in effect immediately prior to the issuance. As of December 31, 2018, no adjustments to the exercise prices had occurred.

The Group performs valuations of the warrants using a probability weighted Black-Scholes Model. This model requires input of assumptions including the risk-free interest rates, volatility, expected life and dividend rates, and has also considered the likelihood of "down-round" financings. Selection of these inputs involves management's judgment and may affect net income.

The assumptions used in the Black-Scholes option pricing model for Tranche I was as follows:

<b>Warrants</b>	<b>Tranche I</b>
Risk-free interest rate	2.62 %
Expected volatility of common stock	100.2 %
Dividend yield	0.00 %
Expected life of warrants	1.9 years

The fair value of the warrants as of issuance date, December 31, 2017 and 2018 is RMB3.7 million and RMB1.5 million (US\$0.2 million), respectively. The change in fair value of the warrants liability resulted in a loss of RMB48.1 million, RMB12.6 million and RMB2.3 million (US\$0.3 million) for the years ended December 31, 2016, 2017 and 2018, respectively.

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## **21. SHAREHOLDER RIGHTS PLAN**

On January 8, 2009, the Company adopted a shareholder rights plan. The shareholder rights plan is designed to protect the best interests of the Company and its shareholders by discouraging third-parties from seeking to obtain control of the Company in a tender offer or similar hostile transaction. The shareholder rights plan was amended on March 9, 2009, June 8, 2017 and June 16, 2017.

Pursuant to the terms of the shareholder rights plan, as amended, one right was distributed with respect to each ordinary share of the Company outstanding at the close of business on January 22, 2009. The rights will become exercisable only if a person or group (the “Acquiring Person”) obtains ownership of 15% or more of the Company’s voting securities (including by acquisition of the Company’s ADSs representing ordinary shares) (a “Triggering Event”), subject to certain exceptions. In the case of a Triggering Event, the rights plan entitles shareholders other than the Acquiring Person to purchase, for an exercise price of US\$19.50, a number of shares with a value twice that of the exercise price. The number of shares each such shareholder will be entitled to purchase is equal to the product of (i) the number of shares then owned by such shareholder and (ii) two times the exercise price divided by the then current market price per share. The rights plan will continue in effect until January 8, 2019, unless the plan is terminated by the Company or the rights are redeemed by the Company before the plan expires. The plan has not been exercisable as of December 31, 2018. As of the issuance date of financial statements, the rights plan has expired and not been extended.

## **22. EMPLOYEE BENEFITS**

Full-time employees of the Group’s subsidiaries and VIE subsidiaries registered in the PRC are entitled to staff welfare benefits, including medical care, welfare subsidies, unemployment insurance and pension benefits through a PRC government-mandated multi-employer defined contribution plan. These entities are required to accrue for these benefits based on certain percentages of the employees’ salaries in accordance with the relevant regulations, and to make contributions to the state-sponsored pension and medical plans out of the amounts accrued for medical and pension benefits. The total amounts charged to the consolidated statements of operations and comprehensive loss for such employee benefits amounted to RMB15.4 million, RMB12.9 million and RMB7.9 million (US\$1.1 million) for the years ended December 31, 2016, 2017 and 2018, respectively. The PRC government is responsible for the medical benefits and ultimate pension liability to these employees.

## 23. SHARE-BASED COMPENSATION

### 23.1 Share Option Plan

On December 15, 2004, in connection with its initial public offering, the Company adopted a share option plan (“2004 Option Plan”). As of December 31, 2013, the total number of ordinary shares reserved in the 2004 Option Plan was 6,449,614 shares. The maximum contractual term of the awards under this plan shall be no more than five years from the date of grant. The options granted under this plan shall be at the money on the date of grant and typically vest over a three-year period, with one third of the options to vest on the each of the anniversary after the grant date. The 2004 Option Plan was amended in November 2015 to increase the maximum aggregate number of ordinary shares to 14,449,614 shares. The 2004 Option Plan was amended in August 2016 to increase the maximum aggregate number of ordinary shares to 34,449,614 shares. In December 2018, the 2004 Option Plan was amended to increase the maximum aggregate number of ordinary shares to 100,000,000 shares. On June 6, 2017, the Group and optionees have entered into certain stock option agreements, pursuant to which the Group has granted to the optionees options to acquire the ordinary shares, par value US\$0.01 each, of the Group. According to the agreements, 6,328,535 options were exercised to ordinary shares, and 10,806,665 options were canceled. As of December 31, 2018, options to purchase 2,050,000 ordinary shares are outstanding and options to purchase 89,956,594 ordinary shares are available for future grant under the 2004 Option Plan.

### Stock Options

The following table summarizes the Group’s share option activities with its employees and directors:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of January 1, 2018	-	-	-	Nil
Granted	5,750,000	US\$ 0.93	-	Nil
Exercised	-	-	-	Nil
Forfeited	(5,700,000 )	US\$ 0.93	-	Nil
Outstanding as of December 31, 2018	50,000	US\$ 0.93	4.07	Nil
Vested and expected to vest as of December 31, 2018	50,000	US\$ 0.93	4.07	Nil
Exercisable as of December 31, 2018	50,000	US\$ 0.93	4.07	Nil

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The options expected to vest are estimated by applying the pre-vesting forfeiture rate assumptions to total unvested options. The total intrinsic value of options exercised during the year was nil for years ended December 31, 2016, 2017 and 2018.

On January 24, 2018, as approved by the Board of Directors, the Group granted share options totaling 5,750,000 shares to directors, officers and consultants. The remaining shares shall become vested in a series of 36 successive equal monthly installments upon grantees' completion of each month of service to the Company over the 36-month period measured from the grant date. On September 4, 2018, the Group canceled a portion of the options totaling 4,700,000 share options granted to directors, officers and consultants. The remaining 1,000,000 share options were forfeited due to the resignation of directors.

