

KONGZHONG CORP  
Form F-1/A  
July 07, 2004

As filed with the Securities and Exchange Commission on July 6, 2004

Registration No. 333-116172

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**Amendment No. 4 to  
Form F-1  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933**

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**KongZhong Corporation**

*(Exact Name of Registrant as Specified in Its Charter)*

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**Cayman Islands**  
*(State or other jurisdiction of  
incorporation or organization)*

**7389**  
*(Primary Standard Industrial  
Classification Code Number)*

**Not Applicable**  
*(IRS Employer  
Identification Number)*

**8/F, Tower A, Yuetan Building**

**No. 2 Yuetan North Street  
Beijing, China 100045  
(8610) 6808-1818**

*(Address and telephone number of Registrant's principal executive offices)*

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**CT Corporation System  
111 Eighth Avenue  
New York, New York 10011  
(212) 664-1666**

*(Name, address and telephone number of agent for service)*

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, please check the following box.

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

**CALCULATION OF REGISTRATION FEE**

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price <sup>(1)(2)</sup>	Amount of Registration Fee
Ordinary shares par value \$0.0000005 per share <sup>(3)</sup>	\$138,000,000	\$17,485 <sup>(4)</sup>

- (1) Estimated solely for the purpose of determining the amount of the registration fee in accordance with Rule 457(o) under the Securities Act of 1933, as amended.
- (2) Includes shares initially offered and sold outside the United States that may be resold from time to time in the United States, including shares that may be purchased by the underwriters pursuant to over-allotment options. The shares are not being registered for the purpose of sales outside the United States.
- (3) American Depositary Shares issuable upon deposit of the ordinary shares registered hereby will be registered under a separate registration statement on Form F-6. Each American depositary share represents 40 ordinary shares.
- (4) \$12,670 of the registration fee was paid with the registration statement publicly filed with the Commission on June 4, 2004, and an additional \$4,815 was paid with amendment No. 1 publicly filed with the Commission on June 17, 2004.

**The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS

Subject to Completion

July 6, 2004

10,000,000 American Depositary Shares

## KongZhong Corporation

Representing 400,000,000 Ordinary Shares

This is our initial public offering of American Depositary Shares, or ADSs. Each ADS represents 40 of our ordinary shares. We are selling 8,000,000 ADSs, representing 320,000,000 ordinary shares, and our selling shareholders are selling 2,000,000 ADSs, representing 80,000,000 ordinary shares. No public market currently exists for our ADSs or ordinary shares. The initial offering price of our ADSs is expected to be between \$10 and \$12 per ADS.

The ADSs have been approved to be included for quotation on the Nasdaq National Market under the symbol KONG.

**Before buying any ADSs, you should read the discussion of material risks of investing in our ADSs in Risk factors beginning on page 13.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

	Per ADS	Total
Initial public offering price	\$	\$
Underwriting discounts and commissions	\$	\$
Proceeds, before expenses, to us	\$	\$
Proceeds, before expenses, to the selling shareholders	\$	\$

The underwriters may also purchase up to 1,500,000 ADSs from us at the public offering price, less underwriting discounts and commissions, within 30 days from the date of this prospectus. The underwriters may exercise this option only to cover over-allotments, if any. We will not receive any proceeds from the sale of ADSs by the selling shareholders.

At our request, the underwriters have reserved at the initial public offering price up to 5% of the ADSs for sale to certain of our business associates, friends and family of employees and directors of our company, and other persons associated with us who have expressed an interest in purchasing our ADSs in this offering.

The underwriters are offering the ADSs as set forth under Underwriting. Delivery of the ADSs will be made on or about , 2004.

**UBS Investment Bank**

**Banc of America Securities LLC**

**CIBC World Markets**

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You should only rely on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, ADSs only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of ADSs.

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## Prospectus summary

*This summary highlights information contained elsewhere in this prospectus. You should read the entire prospectus carefully. Unless the context otherwise requires, information contained in this prospectus assumes that the underwriters will not exercise their option to purchase additional ADSs in this offering. All references to KongZhong, we, us, or our include KongZhong Corporation and its subsidiary and operating companies as a combined entity. All references to and statements regarding China, the People's Republic of China, or the PRC, in this prospectus do not apply to Hong Kong, Macau and Taiwan. All references to RMB or Renminbi are to the legal currency of China and all references to US dollars and \$ are to the legal currency of the United States.*

### OUR BUSINESS

We are the leading provider of advanced second generation, or 2.5G, wireless interactive entertainment, media and community services, in terms of revenue, to customers of China Mobile Communications Corporation, or China Mobile, which has the largest mobile subscriber base in the world. China Mobile ranked KongZhong as the number one wireless value-added service provider on its network in terms of revenue for 2.5G wireless value-added services in 2003 and the first quarter of 2004. In addition, we have recently begun to provide wireless value-added services on the networks of China United Telecommunications Corporation, or China Unicom, China Telecommunications Corporation, or China Telecom, and China Network Communications Group Corporation, or China Netcom. Each of China Mobile, China Unicom, China Telecom and China Netcom is a state-owned enterprise, the majority of the equity interest of which is owned by the People's Republic of China. We are headquartered in Beijing and provide our services throughout China.

We primarily deliver our services through the 2.5G wireless standard. The higher transmission capacity of 2.5G allows users to access higher quality graphics and richer content and interactivity, in comparison with the second generation, or 2G, wireless standard, which has slightly lower service fees and may be accessed through less expensive mobile handsets. We deliver our 2.5G services through wireless access protocol, or WAP, multimedia messaging services, or MMS, and Java™ technology platforms. We also offer a range of data and voice services based on the 2G wireless standard through short messaging services, or SMS, interactive voice response, or IVR, and color ring back tones, or CRBT, technology platforms.

We deliver a broad range of services, through multiple technology platforms, which users can access directly from their mobile phones by choosing an icon embedded in select models of handsets, or from a mobile operator's portal or web site. Our services are organized in three major categories, consisting of:

- Ø **Interactive entertainment.** Our interactive entertainment services include mobile games, pictures, karaoke, electronic books and mobile phone personalization features, such as ringtones, wallpaper, clocks and calendars.
- Ø **Media.** Our media services provide content such as domestic and international news, entertainment, sports, fashion, lifestyle and other special interest areas.
- Ø **Community.** Our community services include interactive chat, message boards, photo albums, dating and networking.

Our focus on establishing a leadership position in the rapidly growing advanced wireless value-added services market in China and our ability to cultivate cooperation arrangements with the mobile operators, mobile handset manufacturers and distributors, content providers and other business partners to produce, promote and market our services in the Chinese market have resulted in rapid growth of our financial and operating performance. Through these cooperation arrangements, we provide or promote our services and obtain content, and pay service fees to these mobile operators,



mobile handset manufacturers, mobile handset distributors, content providers and other partners, where relevant. Since commencing operations in May 2002, we have:

- Ø Grown our revenues and net income to \$7.8 million and \$2.4 million, respectively, in 2003;
- Ø Grown our revenues and net income to \$7.1 million and \$3.1 million, respectively, in the first quarter of 2004;
- Ø Grown our gross revenues and net income by 86% and 101%, respectively, in the first quarter of 2004 over the previous quarter;
- Ø Maintained our focus on 2.5G services, with 2.5G services contributing approximately 73% of our gross revenues in the first quarter of 2004; and
- Ø Increased our number of registered users to 9.4 million, of which 5.8 million users were classified as active users during the first quarter of 2004.

#### **INDUSTRY OVERVIEW**

The wireless value-added services market, which provides services that allow mobile phone users to receive and transmit text, images and other forms of digital data or voice content via their mobile handsets, represents a new and fast-growing sector within China's rapidly evolving telecommunications industry. Analysys Consulting Ltd., or Analysys, estimates that total wireless value-added services revenue in China rose from \$211.5 million in 2002 to \$452.5 million in 2003 and is expected to grow to \$800.4 million in 2004. Chinese consumers have been quick to adopt and use new wireless value-added services as a means of communication, as well as a source of information and entertainment, partly due to the proliferation of mobile phones as a more accessible alternative to both fixed-line phone services and personal computer-based Internet services in China.

The evolution of the market for mobile services in China has thus far closely followed the industry development experienced in Japan and Korea, where mobile operators have provided platforms for third party service providers to offer services to customers of the mobile operator.

China Mobile launched its Monternet™ platform for wireless value-added services in November 2000 and China Unicom launched its Uni-Info™ platform in May 2001, using a business model similar to the model used in Japan and Korea. Key characteristics of China's wireless value-added services market include the rapid expansion of China's mobile telecommunications industry, increasing user receptivity, the availability of more advanced handsets in the Chinese market and support from mobile operators.

The wireless value-added services market in China is evolving as mobile telecommunications technology becomes more advanced. China Mobile began operating its 2.5G network in May 2002 and China Unicom began operating its 2.5G network in November 2002. Gartner Dataquest estimates that 48% and 60% of the mobile handsets sold in China in 2004 and 2005, respectively, will be General Packet Radio Services, or GPRS, handsets with 2.5G capability. Analysys estimates that the market for WAP services will increase to \$97.9 million in 2004 from \$25.7 million in 2003, representing an increase of 280%, and MMS services will increase to \$82.8 million in 2004 from \$27.8 million in 2003, representing an increase of 198%.

#### **OUR STRENGTHS AND CHALLENGES**

We are an early entrant in China's 2.5G wireless value-added services market. Since our establishment, we have moved quickly to identify market trends, develop technologically advanced services and capture market share, with particular focus on the rapidly growing market for 2.5G services. As a

result, we believe that we are well-positioned to capture the growth opportunities in China's wireless value-added services market. We have developed the following principal strengths:

- Ø Established market position with a well-recognized brand name in wireless interactive entertainment, media and community services;
- Ø Strategic relationships with China's largest mobile operator and key content and distribution partners, including handset manufacturers;
- Ø Leadership in understanding and addressing customer needs by offering a diversified portfolio of innovative services;
- Ø Product development team devoted to enhancing current and developing new services; and
- Ø Experienced management team.

Our ability to realize our business objectives and execute our strategies is subject to risks and uncertainties, including the following:

- Ø Our dependence on China Mobile for substantially all of our revenue and our dependence on its billing system;
- Ø Our limited operating history and dependence on our key personnel;
- Ø The possibility that the PRC government could determine that the agreements that establish our operating structure do not comply with PRC government restrictions on foreign investment in the value-added telecommunications industry;
- Ø The intense competition that we face in the wireless value-added services market due to low barriers to entry;
- Ø The rapidly evolving wireless value-added industry, which makes predicting future consumer acceptance and demand difficult;
- Ø Investors may not be able to exercise their right to vote the ordinary shares underlying our ADSs;
- Ø Cayman Islands law may provide shareholders with fewer rights than they would be afforded under the United States law; and
- Ø The uncertain legal and regulatory environment in China, which could limit the legal protections available to foreign investors.

Users can purchase our value-added services on a per-use basis and, in most cases, on a subscription basis. We provide our services mainly pursuant to our cooperation arrangements with the mobile operators, the terms of which are generally for one year or less. We do not directly bill our users, and depend on the billing systems and records of the mobile operators to bill and collect all fees. We generally do not have the ability to independently verify the accuracy of the billing systems of the mobile operators. As mobile operators do not provide us detailed revenue breakdown on a service-by-service basis, we depend on our internal database system to monitor revenue derived from each of our services. We make our business decisions based on our internal data, taking into account other factors including strategic considerations.

We initially ascertain the value of our services provided based on delivery confirmations sent to us by the networks of the mobile operators within 72 hours of delivery, but record revenues based solely on the monthly statements provided to us by the mobile operators. There has historically been a discrepancy, of approximately 10% in both 2003 and the first quarter of 2004, between the value we calculate based on delivery confirmations and the value that we are entitled to receive based on the monthly statements provided by the mobile operators. From time to time, for purposes of reporting our quarterly results to the market, we may need to estimate a portion of our reported revenue for the

services provided in the event that we have not received monthly statements from the mobile operators by the time we report our earnings for a particular period.