The weighted-average grant-date fair value of options granted during 2018 was US\$0.51. The fair value of the share options were measured on the respective grant dates based on the Black-Scholes option pricing model, with below assumptions made regarding expected term and volatility, risk-free interest rate and dividend yield:

**For the year  
ended  
December 31,  
2018**

Risk-free interest rate	2.19	%
Expected life (years)	2.93	
Expected dividend yield	0.00	%
Volatility	78.55	%
Fair value of options at grant date	US\$ 0.51	

On August 6, 2016, The Group granted share options totaling 6,000,000 shares to Mr. Zhu Jun, chairman and chief executive officer, and a third-party consultant as a reward for facilitating the Mongolia funding platform with total funding amount of RMB157.5 million (US\$22.9 million) to the Group. According to ASC 718, the share option was applicable to the performance condition due to the share options would be vested in line with the percentage of funding received by the Group. In 2017, the options totaling 5,000,000 granted to Zhu Jun were canceled. As of December 31, 2018, options totaling 1,000,000 shares to a third-party consultant were outstanding.

On January 24, 2018, as approved by the Board of Directors, the Group granted share options totaling 2,500,000 shares to directors and consultant, subject to performance conditions, of which 1,000,000 shares granted will vest upon the success of improvement on the Group's online game business and 1,500,000 shares will vest upon the success of the Group's fund raising. On September 4, 2018, the Group canceled a portion of the options totaling

1,500,000 share options granted to director and consultant.

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The following table summarizes the share option activities subject to performance condition:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of January 1, 2018	1,000,000	US\$1.86	3.60	Nil
Granted	2,500,000	US\$0.93	-	Nil
Exercised	-	-	-	Nil
Forfeited	(1,500,000)	US\$0.93	-	Nil
Outstanding as of December 31, 2018	2,000,000	US\$1.86	2.06	Nil
Vested and expected to vest as of December 31, 2018	2,000,000	US\$1.86	2.06	Nil
Exercisable as of December 31, 2018	365,079	US\$1.86	0.06	Nil

The grant-date fair value of share options with performance condition during 2018 was US\$0.51. The fair value of the awards that are based on the performance condition was calculated using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	2.19 %
Expected life (years)	2.93
Expected dividend yield	0.00 %
Volatility	78.55 %
Fair value of options at grant date	US\$0.51

#### ***Cancellation and Acceleration Vesting of Share-Based Awards***

On June 6, 2017, the Group canceled a portion of the options totaling 10,806,665 and accelerated the vesting and exercise of the remaining options totaling 6,328,535 for options granted to 15 directors, officers and employees. The exercise price was modified to US\$0.00, which the original exercise price of the accelerated vesting options ranged from US\$1.53 to US\$1.86. The incremental compensation cost recognized due to the cancellation and acceleration vesting of options was RMB33.0 million (US\$4.8 million) in 2017. The fair value of the options canceled and accelerated vested under service and performance condition was measured on the modification date using Binomial Tree Pricing Model with the following assumptions:

Risk-free interest rate	1.16%-1.62 %
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Expected life (years)	4.49-5.00	
Expected dividend yield	0.00	%
Volatility	62%-74	%
Fair value of options at modification date	US\$0.06-US\$0.31	

The fair value of the options canceled and accelerated vested under market condition was measured on the modification date using the Monte Carlo Simulation model with the following assumptions:

Risk-free interest rate	1.52	%
Expected life (years)	5.00	
Expected dividend yield	0.00	%
Volatility	72	%
Fair value of options at modification date	US\$0.18-US\$0.25	

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

For the years ended December 31, 2016, 2017 and 2018, the Group recorded share-based compensation of RMB28.1 million, RMB38.0 million and RMB3.9 million (US\$0.6 million), respectively, for options granted to the Group's employees and directors.

As of December 31, 2018, there was approximately RMB7.5 million (US\$1.1 million) unrecognized compensation cost, adjusted for estimated forfeitures, related to nonvested options, for the options with performance condition issued to non-employee, a third-party consultant, subject to ASC 505-50. Unrecognized compensation cost would be addressed in Commitment (see Note 30). The cost related to performance condition option was recognized according to the funding schedule. Total unrecognized compensation cost may be adjusted for future changes in estimated forfeitures.

### ***Restricted Ordinary Shares***

On September 4, 2018, the Group granted an aggregate amount of 30,000,000 restricted ordinary shares to directors, officers and consultants. In exchange for such restricted ordinary shares granted, the Group forfeited and canceled the stock options in the total amount of 6,200,000 shares previously granted on January 24, 2018. Half of each individual's shares will only vest if the Group meets certain target on non-GAAP profit before tax in 2019. If the Group fails to achieve this target, such half of each individual's shares will be forfeited and canceled. The remaining half of each individual's shares is subjected to a half year lock-up period. After the half year lock-up period, such remaining shares shall become vested in 36 successive equal monthly installments upon grantees' completion of each month of service to the Group measured from the last day of each month after the vesting commencement date.

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### 23.2 Ordinary Shares Granted to Incsight Limited (“Incsight”)

Incsight is a company incorporated in the British Virgin Islands and wholly owned by Mr. Zhu Jun. On December 8, 2010, as approved by the Board of Directors, the Company granted 1,500,000 ordinary shares to IncSight, subject to performance conditions, of which 500,000 ordinary shares granted will vest when the Group achieves breakeven and 1,000,000 ordinary shares will vest when the Group's cumulative profit reaches US\$5.0 million in a quarter subsequent to the quarter in which the Group breaks even. The ordinary shares granted are not entitled to receive dividends until vested. The Board of Directors considered the grant of ordinary shares as an incentive to retain Mr. Zhu Jun's services with the Group. The awarded nonvested shares would be valid for five years from December 8, 2010. For the quarter ended September 30, 2014, the Group achieved breakeven. It was considered probable the performance targets will be met for the total of 1,500,000 ordinary shares. The fair value of the granted nonvested shares was US\$6.48 per share, the market price on the date of grant. On December 7, 2015, 500,000 ordinary shares granted to IncSight were vested. The awarded nonvested shares were valid for additional three years and had expired on December 7, 2018. The Group recorded share-based compensation of RMB1.9 million, RMB0.5 million and nil for the years ended December 31, 2016, 2017 and 2018, respectively. The following table reflects the activity of nonvested shares for the year ended December 31, 2018:

	<b>Number of Options</b>	<b>Weighted-Average Grant-Date Fair Value</b>
Nonvested as of January 1, 2018	1,000,000	US\$ 6.48
Granted	-	-
Forfeited	(1,000,000 )	US\$ 6.48
Vested	-	-
Nonvested as of December 31, 2018	-	-

### 23.3 Stock Options and Ordinary Shares Granted by Red 5

In February 2006, Red 5 adopted a Stock Incentive Plan (“Red 5 Stock Incentive Plan”) under which Red 5 may grant to its employees, director and consultants stock options to purchase common shares or restricted shares. As of December 31, 2010, 13,626,955 shares were reserved under Red 5 Stock Incentive Plan. In September, 2011, Red 5 further increased the number of common shares reserved to 22,855,591. If an option shall expire or terminate for any reason without having been exercised in full, the reserved shares subject to such option shall again be available for subsequent option grants under the plan. From the inception of this plan to December 31, 2018, Red 5 granted a total of 38,191,879 options to its employees and directors at the exercise price ranging from US\$0.0001 to US\$0.2450 per share, which vest over four years commencing from grant date. Options expire within a period of not more than ten years from the grant date. An option granted to a person who is a greater than 10% shareholder on the date of grant may not be exercisable more than five years after the grant date. As of December 31, 2018, options to purchase 5,111,250 shares of common stock were outstanding and options to purchase 15,480,087 shares of common stock were available for future grant.

The following table summarizes the Red 5’s share option activities with its employees and directors for the year ended December 31, 2018:

	<b>Number of Options</b>	<b>Weighted-Average Exercise Price per Option</b>	<b>Weighted-Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding as of January 1, 2018	5,476,250	US\$ 0.053	3.08	Nil
Granted	-	-	-	Nil
Exercised	-	-	-	Nil
Forfeited	(365,000 )	US\$ 0.115	-	Nil
Outstanding as of December 31, 2018	5,111,250	US\$ 0.049	2.24	Nil
Vested and expected to vest as of December 31, 2018	5,111,250	US\$ 0.049	2.24	Nil
Exercisable as of December 31, 2018	4,810,176	US\$ 0.049	2.24	Nil

The option’s intrinsic value was calculated by the excess of the estimated fair value of Red 5’s common shares, which was determined by the Group with the assistance of an independent valuation firm.

The options expected to vest are estimated by applying the pre-vesting forfeiture rate assumptions to total unvested options. The total intrinsic value of options exercised for the year ended December 31, 2016, 2017 and 2018 were nil.

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The fair value of options granted ranged from US\$0.012 to US\$0.149, measured on the grant date based on the Black-Scholes option pricing model with assumptions made regarding expected term and volatility, risk-free interest rate and dividend yield:

Risk-free interest rate	0.78%-5.00	%
Expected life (years)	4.00-6.00	
Expected dividend yield	0.00	%
Volatility	38.89%-69.36	%

Red 5 recorded share-based compensation of RMB0.4 million, RMB0.3 million and RMB0.04 million (US\$0.01 million) for options and shares of restricted common stock granted for the years ended December 31, 2016, 2017 and 2018, respectively. The share-based payment awards were recorded as a component of noncontrolling interest in the consolidated financial statements.

As of December 31, 2018, there was approximately RMB0.04 million (US\$0.01 million) of unrecognized compensation cost, adjusted for estimated forfeitures, related to nonvested share-based awards granted to Red 5 grantees. This cost is expected to be recognized over 0.2 years. Total unrecognized compensation cost may be adjusted for future changes in estimated forfeitures.

## **24. RELATED PARTY TRANSACTIONS AND BALANCES**

### *Transaction with equity investee*

In 2013, the Group entered into an agreement with ZTE9, an equity investee of the Group, to jointly operate IPTV games in China. According to the agreement, the Group pays ZTE9 a royalty fee for providing game contents on IPTV. Net royalty and other service fees related to IPTV business charged by ZTE9 to the Group amounted to RMB7.1 million and RMB5.2 million (US\$0.8 million) for the years ended December 31, 2017 and 2018, respectively. The Group provided IPTV related supporting service to ZTE9 of nil and RMB0.2 million (US\$0.03 million) for the years ended December 31, 2017 and 2018, respectively. Total amount due to ZTE9 for IPTV business was RMB2.7 million and RMB5.1 million (US\$0.7 million) as of December 31, 2017 and 2018, respectively. The Group lent RMB4.0 million and RMB0.6 million (US\$0.1 million) to ZTE9 to fund its operations in 2017 and 2018, respectively. ZTE9 has repaid RMB1.7 million (US\$0.3 million) in 2018. Total amount due from ZTE9 for outstanding loans was RMB2.1 million and RMB1.0 million (US\$0.1 million) as of December 31, 2017 and 2018, respectively.

In 2017, the Group charged service fee to Big Data of RMB0.05 million. In 2018, the service fee charged was RMB0.05 million (US\$0.01 million), and the outsourcing service fee was RMB0.4 million (US\$0.06 million) of which RMB0.1 million (US\$0.01 million) remained outstanding as of December 31, 2018.

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In 2014, the Group entered into a license agreement with System Link, a 50% joint venture of the Group, for publishing and operating Firefall for a five-year term in the PRC. Under this license agreement, System Link is expected to pay Red 5 and Red 5 Singapore a total of no less than US\$160.0 million (including license fee and royalties) during the term of the agreement. In 2015, System Link paid US\$10.0 million to the Group as license fee. The Group recorded the US\$10.0 million as amount due to the related party and was to amortize the amount over the five-year period. System Link has been dormant since the cessation of Firefall in March 2016 and the termination of CrossFire 2 license in November 2017. Red 5 Singapore filed a lawsuit against System Link in 2016. Due to ongoing litigation and non-operation of Firefall, Red 5 was no longer required to render any service to System Link in relation to the operation of Firefall. As such, Red 5 recognized the remaining unamortized license fee as revenue in 2017. The balance due to System Link (non-current) was nil as both of December 31, 2017 and 2018. The Group recognized licensing revenue of RMB13.6 million, RMB 51.1 million and nil for the years ended December 31, 2016, 2017 and 2018, respectively. Litigation against System Link by Red 5 Singapore is on-going as of December 31, 2018.