#### **OUR STRATEGIES**

Our strategic objective is to build the leading brand and be the leading provider of wireless interactive entertainment, media and community services to mobile phone users among all mobile operators in China. We intend to undertake strategic initiatives focused on expanding our market presence, diversifying our range of service offerings and sustaining and enhancing our profitability and market position. In particular, we intend to:

- Ø Further promote and develop the KongZhong brand;
- Ø Capture market opportunities to strengthen and diversify our business and revenue streams;
- Ø Continue to develop and expand the scope of strategic relationships with key industry players;
- Ø Continue to develop and diversify our portfolio of service offerings to attract new customers and to increase usage among our existing customers;
- Ø Enhance our profitability by optimizing our product mix and focusing on the development and marketing of advanced wireless value-added services; and
- Ø Selectively acquire businesses that enhance our service portfolio, proprietary content, distribution channels and technology.

#### **CORPORATE STRUCTURE**

We were incorporated in May 2002 under the laws of the Cayman Islands. We conduct our business in China solely through our wholly-owned subsidiary, KongZhong Beijing. In order to meet domestic ownership requirements under PRC law, which restrict us and KongZhong Beijing, as foreign or foreign-invested companies, from operating in certain value-added telecommunications and Internet services, we have established Beijing AirInbox in China, which is wholly-owned by PRC citizens. In addition, we have recently established Beijing Boya Wuji in China, which is also wholly-owned by PRC citizens. We do not have any equity interest in Beijing AirInbox or Beijing Boya Wuji, but instead enjoy the economic benefits of these companies through a series of contractual arrangements which we and KongZhong Beijing have entered into with these companies and their respective shareholders. These contractual arrangements include agreements on provision of loans, provision of services, license of intellectual property, and certain corporate governance and shareholder rights matters.

The chart below sets forth our corporate and share ownership structure as of the date of this prospectus, after giving effect to this offering, and assuming that (i) all of our preferred shares are converted into ordinary shares and (ii) the underwriters do not exercise their over-allotment options.

**PRINCIPAL EXECUTIVE OFFICES**

Our principal executive office is currently located at 8/F, Tower A, Yuetan Building, No. 2 Yuetan North Street, Beijing, China 100045, and will be moved to 33/F, Tengda Building, No. 168, Xiwai Avenue, Haidian District, Beijing, China, 100044 in August 2004. Our telephone number is (8610) 6808-1818. Our web site address is <http://www.kongzhong.com>. Information contained on our web site does not constitute a part of this prospectus. Our agent for service of process is CT Corporation System at 111 Eighth Avenue, New York, New York 10011.

## THE OFFERING

*Unless otherwise indicated, information in this prospectus assumes that the underwriters will not exercise the over-allotment option to purchase additional American Depositary Shares, or ADSs. See Underwriting.*

The Offering	10,000,000 ADSs, representing 400,000,000 ordinary shares.
ADSs	Each ADS represents 40 ordinary shares that will be held by Citibank, N.A., as depository. At the request of our investors or their representatives, the ADSs will be evidenced by American Depositary Receipts, or ADRs. As an ADR holder, you will not be treated as one of our shareholders. You will have rights as provided in the deposit agreement. Under the deposit agreement, you may instruct the depository to vote the shares underlying the ADRs. The depository will pay you the cash dividends or other distributions it receives on shares after deducting fees and expenses. You must pay a fee for each issuance or cancellation of an ADS, distribution of securities by the depository or any other depository service. You may turn in your ADRs at the depository's office and, after payment of some fees and expenses, the depository will deliver the deliverable shares underlying your ADSs to you. To better understand the terms of the ADSs, you should carefully read the section in this prospectus entitled Description of American depositary shares. We also encourage you to read the deposit agreement, which is an exhibit to the registration statement that includes this prospectus.
Ordinary Shares	Shares in our registered capital, par value of \$0.0000005 per share.
Over-allotment Option	To the extent that the underwriters sell more than 10,000,000 ADSs, they have the option to purchase up to an additional 1,500,000 ADSs from us at the initial public offering price less underwriting discounts and commissions.
Price per ADS in the Offering	We currently estimate that the initial public offering price per ADS will be between \$10 and \$12. The initial public offering price per ADS is payable in U.S. dollars.
Use of Proceeds	Our net proceeds from this offering are expected to be approximately \$80 million (assuming an initial public offering price of \$11, the mid-point of the range shown on the front cover page). We anticipate using these net proceeds for acquisitions or investments in businesses that we believe are complementary to our existing business, product development, sales and marketing and general

corporate purposes. See Use of proceeds. We will not receive any proceeds from the sale of ADSs by the selling shareholders.

Directed Share Program	At our request, the underwriters have reserved at the initial public offering price up to 5% of the ADSs for sale to certain of our business associates, friends and family of our employees and directors and other persons associated with us who have expressed an interest in purchasing our ADSs in this offering.
Risk Factors	See Risk factors and other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in our ADSs.
ADSs Offered by Us	8,000,000 ADSs
ADSs Offered by Our Selling Shareholders	2,000,000 ADSs
Ordinary Shares Outstanding After the Offering	1,370,000,000 ordinary shares.
ADS Equivalents Outstanding After the Offering	34,250,000 ADSs
Listing	We have received approval to have our ADSs included for quotation on the Nasdaq National Market.
Proposed Nasdaq Symbol for Our ADSs	KONG

**CONVENTIONS**

The information in this prospectus gives effect to the automatic conversion of all of our outstanding Series A convertible preferred shares, or Series A preferred shares, and Series B redeemable convertible preferred shares, or Series B preferred shares, into an aggregate of 581,000,000 ordinary shares, which conversion will occur concurrently with the consummation of this offering. In addition, unless specifically indicated otherwise or unless the context otherwise requires, the information in this prospectus gives effect to the 20-for-1 share split of our ordinary shares as effected on March 18, 2004.

The number of ordinary shares outstanding after this offering is based on the number of shares outstanding as of March 31, 2004 and does not include: (i) 86,120,000 ordinary shares subject to options outstanding, of which 18,045,000 were exercisable, as of March 31, 2004 and (ii) 18,880,000 additional ordinary shares that are reserved for issuance under our 2002 Equity Incentive Plan, or the 2002 Plan. See Management Stock options.

Unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB were made at the noon buying rate in the City of New York for cable transfers in RMB per U.S. dollar as certified for customs purposes by the Federal Reserve Bank of New York on March 31, 2004, which was RMB8.2770 = \$1.00.

We make no representation that the RMB or U.S. dollar amounts referred to herein could have been or could be converted to U.S. dollars or RMB, as the case may be, at any particular rate.

## Summary consolidated financial and operating data

The following summary consolidated financial data should be read in conjunction with our audited consolidated financial statements, the notes thereto and Management's discussion and analysis of financial condition and results of operations included elsewhere in this prospectus. We commenced operations in May 2002. The summary consolidated statements of operations data for the period from May 6, 2002 to December 31, 2002, for the year ended December 31, 2003 and the three months ended March 31, 2004, and the summary consolidated balance sheet data as of December 31, 2002 and 2003 and March 31, 2004 set forth below are derived from our audited consolidated financial statements included elsewhere in this prospectus. Our audited consolidated financial statements have been prepared and presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP, and audited by Deloitte Touche Tohmatsu. Due to the relatively new and rapidly evolving nature of the wireless value-added services industry in China, the short history of our company and other factors affecting our business as described under Risk factors, our results of operations in any period are not necessarily indicative of the results that may be expected for any future period.

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Consolidated statements of operations data	For the period from May 6, 2002 to December 31, 2002	For the year ended December 31, 2003	For the three months ended March 31, 2003	For the three months ended March 31, 2004
(in thousands of U.S. dollars, except share and per share data)				
Gross revenues	\$ 200.3	\$ 7,806.7	\$ 703.0	\$ 7,147.6
Cost of revenues	(84.3)	(2,284.0)	(146.5)	(2,239.0)
Gross profit	116.0	5,522.7	556.5	4,908.6
Operating expenses:				
Product development	164.2	1,369.5	176.2	716.5
Sales and marketing	128.9	841.4	140.7	294.1
General and administrative	317.3	882.7	142.4	675.7
Amortization of deferred stock compensation		22.0		80.8
Total operating expenses	610.4	3,115.6	459.3	1,767.1
Income (loss) from operations	(494.4)	2,407.1	97.2	3,141.5
Other expenses				(0.7)
Interest income, net	0.5	1.0	(0.1)	1.3
Net income (loss) before income taxes	(493.9)	2,408.1	97.1	3,142.1
Income tax expense				
Net income (loss)	\$ (493.9)	\$ 2,408.1	\$ 97.1	\$ 3,142.1
Net income (loss) per share:				
Basic	\$ 0.00	\$ 0.01	\$ 0.00	\$ 0.01
Diluted	\$ 0.00(1)	\$ 0.00	\$ 0.00	\$ 0.00
Shares used in calculating net income (loss) per share:				
Basic	415,547,794	469,000,000	469,000,000	469,000,000
Diluted	415,547,794(1)	1,094,824,434	1,090,364,373	1,098,206,555
Pro forma net income (loss) per share (unaudited)				
Basic	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Diluted	\$ 0.00(1)	\$ 0.00	\$ 0.00	\$ 0.00
Shares used in calculating pro forma net income (loss) per share				
Basic	622,124,999	1,050,000,000	1,050,000,000	1,050,000,000
Diluted	622,124,999(1)	1,094,824,434	1,090,364,373	1,098,206,555



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Pro forma net income (loss) per ADS equivalent				
Basic	\$ (0.03)	\$ 0.09	\$ 0.00	\$ 0.12
Diluted	\$ (0.03)	\$ 0.09	\$ 0.00	\$ 0.11

(1) Anti-dilutive preferred shares and options were excluded from the weighted average ordinary shares outstanding for the diluted per share calculation. For 2002, basic loss per share did not differ from diluted loss per share.

Consolidated balance sheet data	As of			
	December 31, 2002	December 31, 2003	March 31, 2004	March 31, 2004
	(in thousands of U.S. dollars)		(unaudited)	Pro forma (unaudited) <sup>(1)</sup>
Cash and cash equivalents	\$ 2,646.2	\$ 3,742.6	\$ 5,736.2	\$ 5,736.2
Accounts receivable	\$ 132.3	\$ 1,703.9	\$ 3,268.8	\$ 3,268.8
Property and equipment, net	\$ 251.0	\$ 848.5	\$ 1,104.2	\$ 1,104.2
Total assets	\$ 3,101.3	\$ 6,567.5	\$ 10,518.1	\$ 10,518.1
Total current liabilities	\$ 75.0	\$ 1,047.3	\$ 1,654.4	\$ 1,654.4
Series B redeemable convertible preferred shares	\$ 2,970.0	\$ 2,970.0	\$ 2,970.0	\$
Total shareholders' equity	\$ 56.3	\$ 2,550.1	\$ 5,772.9	\$ 8,742.9
Total liabilities and shareholders' equity	\$ 3,101.3	\$ 6,567.5	\$ 10,518.1	\$ 10,518.1

- (1) The unaudited pro forma balance sheet information as of March 31, 2004 assumes the conversion upon completion of the initial public offering of all shares of convertible preferred shares outstanding as of March 31, 2004 into ordinary shares.

Operating data	For the period from May 6, 2002 to December 31, 2002	For the year ended December 31, 2003	For the three months ended March 31, 2004
	(in thousands)		
2.5G <sup>(1)</sup>			
Subscriptions <sup>(2)</sup>	351.6	9,021.3	5,508.0
Downloads <sup>(3)</sup>		2,722.1	2,334.2
2G <sup>(4)</sup>			
Subscriptions <sup>(2)</sup>	50.0	1,925.4	2,194.2
Downloads <sup>(3)</sup>	800.0	6,127.4	1,634.6
Total			
Subscriptions <sup>(2)</sup>	401.6	10,946.7	7,702.3
Downloads <sup>(3)</sup>	800.0	8,849.5	3,968.8

- (1) Includes WAP, MMS and Java™. We began to provide WAP, MMS and Java™ services on a paid basis in September 2002, April 2003 and November 2003, respectively.
- (2) Total number of paid monthly subscriptions in the relevant period.
- (3) Total number of paid downloads in the relevant period, excluding downloads made pursuant to subscriptions.
- (4) Includes SMS, IVR and CRBT. We began to provide SMS, IVR and CRBT services on a paid basis in July 2002, December 2003 and October 2003, respectively.

## Summary unaudited consolidated quarterly financial and operating data

The following summary unaudited consolidated quarterly financial data should be read in conjunction with our audited consolidated financial statements, the notes thereto and Management's discussion and analysis of financial condition and results of operations included elsewhere in this prospectus. The summary unaudited consolidated quarterly financial data for each of the periods presented below were derived from our management financial information, which was prepared on substantially the same basis as our audited consolidated financial statements and includes all adjustments that we consider necessary for a fair presentation of our financial position and operating results for the periods presented. Due to the relatively new and rapidly evolving nature of the wireless value-added services industry in China, the short history of our company and other factors affecting our business as described under Risk factors, our results of operations in any period are not necessarily indicative of the results that may be expected for any future periods.

Consolidated statements of operations data	For the three months ended							
	June 30, 2002 <sup>(1)</sup>	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003	March 31, 2004
	(in thousands of U.S. dollars)							
Gross revenues	\$	\$ 43.2	\$ 157.1	\$ 703.0	\$ 1,226.4	\$ 2,030.8	\$ 3,846.5	\$ 7,147.6
Cost of revenues		(18.2)	(66.1)	(146.5)	(330.7)	(651.1)	(1,155.7)	(2,239.0)
Gross profit		25.0	91.0	556.5	895.7	1,379.7	2,690.8	4,908.6
Operating expenses:								
Product development	(27.6)	(37.1)	(99.5)	(176.2)	(271.3)	(390.2)	(531.8)	(716.5)
Sales and marketing	(7.1)	(15.0)	(106.8)	(140.7)	(212.6)	(203.7)	(284.4)	(294.1)
General and administrative	(44.6)	(70.2)	(202.5)	(142.4)	(175.0)	(262.7)	(302.6)	(675.7)
Amortization of deferred stock compensation						(8.8)	(13.2)	(80.8)
Total operating expenses	(79.3)	(122.3)	(408.8)	(459.3)	(658.9)	(865.4)	(1,132.0)	(1,767.1)
Income (loss) from operations	(79.3)	(97.3)	(317.8)	97.2	236.8	514.3	1,558.8	3,141.5
Other expenses								(0.7)
Interest income, net	0.2		0.3	(0.1)	(0.3)	0.7	0.7	1.3
Net income (loss) before income taxes	(79.1)	(97.3)	(317.5)	97.1	236.5	515.0	1,559.5	3,142.1
Income tax expense								
Net income (loss)	\$ (79.1)	\$ (97.3)	\$ (317.5)	\$ 97.1	\$ 236.5	\$ 515.0	\$ 1,559.5	\$ 3,142.1

Other consolidated financial data	For the three months ended							
	June 30, 2002 <sup>(1)</sup>	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003	March 31, 2004
Gross margin		57.9%	57.9%	79.2%	73.0%	67.9%	70.0%	68.7%
Net margin		(225.2)%	(202.1)%	13.8%	19.3%	25.4%	40.6%	44.0%

For the three months ended

Other consolidated financial data	March 31, 2003		June 30, 2003	
	Amount	Percentage of total revenue	Amount	Percentage of total revenue
2.5G <sup>(2)</sup>	\$ 346.0	49%	\$ 914.9	75%
Subscriptions	\$ 346.0	49%	\$ 848.8	69%
Downloads	\$ 0	0%	\$ 66.1	5%
2G <sup>(5)</sup>	\$ 357.0	51%	\$ 311.5	25%
Subscriptions	\$ 171.3	24%	\$ 253.0	21%
Downloads	\$ 185.7	26%	\$ 58.5	5%
Total Revenue	\$ 703.0	100%	\$ 1,226.4	100%
Subscriptions	\$ 517.3	74%	\$ 1,101.8	90%
Downloads	\$ 185.7	26%	\$ 124.6	10%

[Additional columns below]

[Continued from above table, first column(s) repeated]

For the three months ended

Other consolidated financial data	September 30, 2003		December 31, 2003		March 31, 2004	
	Amount	Percentage of total revenue	Amount	Percentage of total revenue	Amount	Percentage of total revenue
2.5G <sup>(2)</sup>	\$ 1,604.6	79%	\$ 3,090.5	80%	\$ 5,244.4	73%
Subscriptions	\$ 1,484.8	73%	\$ 2,651.2	69%	\$ 4,806.6	67%
Downloads	\$ 119.8	6%	\$ 439.3	11%	\$ 437.8	6%
2G <sup>(5)</sup>	\$ 426.2	21%	\$ 756.0	20%	\$ 1,903.2	27%
Subscriptions	\$ 349.9	17%	\$ 675.0	18%	\$ 1,824.8	26%
Downloads	\$ 76.3	4%	\$ 81.0	2%	\$ 78.4	1%
Total Revenue	\$ 2,030.8	100%	\$ 3,846.5	100%	\$ 7,147.6	100%
Subscriptions	\$ 1,834.7	90%	\$ 3,326.2	86%	\$ 6,631.4	93%
Downloads	\$ 196.1	10%	\$ 520.3	14%	\$ 516.2	7%

For the three months ended

Operating data	June 30, 2002 <sup>(1)</sup>	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003	March 31, 2004
(in thousands)								
2.5G <sup>(2)</sup>								
Subscriptions <sup>(3)</sup>	40.0	311.6	1,042.2	1,674.5	2,594.5	3,710.2	5,508.0	
Downloads <sup>(4)</sup>				276.3	674.0	1,771.7	2,334.2	
2G <sup>(5)</sup>								
Subscriptions <sup>(3)</sup>			50.0	253.0	303.7	402.5	966.2	2,194.2
Downloads <sup>(4)</sup>	100.0	700.0	2,068.5	826.6	1,805.1	1,427.2	1,634.6	
Total								
Subscriptions <sup>(3)</sup>	40.0	361.6	1,295.2	1,978.2	2,997.0	4,676.4	7,702.3	
Downloads <sup>(4)</sup>	100.0	700.0	2,068.5	1,103.0	2,479.1	3,198.9	3,968.8	

(1) We commenced operations in May 2002.

(2) Includes WAP, MMS and Java™. We began to provide WAP, MMS and Java™ services on a paid basis in September 2002, April 2003 and November 2003, respectively.

- (3) Total number of paid monthly subscriptions in the relevant period.
- (4) Total number of paid downloads in the relevant period, excluding downloads made pursuant to subscriptions.
- (5) Includes SMS, IVR and CRBT. We began to provide SMS, IVR and CRBT services on a paid basis in July 2002, December 2003 and October 2003, respectively.

## Risk factors

*You should carefully consider each of the risks described below and all of the other information in this prospectus before deciding to invest in our ADSs. If any of the following risks actually occur, our business, financial condition or results of operations could be harmed. In such an event, the trading price of our ADSs could decline and you might lose all or part of your investment.*

### **RISKS RELATING TO OUR BUSINESS**

**We depend on China Mobile for substantially all of our revenue, and any loss or deterioration of our relationship with China Mobile may result in severe disruptions to our business operations and the loss of substantially all of our revenues.**

We derive substantially all of our revenues from the provision of wireless value-added services. We rely on the networks and gateways of China Mobile Communications Corporation, or China Mobile, which has the largest mobile subscriber base in the world, to deliver our services. For each of the two years ended December 31, 2002 and 2003, we derived substantially all of our revenues from our cooperation arrangements with China Mobile.

Through Beijing AirInbox Information Technologies Co., Ltd., or Beijing AirInbox, we have entered into a series of cooperation agreements with China Mobile and a number of its provincial subsidiaries to provide wireless value-added services through China Mobile's networks. Pursuant to our agreements with China Mobile and its provincial subsidiaries, these mobile operators bill and collect fees from mobile phone users for the wireless value-added services we provide.

Our agreements with China Mobile or its subsidiaries are generally for terms of one year or less and approximately 40% of them do not have automatic renewal provisions. We usually renew these agreements or enter into new ones when the prior agreements expire, but on occasion the renewal or new contract can be delayed by periods of one month or more.

If China Mobile ceases to continue to cooperate with us, it will be difficult to find replacement operators with the requisite licenses and permits and comparable infrastructure and customer base to offer our existing wireless value-added services business. In addition, our existing customer base consists almost entirely of subscribers to China Mobile's mobile telephone services. It is unlikely that such customers would continue to use our services if they are not available through China Mobile.

Due to our reliance on China Mobile for our wireless value-added services, any loss or deterioration of our relationship with China Mobile may result in severe disruptions to our business operations, the loss of substantially all of our revenue and a material adverse effect on our financial condition and results of operations.

**The termination or alteration of our cooperation agreements with China Mobile and its subsidiaries would materially and adversely impact our business operations and financial conditions.**

Our negotiating leverage with China Mobile is limited given its leading market position. Our revenue and profitability could be materially adversely affected if China Mobile decides to change its transmission fees or its service fees. In addition, China Mobile or its subsidiaries could impose monetary penalties upon us or even terminate cooperation with us under the cooperation agreements with us, for a variety of reasons, such as the following:

Ø if we fail to achieve the performance standards established by the applicable operator from time to time,

**Risk factors**

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Ø if we breach certain provisions under the agreements, which include, in many cases, the obligation not to deliver content that violates the operator's policies and applicable law, or

Ø if the operator receives a high level of customer complaints about our services.

Due to our dependence on our relationship with China Mobile and its subsidiaries, any termination or material alteration of our cooperation agreements with China Mobile and its subsidiaries would materially and adversely impact our business operations and financial conditions.

**Significant changes in policies or guidelines of China Mobile with respect to services provided by us may result in lower revenue or additional costs for us and materially adversely affect our financial condition or results of operations.**

China Mobile may from time to time issue policies or guidelines, requesting or stating its preference for certain actions to be taken by all wireless value-added service providers using its networks. Due to our reliance on China Mobile, a significant change in its policies or guidelines may have a material effect on us. For example, in an effort to improve customer satisfaction, China Mobile recently revised its billing policies to request all wireless value-added service providers to confirm the subscription status of those users who have not been active in the past three months. Such change in policies or guidelines may result in lower revenues or additional operating costs for us, and we cannot assure you that our financial condition and results of operation will not be materially adversely affected by any policy or guideline change by China Mobile in the future.

**Our dependence on the substance and timing of the billing systems of China Mobile and its subsidiaries may require us to estimate portions of our reported revenue for wireless value-added services. As a result, subsequent adjustments may have to be made to our wireless value-added services revenue in our financial statements.**

As we do not bill our wireless value-added services users directly, we depend on the billing systems and records of the mobile operators, including China Mobile and its subsidiaries, to record the volume of our wireless value-added services provided, charge our users, collect payments and remit to us our portion of the fees. We generally do not have the ability to independently verify or challenge the accuracy of the billing systems of the mobile operators.

We internally tabulate the value of a wireless value-added service provided based on delivery confirmations sent to us by the networks of the mobile operators with respect to each delivery of our services to a user within 72 hours of delivery and record revenues based solely on the monthly statements provided to us by the mobile operators. Generally, within 30 days after the end of each month, statements from the mobile operators confirming the value of our services they billed to users in the month will be delivered to us, and within 30 days after that the mobile operators will pay us for the services, net of their service and transmission fees. However, on occasion such statements for particular operators may be delayed by up to 90 days or more. There has historically been a discrepancy, of approximately 10% in both 2003 and the first quarter of 2004, between the value that we internally tabulate based upon delivery confirmations and the value that we are entitled to receive based on the monthly statements provided by the mobile operators. This discrepancy arises for various reasons, including late notification of delinquent customers, our customer database being out of synchronization with those of mobile operators, duplicate billing and delivery failure. In future periods, we may release our unaudited quarterly financial statements to the market. Due to our past experience with the timing of receipt of the monthly statements from the operators, we expect that we may need to rely on our own internal estimates for the portion of our reported revenues for which we will not have received monthly statements. Our internal estimates will be based on our own internal tabulation of expected revenues from services provided. As the internal tabulation may not be entirely consistent

## Risk factors

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with the actual revenues confirmed by the monthly statements that we eventually receive, we would multiply our internal tabulation of expected revenue from mobile operators from whom we have not received monthly statements by a realization factor applicable to the relevant mobile operator and service and determined according to the average discrepancy over the previous 12 months between our internal tabulations of expected revenues and the actual revenues based on the monthly statements. As a result, we may overstate or understate our revenue for the relevant reporting period. Any difference between our estimated and actual revenue may result in subsequent adjustments to our revenue reported in our financial statements.