*Transaction with T3*

In 2016, Asian Way entered into a license agreement with T3, an equity investee of the Group, for developing a game using augmented reality (AR) technologies based on the intellectual property relating to the game. Upon commercial launch, Asian Way will share certain percentages of revenues of the game to T3. The game is still under development as of December 31, 2018.

*Transaction with Mr. Zhu Jun*

Mr. Zhu Jun, the chairman and chief executive officer, provided loans of RMB73.9 million and RMB11.0 million (US\$1.6 million) to the Group in 2017 and 2018, respectively. The loans were interest-free and the outstanding balance of RMB75.2 million and RMB57.1 million (US\$8.3 million) remained as of December 31, 2017 and 2018, respectively.

**25. LOSS PER SHARE**

Loss per share is calculated as follows:

	For the year ended December 31, 2016 RMB	For the year ended December 31, 2017 RMB	For the year ended December 31, 2018 RMB	For the year ended December 31, 2018 US\$ (Note 3)
Numerator:				
Net loss attributable to ordinary shareholders before accretion on redeemable noncontrolling interest	(593,781,589)	(118,165,850)	(217,092,926)	(31,574,856)
Accretion on redeemable noncontrolling interest	(82,890,188 )	(57,126,233 )	(40,918,773 )	(5,951,389 )
Net loss attributable to ordinary shareholders	(676,671,777)	(175,292,083)	(258,011,699)	(37,526,245)
Denominator:				
Denominator for basic and diluted loss per share – weighted-average shares outstanding	23,874,102	33,426,448	62,114,760	62,114,760
Loss per share				
- Basic and diluted	(28.34 )	(5.24 )	(4.15 )	(0.60 )

The Company had 22,914,046, 5,778,846 and 6,828,846 stock options, warrants and nonvested shares outstanding as of December 31, 2016, 2017 and 2018, respectively, which were excluded in the computation of diluted loss per share in the periods presented, as their effect would have been anti-dilutive due to the net loss reported in such periods.

**26. RESTRICTED NET ASSETS**

Pursuant to laws applicable to entities incorporated in the PRC, the subsidiaries and the VIEs of the Group in the PRC must make appropriations from after-tax profit to non-distributable reserved funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires annual appropriation of 10% of after tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserved fund reaches 50% of their registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserved funds can only be used for specific purposes of enterprise expansion and staff

bonus and welfare are not distributable as cash dividends. The appropriation to these reserves by the Group's PRC entities was nil for the years ended December 31, 2016, 2017 and 2018. The accumulated reserves as of December 31, 2018 were RMB3.8 million (US\$0.6 million). In addition, due to restrictions on the distribution of registered capital from the Company's PRC subsidiaries, the PRC subsidiaries' registered capital of RMB8.2 million (US\$1.2 million) as of December 31, 2018, were considered restricted. As a result of these PRC laws and regulations, as of December 31, 2018, approximately RMB12.0 million (US\$1.8 million), were not available for distribution to the Company by its PRC subsidiaries in the form of dividends, loans or advances.

**27. NONCONTROLLING INTEREST**

As of December 31, 2018, the Group's noncontrolling interests mainly included equity interest in Red 5 and equity awards granted as compensation by the Group's subsidiaries. The following schedule shows the effects of changes in the ownership interest of The9 Limited in its subsidiaries on equity attributed to The9 Limited for the years ended December 31, 2016, 2017 and 2018.

	December 31, 2016	December 31, 2017	December 31, 2018	December 31, 2018 US\$ (Note 3)
	RMB	RMB	RMB	
Net loss attributable to The9 Limited	(593,781,589)	(118,165,850)	(217,092,926)	(31,574,856)
Transfers (to) from the noncontrolling interest:				
Increase in The9 Limited's additional paid-in capital for issuance of shares by Red 5 upon stock option exercise	436,128	-	-	-
Change in The9 Limited's additional paid-in capital for adjustment on noncontrolling interest as a result of issuance of common shares of Red 5 upon vesting of stock options and restricted shares (1)	253,396,755	(7,060)	-	-
Change from net loss attributable to The9 Limited and transfers (to) from noncontrolling interests	(339,948,706)	(118,172,910)	(217,092,926)	(31,574,856)

(1) In June 2016, the Group completed a share exchange transaction with L&A and certain other shareholders of Red 5, whereby the Group exchanged approximately 30.6% equity interest (on a fully-diluted basis) owned in Red 5 for a total of 723,313,020 (after a one-to-five stock split) of newly issued shares of L&A, after deducting a 6% of total shares received (769,481,940 shares) for the payment of a service fee to a third-party consultant. As a result, the percentage of noncontrolling interest in Red 5 changed from 10.4% to 58.1%, after deducting shares of Series B redeemable convertible preferred shares ("SBPS") from total shares of Red 5.

**28. REDEEMABLE NONCONTROLLING INTEREST**

In January 2014, Red 5 issued 27,438,952 SBPS to a third-party investor, Shanghai Oriental Pearl Culture Development Co., Ltd., ("Oriental Pearl"), for an aggregate consideration of RMB118.3 million (US\$17.2 million). In conjunction with the issuance of SBPS, Oriental Pearl also purchased 5,948,488 common shares of Red 5 from two executives of Red 5 at the same per share price as the per share price of SBPS for an aggregate consideration of RMB25.6 million (US\$3.7 million). The purchase price for these common shares was determined to be less than fair value as the transaction was contemplated in conjunction with the issuance of the SPBS. The difference between the purchase price and fair value of SBPS as determined by the Group with the assistance of an independent valuation firm, amounted to RMB131.3 million (US\$19.1million), was recognized as a compensation paid to the two executives in the amount of RMB13.0 million (US\$1.9 million).