### **We have a limited operating history, which may make it difficult for you to evaluate our business.**

We were incorporated in May 2002. As our operating history is limited, the revenue and income potential of our business and markets are unproven. In addition, we face numerous risks, uncertainties, expenses and difficulties frequently encountered by companies at an early stage of development. Some of these risks and uncertainties relate to our ability to:

- Ø maintain our current, and develop new, cooperation arrangements upon which our business depends;
- Ø increase the number of our users by expanding the type, scope and technical sophistication of the content and services we offer;
- Ø respond effectively to competitive pressures;
- Ø increase awareness of our brand and continue to build user loyalty; and
- Ø attract and retain qualified management and employees.

We cannot predict whether we will meet internal or external expectations of our future performance. If we are not successful in addressing these risks and uncertainties, our business, financial condition and results of operations may be materially adversely affected.

### **We have only recently attained profitability, and our historical financial information may not be representative of our future results of operations.**

We have only attained profitability since the first quarter of 2003. We have experienced growth in our business in recent periods in part due to the growth in China's wireless value-added services industry, which may not be representative of future growth or sustainable. We cannot assure you that our historical financial information is indicative of our future operating or financial performance, or our profitability will be sustained.

### **We depend on our key personnel and our business and growth prospects may be severely disrupted if we lose their services.**

Our future success depends heavily upon the continued service of our key executives. In particular, we rely on the expertise and experience of Yunfan Zhou and Nick Yang, our founders and senior officers, in our business operations, and their personal relationships with our other significant shareholders, employees, the regulatory authorities, our clients, our suppliers, the mobile operators and Beijing AirInbox and Beijing Boya Wuji Technologies Co., Ltd., or Beijing Boya Wuji, our operating companies. If Yunfan Zhou or Nick Yang, or both of them, become unable or unwilling to continue in their present positions, or if they join a competitor or form a competing company in contravention of their employment agreements, we may not be able to replace them easily, our business may be



**Risk factors**

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significantly disrupted and our financial condition and results of operations may be materially adversely affected. We do not currently maintain key-man life insurance for any of our key personnel.

Each of Yunfan Zhou and Nick Yang was a party to an employment agreement with Sohu.com Inc. that restricted him during the period of his employment with Sohu.com Inc. and for a period of one year after the termination of such employment from (i) participating or otherwise being involved in any entity that operates an Internet portal in China without the prior written authorization of Sohu.com Inc. and (ii) soliciting or hiring any employee of Sohu.com Inc or soliciting business on behalf or for the benefit of any entity that operates an Internet portal in China from any customer, supplier or business partner of Sohu.com Inc. After their resignation from Sohu.com Inc. in March 2002 and incorporation of our company in May 2002, Messrs. Zhou and Yang received claims made by Sohu.com Inc. in respect of breaches by them of these restrictions. We are not aware of any further claims or legal proceedings initiated or threatened by Sohu.com Inc. against Yunfan Zhou, Nick Yang or us. However, we cannot assure you that Sohu.com Inc. would not bring any claims or legal proceedings against Yunfan Zhou, Nick Yang or us in the future.

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

In December 2001, in order to comply with China's commitments with respect to its entry into the World Trade Organization, or WTO, the State Council promulgated the Administrative Rules for Foreign Investments in Telecommunications Enterprises, or the Telecom FIE Rules. The Telecom FIE Rules set forth detailed requirements with respect to capitalization, investor qualifications and application procedures in connection with the establishment of a foreign-invested telecommunications enterprise. Pursuant to the Telecom FIE Rules, the ultimate ownership interest of a foreign investor in a foreign-funded telecommunications enterprise that provides value-added telecommunications services, including Internet content services, shall not exceed 50%.

We and our subsidiary, KongZhong Information Technologies (Beijing) Co., Ltd., or KongZhong Beijing, are considered as foreign persons or foreign-invested enterprises under PRC laws. As a result, we operate our wireless value-added services in China through Beijing AirInbox, which is owned by PRC citizens. In addition, we have recently set up Beijing Boya Wuji, which is also owned by PRC citizens, to operate our wireless value-added services through mobile operators other than China Mobile. We do not have any equity interest in these operating companies and instead enjoy the economic benefit of them through contractual arrangements, including agreements on provision of loans, provision of services, license of intellectual property, and certain corporate governance and shareholder rights matters. These operating companies conduct substantially all of our operations and generate substantially all of our revenues. They also hold the licenses and approvals that are essential to our business.

There are substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations, including but not limited to the laws and regulations governing the validity and enforcement of our contractual arrangements. Accordingly, we cannot assure you that PRC regulatory authorities will not determine that our contractual arrangements with Beijing AirInbox and Beijing Boya Wuji violate PRC laws or regulations.

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**Risk factors**

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If we or our operating companies were found to violate any existing or future PRC laws or regulations, the relevant regulatory authorities would have broad discretion in dealing with such violation, including, without limitation, the following:

- Ø levying fines;
- Ø confiscating our or our operating companies' income;
- Ø revoking our or our operating companies' business license;
- Ø shutting down the servers or blocking our or our operating companies' web sites;
- Ø restricting or prohibiting our use of the proceeds from this offering to finance our business and operations in China;
- Ø requiring us to restructure our ownership structure or operations; and/or
- Ø requiring us or our operating companies to discontinue our wireless value-added services business.

Any of these or similar actions could cause significant disruptions to our business operations or render us unable to conduct our business operations and may materially adversely affect our business, financial condition and results of operations.

**Our contractual arrangements with Beijing AirInbox and Beijing Boya Wuji may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.**

PRC laws and regulations currently restrict foreign ownership of companies that provide value-added telecommunications services, which include wireless value-added services and Internet content services. As a result, we conduct substantially all of our operations and generate substantially all of our revenues through Beijing AirInbox and Beijing Boya Wuji pursuant to a series of contractual arrangements with them and their respective shareholders. These agreements may not be as effective in providing control over our operations as direct ownership of these businesses. In particular, our operating companies could fail to perform or make payments as required under the contractual agreements, and we will have to rely on the PRC legal system to enforce these agreements, which we cannot be sure would be effective.

**Rapid growth and a rapidly changing operating environment may strain our limited resources.**

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As our user base increases, we will need to increase our investment in our technology infrastructure, facilities and other areas of operations. Our product development, customer service and sales and marketing in particular are important to our future success. If we are unable to manage our growth and expansion effectively, the quality of our services and our customer support could deteriorate and our business may suffer. For example, any such performance issue could prompt China Mobile to cease offering our services over their networks. Our future success will depend on, among other things, our ability to:

- Ø develop and quickly introduce new services, adapt our existing services and maintain and improve the quality of all of our services, particularly as new mobile technologies such as the third generation, or 3G, are introduced,
- Ø effectively maintain our relationships with China Mobile,

**Risk factors**

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- Ø expand the percentage of our revenues which are recurring and are derived from monthly subscription- based services,
- Ø enter into and maintain relationships with desirable content providers,
- Ø continue training, motivating and retaining our existing employees and attract and integrate new employees, including into our senior management,
- Ø develop and improve our operational, financial, accounting and other internal systems and controls, and
- Ø maintain adequate controls and procedures to ensure that our periodic public disclosure under applicable laws, including U.S. securities laws, is complete and accurate.

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

The PRC wireless value-added services market has seen increasingly intense competition. China Mobile's listed subsidiary, China Mobile (Hong Kong) Limited, reported in its 2003 annual results announcement that over 880 service providers supply content and services for its Monternet™ network in 2003. We compete with these companies primarily on the basis of brand, type and timing of service offerings, content, users as well as business partner and channel relationships. We also compete for experienced and talented employees. While we believe that we have certain advantages over our competitors, some of them may have greater access to capital markets, more human and financial resources than we do, and a longer operating history than us. For instance, Internet portals providing wireless value-added services may have an advantage over us with their more established brand names, user base and Internet distribution channels. Furthermore, our competitors may be able to offer a broader range of products and services than we are presently able to offer.

We are facing increasing competition as additional service providers develop new technology and cooperation relationships with key business partners. Our primary competitors in the advanced second generation, or 2.5G, wireless value-added services market in China include Internet portals as well as wireless value-added service providers focused on 2.5G services. Our competitors that hold significant market shares in wireless access protocol, or WAP, are Beijing Mobile Navi Information Technology Services Company, TOM Online Inc., Shenzhen Xuntian Telecommunication Technology Ltd. and Tencent Technology Limited's Mobile QQ, and our competitors that hold significant market shares in multimedia messaging services, or MMS, are TOM Online Inc., Sina Corporation, NetEase.com Inc. and Sohu.com Inc.

Competition is particularly intense in China's second generation, or 2G, based wireless value-added services market as the barriers to entry are relatively low compared to the 2.5G market, resulting in a much higher number of wireless value-added service providers. Our primary competitors in this market include Internet portals. Our competitors that hold significant market shares in this market are Tencent Technology Limited's Mobile QQ, Sina Corporation, Sohu.com Inc., TOM Online Inc. and NetEase.com Inc.

**We may need additional capital and may not be able to obtain such capital on acceptable terms.**

Capital requirements are difficult to plan in our rapidly changing industry. We currently expect that we will need capital to fund our future acquisitions, service development, technological infrastructure and sales and marketing activities.

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## Risk factors

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Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties, including:

- Ø investors' perceptions of, and demand for, securities of telecommunications value-added services companies;
- Ø conditions of the U.S. and other capital markets in which we may seek to raise funds;
- Ø our future results of operations, financial condition and cash flows;
- Ø PRC governmental regulation of foreign investment in value-added telecommunications companies;
- Ø economic, political and other conditions in China; and
- Ø PRC governmental policies relating to foreign currency borrowings.

Any failure by us to raise additional funds on terms favorable to us, or at all, may have a material adverse effect on our business, financial condition and results of operations. For example, we may not be able to carry out parts of our growth strategy to acquire assets, technologies and businesses that are complementary to our existing business or necessary to maintain our growth and competitiveness.

### **The dividends and other distributions on equity we may receive from our subsidiary are subject to restrictions under PRC law or agreements that it may enter into with third parties.**

We are a holding company. Our wholly-owned subsidiary, KongZhong Beijing, has entered into contractual arrangements with Beijing AirInbox and Beijing Boya Wuji, through which we conduct our wireless value-added activities and receive substantially all of our revenues in the form of service fees. We rely on dividends and other distributions on equity paid by our subsidiary and service fees from Beijing AirInbox and Beijing Boya Wuji for our cash requirements in excess of any cash raised from investors and retained by us. If our subsidiary incurs debt in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us. In addition, PRC law requires that payment of dividends by our subsidiary can only be made out of its net income, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, our subsidiary is also required to set aside no less than 10% of its after-tax net income each year to fund certain reserve funds unless such reserve funds have reached 50% of the registered capital of our subsidiary, and these reserves are not distributable as dividends. See note 12 to our historical consolidated financial statements included in this prospectus. Any limitation on the payment of dividends by our subsidiary could materially adversely affect our ability to grow, fund investments, make acquisitions, pay dividends, and otherwise fund and conduct our business.

### **We may not be able to adequately protect our intellectual property, and we may be exposed to infringement claims by third parties.**

We believe the copyrights, service marks, trademarks, trade secrets and other intellectual property we use are important to our business, and any unauthorized use of such intellectual property by third parties may adversely affect our business and reputation. We rely on the intellectual property laws and contractual arrangements with our employees, clients, business partners and others to protect such intellectual property rights. Third parties may be able to obtain and use such intellectual property without authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property in the Internet and wireless value-added related industries in China is uncertain and still evolving, and these laws may not protect intellectual property rights to the same extent as the laws of some other jurisdictions, such as the United States. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, which could result in substantial costs and diversion of our resources, and have a material adverse effect on our business, financial condition and results of operations.