Due to share exchange transaction with L&A in 2016, a 37% share of SBPS was owned by L&A. As of December 31, 2018, the holders of SBPS were as follows:

Holder	December 31, 2017 <b>Number of Shares</b>	December 31, 2018 <b>Number of Shares</b>
L&A International Holdings Limited	10,180,553	10,180,553
Shanghai Oriental Pearl Culture Development Co., Ltd.	17,258,399	17,258,399

As of December 31, 2014, the Group considered the redemption of the SBPS to be probable. The Group accreted the carrying value of SBPS to redemption value using the effective interest rate method over the period from the issuance date to the redemption date.

The key terms of the SBPS are as follows:

**Conversion**

Each SBPS may be converted at any time into common shares at the then applicable conversion price. The initial conversion ratio is 1:1, subject to adjustment in the event of (i) share splits, share combinations, share dividends or distribution, other dividends, recapitalizations and similar events, or (ii) issuance of common shares at a price per share less than the conversion price in effect on the date of or immediately prior to such issuance. In that case, the

conversion price shall be reduced concurrently to the subscription price of such issuance.

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The SBPS shall be automatically converted into common shares immediately prior to the consummation of a public offering of Red 5's shares wherein gross proceeds are at least US\$30,000,000, immediately following the public offering (the "Qualifying IPO").

The conversion option can only be settled by issuance of common shares except that fractional shares may be settled in cash.

### Dividends

The holder of each share of SBPS shall be entitled to receive dividends at the rate per share of \$0.038237 per annum if and when a dividend is declared on common shares. The preferred shares participate in dividends on an as-converted basis and must be paid prior to any payment on common shares.

Upon conversion, any declared or accrued but unpaid dividends will be converted into common shares at the same applicable conversion price.

### Redemption

At any time on or after April 1, 2017, if requested by at least 50% of the holders of SBPS then outstanding, Red 5 shall redeem all of the outstanding SBPS at a redemption price equal to 200% of the issuance price in three equal annual installments. The full amount of the redemption price due but not paid shall accrue interest daily at a rate of 10% per annum from the issuance date of SBPS (see Note 30).

### Voting

Each SBPS has voting rights equivalent to the number of common shares to which it is convertible at the record date. The holders of SBPS shall vote together with the common shareholders, and not as a separate class or series, on all matters put before the shareholders.

Liquidation

The holders of SBPS have preference over holders of common shares with respect to distribution of assets upon voluntary or involuntary liquidation of Red 5. The holders of SBPS shall be entitled to receive 100% of the original issue price ("preferred liquidation"). The holders of SBPS are also entitled to distribution of remaining assets from preferred liquidation, along with other shareholders, while the total distribution entitled to the holders of SBPS should not exceed 200% of the original issue price.

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A reconciliation of redeemable noncontrolling interest is as follows:

	For the year ended December 31, 2017 RMB	For the year ended December 31, 2018 RMB	For the year ended December 31, 2018 US\$ (Note 3)
Redeemable noncontrolling interest opening balance	246,771,132	306,014,668	44,507,987
Issuance of redeemable noncontrolling interest	-	-	-
Net profit/(loss) attributable to redeemable noncontrolling interest	2,117,303	(5,858,902 )	(852,142 )
Accretion of redeemable noncontrolling interest	57,126,233	40,918,773	5,951,389
Redeemable noncontrolling interest ending balance	306,014,668	341,074,539	49,607,234

## 29. DISPOSAL OF A SUBSIDIARY

On August 21, 2018, Beijing Yingke entered into a proposed acquisition agreement with Shanghai IT and Yunmei Partnership, which owned 70% and 30% equity interest in The9 Education, respectively. Beijing Yingke has proposed to acquire the entire equity interest of The9 Education for consideration of RMB12.0 million, payable to Shanghai IT and Yunmei Partnership for RMB8.6 million and RMB3.6 million, respectively.

The proposed acquisition is to sell the shell company of The9 Education, which is listed on NEEQ. Beijing Yingke will not take over the operation of educational services of The9 Education. In November 2017, The9 Education passed a resolution for issuance of additional 20,000,000 new ordinary shares with a par value of RMB1 each, and the new shares were taken and paid-up by Beijing Yingke. In 2017, Shanghai IT received an advance of RMB6.8 million from Beijing Yingke, and Shanghai IT transferred 5,600,000 ordinary shares to Beijing Yingke accordingly. As of December 31, 2017, disposal of The9 Education was yet to be completed. Shanghai IT owned an 8.75% equity interest in The9 Education and controls The9 Education through a VIE structure. In January 2018, the assets and liabilities of The9 Education have been transferred from the shell company to Shanghai IT or disposed upon completion of the transaction.

Followed the disposal of shell company, the Group has disposed of the business operation of educational services for a minimal consideration. The disposal of educational services does not have a significant effect on the Group's operations and financial results. The disposal transaction on The9 Education has completed in January 2019.

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### **30. COMMITMENTS AND CONTINGENCIES**

#### **30.1 Operating lease commitments**

The Group has no significant outstanding operating lease arrangements as of December 31, 2018.

Total rental expenses amounted to RMB12.7 million, RMB4.8 million and RMB0.5 million (US\$0.07 million) for the years ended December 31, 2016, 2017 and 2018, respectively.