## Risk factors

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Due to the manner in which we obtain, collect, produce and aggregate content and applications for our wireless value-added services, and because our services may be used for the distribution of information, claims may be filed against us for defamation, negligence, copyright or trademark infringement or other violations. In addition, third parties could assert claims against us for losses in reliance on information distributed by us. For example, if we are found to have infringed any intellectual property rights of others, we may be enjoined from using such intellectual property, and we may incur licensing fees or be forced to develop alternative intellectual property. We may also incur significant costs in investigating and defending the claims, even if they do not result in liability. We have not purchased liability insurance for these types of claims.

### **We may not be able to register the Chinese name of our service mark KongZhong Network in China, and we may not be able to effectively prevent its unauthorized use by third parties.**

The Chinese name of our service mark KongZhong Network may be deemed a generic term under existing PRC trademark laws and regulations, which prohibit registration of generic terms as trademarks or service marks. We are in the process of applying for registration of the Chinese name of KongZhong Network as our service mark. Our applications, however, may not be accepted and we may not be able to register the Chinese name of KongZhong Network as a service mark in China. As a result, we may not be able to effectively prevent the unauthorized use of the Chinese name of our service mark, KongZhong Network, and our brand name and reputation may be adversely affected by such unauthorized use.

### **Future acquisitions may have an adverse effect on our ability to manage our business.**

Selective acquisitions form part of our strategy to further expand our business. If we are presented with appropriate opportunities, we may acquire additional businesses, technologies, services or products that are complementary to our core wireless value-added services business. Future acquisitions and the subsequent integration of new companies into ours would require significant attention from our management, in particular to ensure that the acquisition does not disrupt our relationships with the mobile operators, or affect our users' opinion of our services and customer support and is effectively integrated with our existing operations and wireless value-added services. The diversion of our management's attention and any difficulties encountered in any integration process could have an adverse effect on our ability to manage our business. Future acquisitions would expose us to potential risks, including risks associated with the assimilation of new operations, services and personnel, unforeseen or hidden liabilities, the diversion of resources from our existing businesses and technologies, the inability to generate sufficient revenue to offset the costs and expenses of acquisitions and potential loss of, or harm to, relationships with employees and content providers as a result of integration of new businesses. Given the sophisticated technologies used in the wireless value-added services industry, the successful, cost-effective integration of other businesses' technology platforms and services into our own would also be a critical, and highly complex, aspect of any acquisition.

### **We have limited business insurance coverage.**

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited business insurance products, and do not, to our knowledge, offer business liability insurance. As a result, we do not have any business liability insurance coverage for our operations. Moreover, while business disruption insurance is available, we have determined that the risks of disruption and cost of the insurance are such that we do not require it at this time. Any business disruption, litigation or natural disaster might result in substantial costs and diversion of resources.

**Risk factors**

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**RISKS RELATING TO OUR INDUSTRY**

**Our ability to generate revenues could suffer if the PRC market for advanced wireless value-added services does not develop as anticipated.**

The wireless value-added services market in China has evolved rapidly over the past four years, with the introduction of new and advanced services, development of consumer preferences, market entry by new competitors and adaptation of strategies by existing competitors. Accordingly, it is extremely difficult to accurately predict consumer acceptance and demand for various existing and potential new offerings and services, and the future size, as well as composition and growth, of this market. Furthermore, given the limited history and rapidly evolving nature of our market, we cannot predict the price that wireless users will be willing to pay for our services or whether users will have concerns about security, reliability, cost and quality of service associated with advanced wireless value-added services. If acceptance of our advanced wireless value-added services is different than anticipated, our ability to maintain or increase our revenue and net income could be materially and adversely affected.

**The laws and regulations governing the wireless value-added telecommunications and Internet industry in China are developing and subject to future changes. Substantial uncertainties exist as to the interpretation and implementation of those laws and regulations.**

Although wireless value-added services are subject to general regulation regarding telecommunications services, we believe that currently, there are no PRC laws at the national level specifically governing wireless value-added services, such as our services related to WAP, MMS, short messaging services, or SMS, Java™, interactive voice response, or IVR, and color ring back tones, or CRBT.

Beijing AirInbox operates Internet web sites in China, which constitute one of the channels through which our services are offered. In recent years, the PRC government has begun to promulgate laws and regulations applicable to Internet-related services and activities, many of which are relatively new and untested and subject to future changes. In addition, various regulatory authorities of the central PRC government, such as the State Council, the Ministry of Information Industry, or MII, the State Administration of Industry and Commerce, or SAIC, and the Ministry of Public Security, are empowered to issue and implement rules to regulate certain aspects of Internet-related services and activities. Furthermore, some local governments have also promulgated local rules applicable to Internet companies operating within their respective jurisdictions. As the Internet industry itself is at an early stage of development in China, there will likely be new laws and regulations promulgated in the future to address issues that may arise from time to time. As a result, uncertainties exist regarding the interpretation and implementation of current and future PRC Internet laws and regulations.

Beijing AirInbox has obtained various value-added telecommunications services licenses for the provisions of its services. In addition, it is in the process of applying for a trans-regional value-added telecommunications license with the MII, in order to provide services in multiple provinces, autonomous regions and municipalities. In addition, Beijing Boya Wuji is in the process of applying for certain licenses required for its services. We cannot assure you that we will obtain these licenses or that the regulatory authorities will not take any action against us if we fail to obtain them. If Beijing AirInbox or Beijing Boya Wuji fails to obtain or maintain any of the required licenses or permits, it may be subject to various penalties, including redressing the violations, confiscation of income, imposition of fines or even suspension of its operations. Any of these measures could materially disrupt our operations and materially and adversely affect our financial condition and results of operations.

**Risk factors**

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**The PRC government or the telecommunications operators may prevent us from distributing, and we may be subject to liability for content that any of them believes is inappropriate.**

China has promulgated regulations governing telecommunications service providers, Internet access and the distribution of news and other information. In the past, the PRC government has stopped the distribution of information over the Internet that it believes to violate Chinese law, including content that is obscene, incites violence, endangers national security, is contrary to the national interest or is defamatory.

The telecommunications operators also have their own policies that restrict the distribution by wireless value-added service providers of content they deem inappropriate. For instance, they have punished certain providers for distributing content deemed by them to be obscene. Such punishments have included censoring of content, delays in payments of fees by the mobile operators to the offending service provider, forfeiture of fees owed by the mobile operators to the offending service provider and suspension of the service on the mobile operators' networks. Accordingly, even if we comply with PRC governmental regulations relating to licensing and foreign investment restrictions, if the PRC government or the mobile operators were to take any action to limit or prohibit the distribution of information we provide or to limit or regulate any current or future content or services available to our users, our revenues could be reduced and our reputation harmed.

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

Any failure to maintain the satisfactory performance, reliability, security and availability of our network infrastructure may cause significant harm to our reputation and our ability to attract and maintain users. Major risks involved in such network infrastructure include, among others, any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures which may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware.

Our network systems are vulnerable to damage from fire, flood, power loss, telecommunications failures, computer viruses, hackings and similar events. Any network interruption or inadequacy that causes interruptions in the availability of our services or deterioration in the quality of access to our services could reduce our user satisfaction and competitiveness. In addition, any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could have a material adverse effect on our business, financial condition and results of operations. We do not maintain insurance policies covering losses relating to our systems and we do not have business interruption insurance.

**The growth of our business may be adversely affected due to public concerns over the security and privacy of confidential user information.**

The growth of our business may be inhibited if the public concern over the security and privacy of confidential user information transmitted over the Internet and wireless networks is not adequately addressed. Our services may decline and our business may be adversely affected if significant breaches of network security or user privacy occur.

**Risk factors**

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**RISKS RELATING TO THE PEOPLE'S REPUBLIC OF CHINA**

**Substantially all of our assets are located in China and substantially all of our revenue is derived from our operations in China. Accordingly, our results of operations and prospects are subject, to a significant extent, to the economic, political and legal developments in China.**

The PRC's economic, political and social conditions, as well as government policies, could affect our business. The PRC economy differs from the economies of most developed countries in many respects.

According to Global Insight, since 1978, China has been one of the world's fastest-growing economies in terms of gross domestic product, or GDP, growth. We cannot assure you, however, that such growth will be sustained in the future. Moreover, the recent slowdown in the economies of the United States, the European Union and certain Asian countries may adversely affect economic growth in China.

The PRC's economic growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but 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.

The PRC economy has been transitioning from a planned economy to a more market-oriented economy. Although in recent years the PRC government has implemented measures emphasizing the use of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is 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. It also exercises significant control over PRC 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. We cannot assure you that China's economic, political or legal systems will not develop in a way that is detrimental to our business, results of operations and prospects.

**Any future outbreak of Severe Acute Respiratory Syndrome or any other epidemic in China may have a material adverse effect on our business operations, financial condition and results of operations.**

From December 2002 to June 2003, China and certain other countries experienced an outbreak of a new and highly contagious form of atypical pneumonia now known as severe acute respiratory syndrome, or SARS. On July 5, 2003, the World Health Organization declared that SARS had been contained. However, in recent months, a few new cases of SARS have been reported in Asia. An outbreak in the future may disrupt our business operations and have a material adverse effect on our financial condition and results of operations. In addition, health or other government regulations may require temporary closure of our offices, or the offices of our advertisers, content providers or partners, which may severely disrupt our business operations and have a material adverse effect on our financial condition and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of SARS or any other epidemic.



**Risk factors**

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**Government control of currency conversion may adversely affect our financial condition and results of operations.**

We receive substantially all of our revenues in Renminbi, which currently is not a freely convertible currency. A portion of these revenues must be converted into other currencies to meet our foreign currency obligations including, among others, payment of dividends declared, if any, in respect of our ordinary shares.

Under China's existing foreign exchange regulations, our subsidiary, KongZhong Beijing, is able to pay dividends in foreign currencies, without prior approval from the State Administration of Foreign Exchange, by complying with certain procedural requirements. However, we cannot assure you that the PRC government will not take measures in the future to restrict access to foreign currencies for current account transactions.

Foreign exchange transactions under the capital accounts of our subsidiary, KongZhong Beijing, and Beijing AirInbox and Beijing Boya Wuji continue to be subject to significant foreign exchange controls and require the approval of PRC governmental authorities, including the State Administration of Foreign Exchange, or SAFE. In particular, if KongZhong Beijing borrows foreign currency loans from us or other foreign lenders, these loans must be registered with SAFE, and if we finance KongZhong Beijing by means of additional capital contributions, these capital contributions must be approved by certain government authorities including the Ministry of Commerce or its local counterparts. In addition, if we finance Beijing AirInbox or Beijing Boya Wuji by loans, we must obtain approval from SAFE. These limitations could affect the ability of KongZhong Beijing, Beijing AirInbox and Beijing Boya Wuji to obtain foreign exchange through debt or equity financing.

**Fluctuation of the Renminbi could adversely affect the value of and dividends payable on our ADSs.**

The value of the Renminbi fluctuates and is subject to changes in PRC political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates. Since 1994, the official exchange rate for the conversion of Renminbi to U.S. dollars has generally been stable. Any devaluation of the Renminbi, however, may adversely affect the value of, and dividends, if any, payable on, our ordinary shares in foreign currency terms, since we will receive substantially all of our revenues, and express our profits, in Renminbi.

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

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. Although legislation in China over the past 20 years has significantly improved the protection afforded to various forms of foreign investment and contractual arrangements in China, these laws, regulations and legal requirements are relatively new and their interpretation and enforcement involve uncertainties, which could limit the legal protection available to us, and foreign investors, including you. In addition, the PRC government may enact new laws or amend current laws that may be detrimental to our current contractual arrangements with Beijing AirInbox and Beijing Boya Wuji, which may in turn have a material adverse effect on our business operations.

**Risk factors**

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**You may experience difficulties in effecting service of legal process and enforcing judgments against us and our management.**

We are a company incorporated under the laws of the Cayman Islands, and our subsidiary and substantially all of our assets are located outside the United States. In addition, some of our directors and officers and their assets are located outside the United States. As a result, it may not be possible to effect service of process within the United States upon our directors or officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws.

Our PRC legal counsel, Llinks Law Office, has advised us that the PRC does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States, the United Kingdom or most other western countries. As a result, recognition and enforcement in China of judgments of a court obtained in those jurisdictions in relation to any matter not subject to a binding arbitration provision may be difficult or impossible. See Enforceability of civil liabilities.

We have been advised by Maples and Calder Asia, our Cayman Islands legal advisers, that the courts of the Cayman Islands are unlikely (i) to recognize or enforce against us judgments of courts of the United States predicated upon certain of the civil liability provisions of the securities laws of the United States or any State thereof and (ii) in original actions brought in the Cayman Islands, to impose liabilities against us predicated upon certain of the civil liability provisions of the securities laws of the United States or any State thereof, if and to the extent that such provisions are penal in nature. However, in the case of laws that are not penal in nature, although there is no statutory enforcement in the Cayman Islands of judgments obtained in the United States, the courts of the Cayman Islands will generally recognize and enforce a judgment of a foreign court of competent jurisdiction without retrial on the merits. A Cayman Islands court may stay proceedings if concurrent proceedings are being brought elsewhere.

**RISKS RELATING TO OUR ADSs**

**If an active trading market for our ADSs does not develop, the price of our ADSs may suffer and may decline below the initial offering price.**

There is no public market for our ADSs or our ordinary shares underlying the ADSs prior to this offering. If an active public market for our ADSs does not develop after this offering, the market price and liquidity of our ADSs may be adversely affected. We have applied to have our ADSs approved for quotation on the Nasdaq National Market. We can provide no assurances that a liquid public market for our ADSs will develop.

The initial public offering price for our ADSs will be determined by negotiation between us and the underwriters based upon several factors, and we can provide no assurance that the price at which the ADSs are traded after this offering will not decline below the initial public offering price.

**Sales of substantial amounts of ADSs in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of the ADSs.**

Upon completion of this offering, we will have 1,370,000,000 ordinary shares outstanding (including those represented by ADSs), of which 400,000,000 ordinary shares represented by 10,000,000 ADSs, or approximately 29.2%, will be publicly held by investors participating in this offering. The ADSs sold in this offering will be freely tradable in the United States without restriction or further registration under the Securities Act, and the ordinary shares held by our existing shareholders may be deposited into the ADS facility and sold in the public market in the future pursuant to, and subject to the restrictions contained in, Rule 144 under the Securities Act and the deposit agreement. If any

## Risk factors

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existing shareholders sell or are perceived as intending to sell a substantial number of our ordinary shares, the prevailing market price for our ADSs could be adversely affected.

**You will experience immediate dilution in the book value of the ADSs that you purchase because the initial public offering price per ADS is higher than the net tangible book value per ADS.**

The initial public offering price per ADS is higher than the net tangible book value per ADS prior to this offering. Therefore, when you purchase ADSs from this offering at the initial public offering price, you will incur an immediate dilution of \$8.36 per ADS. If we issue additional ADSs, you may experience further dilution.

**You may not be able to exercise your right to vote the ordinary shares underlying your ADSs.**

Under the terms of the ADSs and the deposit agreement, you have a general right to vote the ordinary shares underlying the ADSs that you hold. You may instruct the depositary bank, Citibank, N.A., to vote the ordinary shares underlying our ADSs, subject to the terms of the deposit agreement and only if we request Citibank to ask for your instructions. Otherwise, you will not be able to exercise your right to vote unless you withdraw the ordinary shares underlying the ADSs. However, you may not receive voting materials in time to ensure that you are able to instruct Citibank to vote your shares or receive sufficient notice of a shareholders' meeting to permit you to withdraw your ordinary shares to allow you to cast your vote with respect to any specific matter. In addition, Citibank and its agents may not be able to timely send out your voting instructions or carry out your voting instructions in the manner you have instructed. As a result, you may not be able to exercise your right to vote and you may lack recourse if your ordinary shares are not voted as you requested. See Description of American Depositary Shares Voting rights.

**We are incorporated under Cayman Islands law and it may be difficult for you to protect your interests as a shareholder, as Cayman Islands law provides significantly less protection to investors when compared to the laws of the U.S., and your ability to protect your rights through the U.S. federal courts may be limited.**

Our corporate affairs are governed by our Memorandum and Articles of Association, by the Companies Law (2003 Revision) and the common law of the Cayman Islands. The rights of shareholders to take legal action against our directors or us, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands laws are to a large extent governed by the common law of the Cayman Islands. The common law in the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands and from English common law, the decisions of whose courts are of persuasive authority but are not binding on a court in the Cayman Islands. Cayman Islands law in this area may not be as established and may differ from provisions under statutes or judicial precedent in existence in jurisdictions 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. In addition, shareholders of Cayman Islands companies may not have standing to initiate shareholder derivative actions before the federal courts of the United States. As a result of all of the above, our public shareholders may have more difficulty in protecting their interests in actions against the management, directors or our major shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States, and our ability to protect our interests if we are harmed in a manner that would otherwise enable us to sue in a United States federal court may be limited. See Description of share capital Differences in corporate law, where we explain that dissenting shareholders do not enjoy rights

## Risk factors

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comparable to appraisal rights upon the reconstruction and amalgamation of companies, and give more details with respect to shareholder suits.

### **If our dividend is declared and paid in a foreign currency, you may be taxed on a larger amount in U.S. dollars than the U.S. dollar amount that you will actually ultimately receive.**

You will be taxed on the U.S. dollar value of your dividends at the time you receive them, even if you actually receive a smaller amount of U.S. dollars when the payment is in fact converted into U.S. dollars. Specifically, if a dividend is declared and paid in a foreign currency, the amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the payments made in the foreign currency, determined at the spot rate of the foreign currency to the U.S. dollar on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Thus, if the value of the foreign currency decreases before you actually convert the currency into U.S. dollars, you will be taxed on a larger amount in U.S. dollars than the U.S. dollar amount that you will actually ultimately receive.

### **You may be subject to limitations on transfers of our ordinary shares.**

Our ordinary shares are transferable subject to restrictions in our articles of association. However, our board of directors may, in its absolute discretion, decline to register any transfer of any ordinary share without assigning any reasons therefore. In addition, the registration of transfers may be suspended and the register closed as our board of directors may determine, for up to 45 days in any year.

## **RISKS RELATING TO THE OFFERING**

### **The trading prices of our ADSs are likely to be volatile, which could result in substantial losses to investors.**

The trading prices of our ADSs are likely to be volatile and could fluctuate widely in response to factors beyond our control. In particular, the market prices for shares of Internet and technology-related companies often reach levels that may bear no established relationship to the operating performance of these companies. These broad market and industry factors may significantly affect the market prices of our ADSs, regardless of our actual operating performance. The market prices of our ADSs following the offering may be volatile.

Other factors that may affect the volatility in the price and trading volumes for our ADSs include:

- Ø actual or anticipated fluctuations in our quarterly operating results;
- Ø announcements of new services by us or our competitors;
- Ø changes in financial estimates by securities analysts;
- Ø conditions in the wireless value-added services market;
- Ø announcements by our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- Ø additions or departures of key personnel;
- Ø potential litigation; or
- Ø performance and fluctuation of the market prices of other PRC-related companies or technology companies which have securities listed or quoted in the U.S. market.

Any of these factors may result in large and sudden changes in the volume and price at which our ADSs will trade. We cannot give you any assurance that these factors will not occur in the future.

**Risk factors**

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**We could be subject to potential liability arising out of a possible violation of the Securities Act in connection with statements contained in a press release issued by a third-party content provider which contained statements regarding and attributed to us.**

On June 29, 2004, after the filing but before the effectiveness of the registration statement covering the ADSs being sold in the offering, Superscape Group plc, or Superscape, a United Kingdom-based producer of games for mobile phones, issued a press release regarding the signing of an agreement between Superscape and us whereby we will offer games produced by Superscape through China Mobile and other network operators in China. The press release contained statements, based in part on information supplied by our employees without authorization by our senior management, regarding our company, the mobile gaming market in China and our proposed initial public offering. Some of these statements contained in the press release are inconsistent with statements in this prospectus, relate to information not contained in the prospectus or are qualitative projections or forward-looking statements. Portions of the press release were subsequently reprinted by a number of news outlets, including AFX News Limited, China Business On-Line, PrimeZone Media Network, Company News Feed and NA Europe News Distribution Network. **We strongly caution you not to consider any of the information contained in the press release and urge you not to make an investment decision without carefully considering the risks and other information contained in this prospectus.**

The following is a summary of the statements contained in the press release issued by Superscape that are inconsistent with, or provide information not otherwise contained in, other parts of the prospectus or are forward-looking statements:

- Ø The press release stated that our company was founded in March 2002. However, as disclosed under [Our corporate structure Overview](#), our company was incorporated in May 2002.
- Ø The press release stated that our company became profitable by January 2003, with our MMS and wireless Internet revenue ranked number one among all the wireless service providers in China and that by January 2004, our company ranked number one in China in MMS, wireless Internet, and mobile games. In addition, the press release stated that our company is the number one supplier of games to China Mobile. However, as disclosed in our financial statements included in the prospectus, which do not provide monthly financial information, we became profitable in the first quarter of 2003. Further, as disclosed under [Prospectus summary Our business and Business Overview](#), China Mobile ranked us as the number one wireless value-added service provider on its network specifically in terms of revenue for 2.5G wireless value-added services in 2003 and the first quarter of 2004. We do not claim to be the number one wireless service provider or mobile games provider overall in China.
- Ø The press release indicated that we aimed to raise £100 million from our proposed initial public offering for further investment in wireless solutions. As disclosed under [Prospectus summary The offering and Use of proceeds](#), we estimate the net proceeds from the offering to be approximately \$80 million (assuming an initial public offering price of \$11 per ADS, the mid-point of the range shown on the front cover page) and anticipate using the net proceeds for acquisitions or investments in businesses that we believe are complementary to our existing business, product development, sales and marketing, and general corporate purposes.
- Ø The press release included several statements attributed to Yunfan Zhou, our chief executive officer. These included a statement that the Chinese market will become the top mobile gaming market in the world with the largest number of mobile users. Although, as disclosed under [Industry overview Overview The telecommunications industry in China](#), China is now the largest mobile telecommunications market in the world, the prospectus does not otherwise discuss the future position of China's mobile gaming market. The qualitative projection about the future

**Risk factors**

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position of China's mobile gaming market is necessarily speculative in nature. This projection may not materialize, and the actual future position of China's mobile gaming market may vary significantly from this projection and may change over time. Please see Special note regarding forward-looking statements. You should not regard the projection as a representation by us, the underwriters involved in the offering or any other person that the projected market position for China in mobile gaming will in fact be achieved. For this reason, you should only consider this projection after carefully evaluating all of the information in this prospectus, including the risks described in this section and throughout this prospectus.

If any of the statements included in the press release issued by Superscape were to constitute a violation by us of the Securities Act, investors who purchase our ADSs in the offering could have the right, for a period of one year from the date of their purchase of the ADSs, to obtain recovery of the consideration paid in connection with their purchase. We may be liable for up to the total value of the ADSs we sell. If any such liability were asserted, we would contest the claim vigorously.

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## Special note regarding forward-looking statements

These statements relate to our future prospects, developments and business strategies. The statements contained in this prospectus that are not statements of historical fact may include forward-looking statements that involve a number of risks and uncertainties. We have used the words may, will, expect, anticipate, believe, estimate, plan, intend, hope and similar expressions in this prospectus to identify forward-looking statements. These forward-looking statements are made based on our current expectations and beliefs concerning future events affecting us and are subject to risks, uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed in or implied by these forward-looking statements.

In addition, these forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. Actual results may differ materially from the information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risks set forth in Risk factors.

Because of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this prospectus might not occur in the way we expect, or at all. We do not intend to update or otherwise revise the forward-looking statements in this prospectus, whether as a result of new information, future events or otherwise. Accordingly, you should not place undue reliance on any forward-looking information.