#### **30.2 Other operating commitments**

In October 2016, the Group had raised RMB57.5 million (US\$8.4 million), and the Group plans to raise an additional RMB100.0 million (US\$15.4 million) until CrossFire New Mobile Game is launched. Under this fund raising arrangement, the Group will share certain percentages of the revenues from CrossFire New Mobile Game to investors providing funding to the Group. In August 2016, the Group granted a third-party consultant 1,000,000 options to acquire shares of the Group as payment for consulting services related to the RMB157.5 million (US\$22.9 million) financing plan of CrossFire Mobile Game with Inner Mongolia Culture Assets and Equity Exchange. The options will vest in accordance with the schedule of the actual funding to be received. In October 2016, 365,079 options were vested after the Group received the first funding of RMB57.5 million (US\$8.4 million). As of December 31, 2018, due to unforeseen circumstances, the Group has outsourced the development and operation of CrossFire Mobile Game to a third-party company and the Group is not planning to raise the remaining RMB100.0 million (US\$14.5 million). Due to non-recovery of advance paid for financing fee, the Group has provided full impairment on the advance as of December 31, 2018. In January 2019, total 1,000,000 options granted to the third-party consultant were canceled.

In June 2017, Shanghai IT has entered into an investment agreement with the shareholders of Beijing Ti Knight where Shanghai IT will invest a total of RMB9.0 million (US\$1.3 million) in Beijing Ti Knight. As of December 31, 2018, Shanghai IT has invested RMB4.9 million (US\$0.7 million) and has a remaining capital contribution commitment amounting to RMB4.1 million (US\$0.6 million). Shanghai IT's purchase commitment amounting to RMB6.8 million (US\$1.0 million) for the outsourcing development agreement entered on October 9, 2016 with Beijing Ti Knight will be waived if Shanghai IT's accumulated investment in Beijing Ti Knight is more than RMB6.0 million (US\$0.9 million). Hence, as of December 31, 2018, the Group has both a capital commitment and a purchase commitment amounting to RMB4.1 million (US\$0.6 million) and RMB6.8 million (US\$1.0 million), respectively, but the purchase commitment will be waived under the condition that accumulated investment in Beijing Ti Knight by Shanghai IT is more than RMB6.0 million (US\$0.9 million). As of December 31, 2018, the agreements have not been terminated but the related outsourcing development of the related game has been transferred to a third-party company.

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### *30.3 Contingencies*

In June 2016, Asian Development borrowed HK\$92.3 million (US\$11.8 million) from a financial services company at an annual interest rate of 2% for a term of 24 months. This loan is secured by 417,440,000 shares of L&A (see Note 16). Pursuant to the financing agreement (“Agreement”), such loan is considered to be in default since the market price of the pledged shares had fallen below the collateralized stock price by more than 35% for ten consecutive trading days. Asian Development had not made any remediation pursuant to the Agreement. Upon default, the lender shall be entitled to foreclose the pledged shares and become the legal and beneficial owner of the pledged shares. If the market value of the pledged shares cannot cover the total outstanding amount owed by Asian Development to the lender under the Agreement, the lender may claim against Asian Development to recover any outstanding amounts under the Agreement, in addition to foreclosure of the pledged shares as mentioned above.

As mentioned in Note 24, Red 5 and its affiliates are currently in dispute with Qihoo 360 and its affiliates regarding System Link and Firefall and various legal proceedings have been initiated and are ongoing in connection with such dispute. The process of legal proceedings may be lengthy and costly and may divert the attention of the management. If the Group cannot settle the dispute with Qihoo 360 and cannot obtain a judgment in favor of the Group, additional costs or damages may be incurred to adversely affect the Group’s business, financial condition and results of operations. The dispute is still in process as of December 31, 2018. The Group has entered into an additional agreement with an attorney in December 2018 regarding the dispute with Qihoo 360 where the Group shall pay a total of RMB8.0 million (US\$1.2 million) as the attorney fee. The Group has expensed first installment of the attorney fee amounting to RMB3.0 million (US\$0.4 million) as of December 31, 2018 and will pay the remaining attorney fee of RMB5.0 million (US\$0.7 million) after the court decision is issued in the future.

The Group may be subject to other legal or administrative proceedings in the ordinary course of business. The Group does not believe that any currently pending legal or administrative proceeding to which the Group is a party will have a material adverse effect on the business or financial condition.

As described in Note 28, in August 2014, Red 5 issued 27,438,952 Series B redeemable convertible preferred shares of Red 5 to a new investor, Oriental Pearl. Due to the stock exchange transaction with L&A in 2016, a 37% share of the SBPS was owned by L&A as of December 31, 2018 (see Note 28). Per Articles of Association of Red 5, major holders of SBPS, at any time on or after April 1, 2017 (the “Redemption Election”), can require Red 5 to redeem all, but not less than all, of the outstanding shares of SBPS, as applicable, in three equal annual installments. New Star, a wholly owned subsidiary of the Group, owns 39,766,589 Series A redeemable convertible preferred shares which have similar terms with the Series B redeemable convertible preferred shares. The redemption value of SBPS was US\$16.5 million for the first installment, US\$18.1 million for the second installment and US\$19.9 million for the third installment. Since Red 5 is in a net liability position, the Group does not believe the preferred shareholders will request such redemption. As of the report date, there was no such preferred shareholder requiring Red 5 to redeem the preferred shares.

### 31. SEGMENT REPORTING

The Group operates in one segment whose business is developing and operating online games and related services. The Group’s chief operating decision maker is the chief executive officer, who reviews consolidated results when making decisions about allocating resources and assessing performance of the Group. The Group generates its revenues from customers in the Greater China (including PRC, Taiwan, Hong Kong and Macau), North America and other areas for the years ended December 31, 2016, 2017 and 2018.

The following geographic area information includes revenue based on location of players for the years ended December 31, 2016, 2017 and 2018:

	2016 RMB	2017 RMB	2018 RMB	2018 US\$ (Note 3)
Greater China	48,041,372	19,690,716	16,430,205	2,389,674
North America	3,012,901	51,156,109	-	-
Other areas	5,145,013	2,301,731	1,001,653	145,684
Total	56,199,286	73,148,556	17,431,858	2,535,358

A majority of the Group's assets are located in Greater China.