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## Our corporate structure

### OVERVIEW

We were incorporated in May 2002 under the laws of the Cayman Islands as Communication Over The Air Inc., an exempted limited liability company. In March 2004, we changed our name to KongZhong Corporation. Our founders, Yunfan Zhou and Nick Yang, each beneficially owns 27.4% of our company, while the remaining 45.2% is owned by 10 institutional and individual investors. See Principal and selling shareholders.

We conduct our business in China solely through our wholly-owned subsidiary, KongZhong Beijing. In order to meet domestic ownership requirements under PRC law, which restrict us and KongZhong Beijing, as a foreign or foreign-invested company, from operating in certain value-added telecommunications and Internet services, we have established Beijing AirInbox in China, which is wholly-owned by PRC citizens. We have also recently established Beijing Boya Wuji in China, which is also wholly-owned by PRC citizens. We do not have any equity interests in Beijing AirInbox or Beijing Boya Wuji, but instead enjoy the economic benefits of these companies through a series of contractual arrangements as described below.

### OUR CORPORATE STRUCTURE

The chart below sets forth our corporate and share ownership structure as of the date of this prospectus, after giving effect to this offering, and assuming that (i) all of our preferred shares are converted into ordinary shares and (ii) the underwriters do not exercise their over-allotment option.

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**Our corporate structure**

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(1) Other investors include Global Lead Technology Limited, Draper Fisher Jurvetson ePlanet Ventures L.P., Draper Fisher Jurvetson ePlanet Partners Fund, LLC, Draper Fisher Jurvetson ePlanet Ventures GmbH & Co. KG, Lucky Dragon Holdings Group Ltd., eGarden I, Calver Investments Limited, eGarden Ventures (HK), Ltd., Yin Alice Chau and CENO Investment Limited.

(2) We provided loans to each of the shareholders of Beijing AirInbox for their equity contributions into the registered capital of Beijing AirInbox.

(3) We do not have any ownership interest in Beijing AirInbox or Beijing Boya Wuji. We and our subsidiary, KongZhong Beijing, have entered into a series of contractual arrangements with these companies and their respective shareholders.

PRC regulations currently restrict foreign ownership of companies that provide value-added telecommunications services, which include wireless value-added services. See also Regulation. To comply with PRC regulations, we conduct substantially all of our operations through Beijing AirInbox, which is 45% owned by Yang Cha, one of our employees, 42% by Songlin Yang, an uncle of our co-founder, Nick Yang, 10% by Yunfan Zhou, our co-founder and 3% by Zhen Huang, the wife of Nick Yang. We also established in March 2004 Beijing Boya Wuji, which is equally owned by each of Yunfan Zhou and Zhen Huang, to conduct our wireless value-added services through mobile operators other than China Mobile. We do not have any equity interest in Beijing AirInbox or Beijing Boya Wuji, but instead enjoy the economic benefits of these companies through a series of contractual

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## Our corporate structure

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arrangements, which we and KongZhong Beijing have entered into with these companies and their respective shareholders as described below. For a description of each of these agreements, see [Related party transactions](#) [Other related party agreements](#).

As part of these contractual arrangements, we have entered into loan agreements with each of the shareholders of Beijing AirInbox, pursuant to which long-term loans were provided to each of these shareholders to be invested exclusively in Beijing AirInbox. Each shareholder has also agreed to repay these loans only in the form of a transfer of all of his or her interest in Beijing AirInbox to either KongZhong Beijing or our designees to the extent allowed by PRC law under certain circumstances. We currently do not plan to extend any additional loans to the shareholders of Beijing AirInbox or any loans to the shareholders of Beijing Boya Wuji in the future. See [Related party transactions](#) [Other related party agreements](#).

Beijing AirInbox and Beijing Boya Wuji and their respective shareholders have also entered into exclusive share option agreements with KongZhong Beijing. Pursuant to these agreements, each of the shareholders of Beijing AirInbox and Beijing Boya Wuji has granted an exclusive option to KongZhong Beijing or our designees to purchase all or part of such shareholder's equity interest in Beijing AirInbox or Beijing Boya Wuji, as applicable, in accordance with PRC law, and has covenanted not to encumber such equity interest in any manner other than as permitted by KongZhong Beijing.

KongZhong Beijing has entered into certain business operation agreements with Beijing AirInbox and Beijing Boya Wuji and their respective shareholders. Pursuant to these agreements, Beijing AirInbox and Beijing Boya Wuji and their respective shareholders agreed to appoint individuals designated by KongZhong Beijing to the management team of Beijing AirInbox and Beijing Boya Wuji, and to refrain from taking certain actions that may materially affect these companies' operations. Each of the shareholders of Beijing AirInbox and Beijing Boya Wuji has also executed an irrevocable power of attorney in favor of individuals designated by KongZhong Beijing. Pursuant to the powers of attorney, those designated individuals have full power and authority to exercise all of such shareholders' rights with respect to their equity interests in Beijing AirInbox or Beijing Boya Wuji.

KongZhong Beijing has entered into an exclusive technical and consulting services agreement with each of Beijing AirInbox and Beijing Boya Wuji. Pursuant to these exclusive technical and consulting services agreements, KongZhong Beijing provides technical and consulting services to Beijing AirInbox and Beijing Boya Wuji in exchange for services fees. Each of the shareholders of Beijing AirInbox and Beijing Boya Wuji also entered into equity pledge agreements with Beijing KongZhong, pursuant to which these shareholders pledged their interest in Beijing AirInbox and Beijing Boya Wuji, respectively, for the performance of these companies' payment obligations under the respective exclusive technical and consulting services agreements.

KongZhong Beijing has entered into an exclusive trademark license agreement and domain name agreement with each of Beijing AirInbox and Beijing Boya Wuji. Pursuant to these agreements, KongZhong Beijing granted each of Beijing AirInbox and Beijing Boya Wuji a non-exclusive license to use its trademarks and domain names in exchange for a fee.

In the opinion of our PRC legal counsel, Llinks Law Office, the ownership structures of KongZhong Beijing, Beijing AirInbox and Beijing Boya Wuji, our contractual arrangements with these companies and their respective shareholders and the businesses and operations of these companies as described in this prospectus, are in compliance with all existing PRC laws and regulations and are enforceable in accordance with their terms and conditions. In addition, our PRC legal counsel is of the opinion that, with respect to Beijing AirInbox, no consent, approval or license, other than those already obtained, is required under any of the existing PRC laws and regulations for the effectiveness and enforceability of the ownership structures, contractual arrangements, businesses and operations of these companies except for a trans-regional value-added telecommunications services permit. As a newly incorporated

**Our corporate structure**

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company, Beijing Boya Wuji is in the process of applying for certain licenses and permits that are necessary for its business. Nevertheless, there are substantial uncertainties regarding the interpretation and implementation of current PRC laws and regulations. See Risk factors Risks relating to our business PRC laws and regulations restrict foreign investment in China s telecommunications services industry, and substantial uncertainties exist with respect to our contractual arrangements with Beijing AirInbox and Beijing Boya Wuji due to uncertainties regarding the interpretation and application of current or future PRC laws and regulations, and Our contractual arrangements with Beijing AirInbox and Beijing Boya Wuji may not be as effective in providing operational control as direct ownership of these businesses and Regulation. As discussed in those risk factors, certain events may cause us to lose the benefits and control intended to be created by these arrangements.

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## Use of proceeds

We estimate we will receive net proceeds from the offering of approximately \$80 million from the sale of 8,000,000 ADSs after deducting the underwriting discounts and expenses payable by us in the offering and assuming an initial public offering price of \$11 per ADS. We will not receive any proceeds from the sale of ADSs by the selling shareholders. We currently intend to use the net proceeds to us as follows, though the allocation of the use of proceeds may change along with evolving business conditions and other management considerations:

- Ø up to \$40 million for acquisitions or investments in businesses that we believe are complementary to our existing business, although no acquisitions or investments are pending;
- Ø up to \$8 million for product development;
- Ø up to \$8 million for sales and marketing; and
- Ø any remaining balance for general corporate purposes.

To the extent that the net proceeds we receive from this offering are not immediately applied for the above purposes, we intend to use them for our working capital, to purchase U.S. Treasury debt securities and other short-term investment grade debt securities or to deposit the proceeds into interest-bearing bank accounts. These investments may have a material adverse effect on the U.S. federal income tax consequences of an investment in our ADSs. It is possible that we may become a passive foreign investment company, or PFIC, for United States federal income taxpayers, which could result in negative tax consequences to you. These consequences are described in more detail in [Taxation](#).

Our industry is evolving rapidly and could cause significant and rapid changes to our strategies and business plans. Accordingly, the actual application of the proceeds may change. As new business opportunities arise or circumstances change, we may reallocate all or part of the net proceeds to other business plans or new projects or hold such funds in temporary investments.

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## Dividend policy

We currently intend to retain future earnings, if any, to finance our business and to fund growth and expansion of our business and, therefore, do not expect to pay any cash dividends in the foreseeable future. Any future determination to pay dividends will be made at the discretion of our board of directors and will be based upon our financial results, shareholders' interests, general business conditions and strategies, capital requirements, contractual restrictions on the payment of dividends and any other conditions our board of directors deems relevant.

Holders of ADSs will be entitled to receive dividends, subject to the terms of the deposit agreement, to the same extent as the holders of our ordinary shares. Cash dividends will be paid to the depository in U.S. dollars and paid to holders of ADSs according to the terms of the deposit agreement. Other distributions, if any, will be paid by the depository to holders of ADSs by any means it deems legal and practical. Under the deposit agreement, the depository is required to distribute dividends to the holders of ADS unless such distribution is prohibited by law or is impracticable. The amounts distributed to holders will be net of fees, expenses, taxes and other governmental charges payable by holders under the deposit agreement. See [Description of American Depositary Shares](#) [Dividends and distributions](#).

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## Dilution

Dilution is the amount by which the initial public offering price paid by purchasers of the ADSs offered hereby will exceed the pro forma net tangible book value per ADS after the offering. As of March 31, 2004, our pro forma net tangible book value per ADS was \$0.33, or \$0.01 per ordinary share. Net tangible book value per ordinary share represents our total tangible assets minus our total liabilities and liquidation values of our preferred shares, divided by the total number of ordinary shares outstanding as of March 31, 2004. Net tangible book value per ADS is equal to 40 times the net tangible book value per ordinary share. Our pro forma net tangible book value per ordinary share represents the amount of net tangible book value per ordinary share after giving effect to the automatic conversion of all of our outstanding Series A convertible preferred shares and Series B redeemable convertible preferred shares into our ordinary shares.

After giving effect to the sale of our ADSs offered in this offering (assuming an initial public offering price of \$11 per ADS) and after deducting underwriting discounts and commissions and other estimated expenses of this offering, but without taking into account any other changes in such tangible book value after March 31, 2004, our net tangible book value per ADS would increase to \$2.64 per ADS. This represents an immediate increase of \$2.31 in net tangible book value per ADS to our existing shareholders and an immediate dilution of \$7.59, or \$8.36 before deducting underwriting discounts and commissions and other estimated expenses of this offering, per ADS equivalent to purchasers of our ADSs purchasing at the initial public offering price.

The following table illustrates the immediate dilution per ADS to new investors:

Assumed initial public offering price per ADS		\$ 11.00
Pro forma net tangible book value per ADS as of December 31, 2003	\$ 0.33	
Increase in net tangible book value per ADS attributable to the sale of our ADSs	\$ 2.31	
Pro forma net tangible book value per ADS after this offering		\$ 2.64
Dilution in net tangible book value per ADS to new investors		\$ 8.36

The following table summarizes, on a pro forma basis as of March 31, 2004, the differences between existing shareholders and new investors with respect to the number of ordinary shares purchased from us, the total consideration paid to us and the average price per ordinary share paid by existing shareholders and by new investors purchasing the ADSs in this offering assuming the initial public offering price of \$11 per ADS and without giving effect to underwriting discounts and commissions and other estimated offering expenses payable by us.