### ***32. SUBSEQUENT EVENTS***

In January 2019, the Group canceled a total of 15,000,000 ordinary shares including 7,500,000 and 4,500,000 ordinary shares in the form of restricted ordinary shares previously granted to Zhu Jun and Qin Jie on September 4, 2018.

In June 2017, the Group entered into a share purchase agreement with IncSight Limited (“IncSight”), pursuant to which the Group will issue and sell 12,500,000 ordinary shares of the Group, par value of US\$0.01, at a per share price of US\$1.20 to IncSight for an aggregate consideration of US\$15.0 million. In February 2019, the Group and IncSight have entered into a termination agreement and IncSight ceased to hold beneficial ownership in 12,500,000 ordinary shares.

In February 2018, Ark Pacific Special Opportunities Fund I, L.P. (“AP Fund”) assigned its rights and obligations under the share purchase agreement as a whole, as well as 12,500,000 unpaid ordinary shares to a third-party, Jupiter Explorer Limited (“Jupiter”), and Jupiter assumed all the rights and obligations of AP Fund under the share purchase agreement. In February 2019, the Group and Jupiter have entered into a termination agreement and Jupiter ceased to hold beneficial ownership in 12,500,000 ordinary shares.

In March 2019, the Group entered into a deed of settlement agreement with Splendid Days Limited (“SDL”) relating to the settlement of convertible notes which expired in December 2018, pursuant to which the convertible notes should be repaid by May 31, 2019 through the proceeds from planned sale of the mortgaged properties. In January 2019, the Group granted a total of 11,700,000 restricted ordinary shares to two third-party consultants as payment for consulting services related to the settlement of the convertible notes.

In March 2019, the Group entered into a joint venture agreement with Faraday & Future Inc. (“F&F”) to establish a joint venture to manufacture, market, distribute and sell electric cars in China. Under the terms of joint venture agreement, the Group will make capital contribution of up to US\$600.0 million in three equal installments to the joint venture, and F&F will make contributions including its use rights for a piece of land in China to manufacture electric cars and will grant the joint venture an exclusive license to manufacture, market, distribute and sell certain F&F’s car models and other potential selected car models in China, in each case subject to the satisfaction of certain conditions, such as establishment of the joint venture and funding arrangements. The Group has paid the initial deposit of US\$5.0 million as of the issuance date of these financial statements. The Group is considering different ways to raise the required capital, including additional equity financing.

In April 2019, the Group announced an extraordinary general meeting (the “EGM”) of shareholders to be held on May 6, 2019. The EGM will consider and vote on the proposals of : (i) Increase of the number of authorized shares to

5,000,000,000 which will be divided into 4,300,000,000 Class A ordinary shares ("Class A Ordinary Shares") , 600,000,000 Class B ordinary shares ("Class B Ordinary Shares") and 100,000,000 ordinary shares to be determined in accordance with the Amended and Restated Memorandum and Articles of Association; (ii) Class A Ordinary Share shall entitle the holder thereof to one vote per share, and each Class B Ordinary Share shall entitle the holder thereof to fifty (50) votes per share on all matters subject to vote at general meetings of the Group; and (iii) the Group's Amended and Restated Memorandum and Articles of Association.



**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY****FINANCIAL STATEMENTS SCHEDULE I****THE9 LIMITED****FINANCIAL INFORMATION OF PARENT COMPANY****CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS****FOR THE YEARS ENDED DECEMBER 31, 2016, 2017 AND 2018**

	2016 RMB	2017 RMB	2018 RMB	2018 US\$ (Note 3)
Revenue	-	-	-	-
Cost of revenue	-	-	-	-
Gross loss	-	-	-	-
Operating expenses:				
Product development	(34,101 )	(43,710 )	-	-
Sales and marketing	(262,674 )	(231,884 )	-	-
General and administrative	(40,881,238 )	(62,979,090 )	(21,435,150 )	(3,117,613 )
Total operating expenses	(41,178,013 )	(63,254,684 )	(21,435,150 )	(3,117,613 )
Loss from operations	(41,178,013 )	(63,254,684 )	(21,435,150 )	(3,117,613 )
Interest expenses	(50,409,271 )	(76,989,899 )	(98,308,205 )	(14,298,335 )
Fair value change on convertible bonds and warrants	48,057,204	12,615,466	2,251,427	327,456
Foreign exchange (loss) gain	(17,116,102 )	35,473,519	1,963,364	285,560
Other income (expenses), net	5,952,464	(21,649,514 )	(18,180,060 )	(2,644,180 )
Loss before income tax expense and share of loss in equity method investments	(54,693,718 )	(113,805,112 )	(133,708,624 )	(19,447,112 )
Income tax expense	-	-	-	-
Recovery of equity investment in excess of cost	-	60,548,651	-	-
Equity in loss of subsidiaries and VIEs	(539,087,871 )	(64,909,389 )	(83,384,302 )	(12,127,744 )
Net loss	(593,781,589 )	(118,165,850 )	(217,092,926 )	(31,574,856 )
Other comprehensive income (loss), net of tax:				
Currency translation adjustments	5,954,611	(19,027,771 )	7,241,192	1,053,188
Total comprehensive loss	(587,826,978 )	(137,193,621 )	(209,851,734 )	(30,521,668 )

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**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY****FINANCIAL STATEMENTS SCHEDULE I****THE9 LIMITED****FINANCIAL INFORMATION OF PARENT COMPANY****CONDENSED BALANCE SHEETS****AS OF DECEMBER 31, 2017 AND 2018**

	December 31, 2017 RMB	December 31, 2018 RMB	December 31, 2018 US\$ (Note 3)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	18,733	18	3
Prepayments and other current assets, net	59,008	61,979	9,014
Amounts due from intercompany	1,380,804,221	1,305,838,856	189,926,384
Total current assets	1,380,881,962	1,305,900,853	189,935,401
Investments in subsidiaries and VIEs	(1,586,024,281)	(1,635,525,945)	(237,877,382)
Total assets	(205,142,319 )	(329,625,092 )	(47,941,981 )
<b>LIABILITIES</b>			
Current liabilities:			
Accrued expenses and other current liabilities	4,350,126	5,248,838	763,412
Warrants	3,742,271	1,490,844	216,834
Convertible notes	260,563,020	375,257,140	54,578,887
Total current liabilities	268,655,417	381,996,822	55,559,133
Total liabilities	268,655,417	381,996,822	55,559,133
<b>SHAREHOLDERS' EQUITY (DEFICIT)</b>			
Ordinary shares	3,328,852	6,502,658	945,772
Additional paid-in capital	2,527,215,315	2,496,069,065	363,038,188
Statutory reserves	28,071,982	28,071,982	4,082,900
Accumulated other comprehensive loss	(16,445,748 )	(9,204,556 )	(1,338,746 )
Accumulated deficit	(3,015,968,137)	(3,233,061,063)	(470,229,228)

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Total shareholders' deficit	(473,797,736 )	(711,621,914 )	(103,501,114)
Total liabilities and shareholders' equity	(205,142,319 )	(329,625,092 )	(47,941,981 )

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**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY****FINANCIAL STATEMENTS SCHEDULE I****THE9 LIMITED****FINANCIAL INFORMATION OF PARENT COMPANY****CONDENSED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2016 2017 AND 2018**

	<b>2016</b> RMB	<b>2017</b> RMB	<b>2018</b> RMB	<b>2018</b> US\$ (Note 3)
Cash flows from operating activities:				
Net loss	(593,781,589)	(118,165,850)	(217,092,926)	(31,574,856)
Adjustments for:				
Employee share-based compensation expense	27,689,259	37,727,861	3,645,751	530,252
Fair value change on warrants liability	(48,057,204 )	(12,615,466 )	(2,251,427 )	(327,456 )
Amortization of discount and interest on convertible note	50,409,270	76,990,826	98,308,205	14,298,335
Foreign exchange loss (gain)	17,116,102	(35,473,519 )	(1,963,364 )	(285,560 )
Recovery of equity investment in excess of cost	-	(60,548,651 )	-	-
Equity in loss of subsidiaries and VIEs	539,087,871	64,909,389	83,384,302	12,127,744
Consulting fee paid by equity	-	13,454,692	4,172,800	606,909
Change in prepayments and other current assets	(62,274 )	915,269	(2,971 )	(432 )
Change in accounts payable	(148,204 )	-	-	-
Change in amounts due from intercompany	3,021,127	(130,954,737)	30,882,203	4,491,630
Change in accrued expenses and other current liabilities	2,613,023	(2,092,500 )	898,712	130,712
Net cash used in operating activities	(2,112,619 )	(165,852,686)	(18,715 )	(2,722 )
Cash flows from investing activity:				
Settlement payment from investee	-	165,812,500	-	-
Cash flows from financing activities:				
Proceeds from stock option exercises	2,142,554	-	-	-
Net cash provided by (used in) financing activities	2,142,554	-	-	-
Net change in cash and cash equivalents	29,935	(40,186 )	(18,715 )	(2,722 )
Cash and cash equivalents, beginning of year	28,984	58,919	18,733	2,725

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Cash and cash equivalents, end of year	58,919	18,733	18	3
Supplement disclosure of cash flow information:				
Interest paid	-	-	-	-
Income taxes paid	-	-	-	-

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**ADDITIONAL FINANCIAL INFORMATION OF PARENT COMPANY**

**FINANCIAL STATEMENTS SCHEDULE I**

**THE9 LIMITED**

**FINANCIAL INFORMATION OF PARENT COMPANY**

**NOTES TO SCHEDULE I**

1) Schedule I has been provided pursuant to the requirements of *Rule 12-04(a)* and *5-04(c)* of *Regulation S-X*, which require condensed financial information as to the financial position, changes in financial position and results of operations of a parent company as of the same dates and for the same periods for which audited consolidated financial statements have been presented when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

2) As disclosed in Note 1 to the consolidated financial statements, The9 Limited (the “Company”) was incorporated in December 22, 1999 in the Cayman Islands to be the holding company of the Group principally engaged in the development and operation of online games and internet related businesses, including massively multiplayer online games (“MMOGs”), mobile games, web games and TV games.

3) The condensed financial information has been prepared using the same accounting policies as set out in the consolidated financial statements except that the equity method has been used to account for investments in its subsidiaries and VIEs. For the parent company, the Company records its investments in subsidiaries and VIE under the equity method of accounting as prescribed in *ASC 323, Investments-Equity Method and Joint Ventures*. Such investments are presented on the Condensed Balance Sheets as “Investment in subsidiaries and VIEs” and the subsidiaries and VIEs’ profit or loss as “Equity in income/loss of subsidiaries and VIEs” on the Condensed Statements of Comprehensive Loss. Ordinarily under the equity, an investor in an equity method investee would cease to recognize its share of the losses of an investee once the carrying value of the investment has been reduced to nil absent an undertaking by the investor to provide continuing support and fund losses. For the purpose of this Schedule I, the parent company has continued to reflect its share, based on its proportionate interest, of the losses of subsidiaries and VIE regardless of the carrying value of the investment even though the parent company is not obligated to provide continuing support or fund losses.

**4)** As of December 31, 2017 and 2018, there were no material contingencies, significant provisions of long-term obligations, mandatory dividend or redemption requirements of redeemable stocks or guarantees of the Company. No dividend was paid by the Company's subsidiaries to the Company in 2016, 2017 and 2018.

**5)** Translations of balances in the additional financial information of The9 Limited (“Parent Company”) — Financial Statements Schedule I from RMB into US\$ as of December 31, 2018 and for the year ended December 31, 2018 are solely for the convenience of the readers and were calculated at the rate of US\$1.00 = RMB6.8755, representing the noon buying rate set forth in the H.10 statistical release of the U.S. Federal Reserve Board on December 31, 2018. No representation is made that the RMB amounts could have been, or could be, converted, realized or settled into US\$ at that rate on December 31, 2018, or at any other rate.

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