	Ordinary Shares Purchased		Total Consideration		Average Price	Average Price
	Number	%	Amount	%	Per Ordinary Share	Per ADS
Existing shareholders	1,050,000,000	76.6%	\$ 3,520,271	3.8%	\$ 0.003	\$ 0.13
New investors	320,000,000	23.4%	\$ 88,000,000	96.2%	\$ 0.275	\$ 11.00
Total	1,370,000,000	100.0%	\$ 91,520,271	100.0%		

The foregoing discussion and table assumes no exercise of any outstanding stock options. As of March 31, 2004, there were stock options outstanding to purchase an aggregate of 86,120,000 ordinary shares, of which 18,045,000 were exercisable, at a weighted average exercise price of \$0.0060 per share. If all these options had been exercised on March 31, 2004, before giving effect to

**Dilution**

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this offering, our pro forma net tangible book value would have been approximately \$0.33 per ADS, or \$0.01 per ordinary share, the increase in net tangible book value attributable to new investors would have been \$2.28 per ordinary share, or \$0.06 per ADS, and the dilution in pro forma net tangible book value to new investors would have been \$8.39 per ADS, or \$0.21 per ordinary share.

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## Capitalization

The following table sets forth our capitalization as of March 31, 2004:

- Ø on a pro forma basis reflecting conversion of outstanding Series A and Series B preferred shares; and
- Ø on a pro forma as adjusted basis to reflect this offering, assuming an initial public offering price of \$11 per ADS, which is the mid-point of the estimated price range of between \$10 and \$12, after deducting underwriting discounts and commissions and other estimated expenses payable by us in relation to the offering, as if such sale occurred, and assuming the underwriters do not exercise the over-allotment option. Except as set forth below, there has been no material change in our consolidated capitalization since March 31, 2004.

This information should be read in conjunction with Management's discussion and analysis of financial condition and results of operations and our consolidated financial statements and related notes thereto included elsewhere in this prospectus.

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## Capitalization

	As of March 31, 2004		
	Actual	Pro forma	Pro forma as adjusted
	(in thousands of U.S. dollars, except share data)		
Minority interest	\$ 120.8	\$ 120.8	\$ 120.8
Series B preferred shares, net of issuance costs of \$30,000 (\$0.0000005 par value; 350,000,000 shares authorized, 350,000,000 issued and outstanding in 2003; redeemable in 2007 at \$0.0085715 per share) (nil issued and outstanding on a pro forma and pro forma as adjusted basis) (liquidation value \$4,499,950)	\$ 2,970.0	\$	\$
Shareholder's equity:			
Series A preferred shares (\$0.0000005 par value; 231,000,000 shares authorized, 231,000,000 shares issued and outstanding in 2003) (nil issued and outstanding on a pro forma and pro forma as adjusted basis) (liquidation value \$550,011)	\$ 0.1	\$	\$
Ordinary shares (\$0.0000005 par value; 999,419,000,000 shares authorized, 469,000,000 shares issued and outstanding in 2003) (1,050,000,000 shares issued and outstanding on a pro forma basis as of March 31, 2004) <sup>(1)</sup> (1,370,000,000 shares issued and outstanding on a pro forma as adjusted basis)	0.2	0.5	0.6
Additional paid-in capital	3,020.9	5,990.7	87,830.6
Deferred stock compensation	(2,303.2)	(2,303.2)	(2,303.2)
Accumulated other comprehensive loss	(1.5)	(1.5)	(1.5)
Retained earnings	5,056.4	5,056.4	5,056.4
Total shareholders' equity	\$ 5,772.9	\$ 8,742.9	\$ 90,582.9

- (1) The number of ordinary shares outstanding as of March 31, 2004 does not include: (i) 86,120,000 ordinary shares subject to options outstanding as of March 31, 2004 and (ii) 18,880,000 additional ordinary shares that are reserved for issuance under our 2002 Equity Incentive Plan, or the 2002 Plan.

## Exchange rate information

We present our historical consolidated financial statements in U.S. dollars. In addition, certain pricing information is presented in U.S. dollars and certain contractual amounts that are in Renminbi include a U.S. dollar equivalent solely for the convenience of the reader. Except as otherwise specified, this pricing information and these contractual amounts are translated at RMB8.2770 = \$1.00, the prevailing rate on March 31, 2004. The translations are not a representation that the Renminbi amounts could actually be converted to U.S. dollars at this rate. For a discussion of the exchange rates used for the presentation of our financial statements, see note 2 to our financial statements.

The People's Bank of China sets and publishes daily a base exchange rate with reference primarily to the supply and demand of Renminbi against the U.S. dollar in the market during the prior day. The People's Bank of China also takes into account other factors such as the general conditions existing in the international foreign exchange markets. Although Chinese governmental policies were introduced in 1996 to reduce restrictions on the convertibility of Renminbi into foreign currency for current account items, conversion of Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or security, requires the approval of the State Administration for Foreign Exchange and other relevant authorities.

The noon buying rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York were RMB8.2766 = \$1.00 on July 2, 2004. The following table sets forth the high and low noon buying rates between Renminbi and U.S. dollars for each of the periods shown:

Period	Noon Buying Rate RMB per \$1.00	
	High	Low
December 2003	8.2772	8.2765
January 2004	8.2772	8.2767
February 2004	8.2773	8.2769
March 2004	8.2774	8.2767
April 2004	8.2772	8.2768
May 2004	8.2773	8.2768
June 2004	8.2768	8.2766

The following table sets forth the period-end noon buying rates and the average noon buying rates between Renminbi and U.S. dollars for each of 1999, 2000, 2001, 2002, 2003 and 2004 (through June 30), calculated by averaging the noon buying rates on the last day of each month of the periods shown:

	Average Noon Buying Rate RMB per \$1.00
1999	8.2785
2000	8.2784
2001	8.2772
2002	8.2772
2003	8.2771
2004 (through June 30, 2004)	8.2769

## Selected consolidated financial and operating data

The following selected consolidated financial data should be read in conjunction with our audited consolidated financial statements, the notes thereto and Management's discussion and analysis of financial condition and results of operations included elsewhere in this prospectus. The selected consolidated statements of operations data for the period from May 6, 2002 to December 31, 2002 and for the year ended December 31, 2003 and the three months ended March 31, 2004 (unaudited), and the selected consolidated balance sheet data as of December 31, 2002 and 2003 and March 31, 2004 (unaudited) set forth below are derived from our audited consolidated financial statements included elsewhere in this prospectus. Our audited consolidated financial statements have been prepared and presented in accordance with U.S. GAAP and audited by Deloitte Touche Tohmatsu. We commenced operations in May 2002. Due to the relatively new and rapidly evolving nature of the wireless value-added services industry in China, the short history of our company and other factors affecting our business as described under Risk factors, our results of operations in any period are not necessarily indicative of the results that may be expected for any future period.

Consolidated statements of operations data	For the period from May 6, 2002 to December 31, 2002	For the year ended December 31, 2003	For the three months ended March 31, 2004
	(in thousands of U.S. dollars)		
Gross revenues	\$ 200.3	\$ 7,806.7	\$ 7,147.6
Cost of revenues	(84.3)	(2,284.0)	(2,239.0)
Gross profit	116.0	5,522.7	4,908.6
Operating expenses:			
Product development	164.2	1,369.5	716.5
Sales and marketing	128.9	841.4	294.1
General and administrative	317.3	882.7	675.7
Amortization of deferred stock compensation		22.0	80.8
Total operating expenses	610.4	3,115.6	1,767.1
Income (loss) from operations	(494.4)	2,407.1	3,141.5
Other expenses			(0.7)
Interest income, net	0.5	1.0	1.3
Net income (loss) before income taxes	(493.9)	2,408.1	3,142.1
Income tax expense			
Net income (loss)	\$ (493.9)	\$ 2,408.1	\$ 3,142.1
Net income (loss) per share:			
Basic	\$ 0.00	\$ 0.01	\$ 0.01
Diluted	\$ 0.00(1)	\$ 0.00	\$ 0.00
Shares used in calculating net income (loss) per share:			
Basic	415,547,794	469,000,000	469,000,000
Diluted	415,547,794(1)	1,094,824,434	1,098,206,555

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Pro forma net income (loss) per share  
(unaudited)

Basic	\$ 0.00	\$ 0.00	\$ 0.00
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	\$ 0.00(1)	\$ 0.00	\$ 0.00
	<u>          </u>	<u>          </u>	<u>          </u>

Shares used in calculating pro forma net  
income (loss) per share

Basic	622,124,999	1,050,000,000	1,050,000,000
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	622,124,999(1)	1,094,824,434	1,098,206,555
	<u>          </u>	<u>          </u>	<u>          </u>

Pro forma net income (loss) per ADS  
equivalent

Basic	\$ (0.03)	\$ 0.09	\$ 0.12
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	\$ (0.03)	\$ 0.09	\$ 0.11
	<u>          </u>	<u>          </u>	<u>          </u>

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(1) Anti-dilutive preferred shares and options were excluded from the weighted average ordinary shares outstanding for the diluted per share calculation. For 2002, basic loss per share did not differ from diluted loss per share.

**Selected consolidated financial data**

Consolidated balance sheet data	As of			
	December 31, 2002	December 31, 2003	March 31, 2004	March 31, 2004
	(in thousands of U.S. dollars)			Pro forma (unaudited) <sup>(1)</sup>
Cash and cash equivalents	\$2,646.2	\$3,742.6	\$ 5,736.2	\$ 5,736.2
Accounts receivable	\$ 132.3	\$1,703.9	\$ 3,268.8	\$ 3,268.8
Property and equipment, net	\$ 251.0	\$ 848.5	\$ 1,104.2	\$ 1,104.2
Total assets	\$3,101.3	\$6,567.5	\$10,518.1	\$10,518.1
Total current liabilities	\$ 75.0	\$1,047.4	\$ 1,654.4	\$ 1,654.4
Series B redeemable convertible preferred shares	\$2,970.0	\$2,970.0	\$ 2,970.0	\$
Total shareholders' equity	\$ 56.3	\$2,550.1	\$ 5,772.9	\$ 8,742.9
Total liabilities and shareholders' equity	\$3,101.3	\$6,567.5	\$10,518.1	\$10,518.1

- (1) The unaudited pro forma balance sheet information as of March 31, 2004 assumes the conversion upon completion of the initial public offering of all shares of convertible preferred shares outstanding as of March 31, 2004 into ordinary shares.

Other consolidated financial data	For the period from May 6, 2002 to December 31, 2002	For the year ended December 31, 2003	For the three months ended March 31, 2004
	(in thousands of U.S. dollars)		
Net cash provided by (used in):			
Operating activities	\$ (579.7)	\$ 1,959.7	\$ 2,243.7
Investing activities	\$ (292.4)	\$ (864.0)	\$ (370.8)
Financing activities	\$3,520.3	\$	\$ 120.8

Operating data	For the period from May 6, 2002 to December 31, 2002	For the year ended December 31, 2003	For the three months ended March 31, 2004
	(in thousands)		
2.5G <sup>(1)</sup>			
Subscriptions <sup>(2)</sup>	351.6	9,021.3	5,508.0
Downloads <sup>(3)</sup>		2,722.1	2,334.2
2G <sup>(4)</sup>			
Subscriptions <sup>(2)</sup>	50.0	1,925.4	2,194.2
Downloads <sup>(3)</sup>	800.0	6,127.4	1,634.6
Total			
Subscriptions <sup>(2)</sup>	401.6	10,946.7	7,702.3
Downloads <sup>(3)</sup>	800.0	8,849.5	3,968.8

- (1) Includes WAP, MMS and Java™. We began to provide WAP, MMS and Java™ services on a paid basis in September 2002, April 2003 and November 2003, respectively.

- (2) Total number of paid monthly subscriptions in the relevant period.

- (3) Total number of paid downloads in the relevant period, excluding downloads made pursuant to subscriptions.

- (4) Includes SMS, IVR and CRBT. We began to provide SMS, IVR and CRBT services on a paid basis in July 2002, December 2003 and October 2003, respectively.

## Management's discussion and analysis of financial condition and results of operations

*The following discussion and analysis should be read in conjunction with our audited consolidated financial statements and the related notes thereto and other information appearing elsewhere in this prospectus. Our audited consolidated financial statements have been prepared in accordance with U.S. GAAP. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information provided under the caption "Risk factors."*

### OVERVIEW

We are the leading provider of 2.5G wireless interactive entertainment, media and community services to customers of China Mobile, which has the largest mobile subscriber base in the world. We primarily deliver our services through the more advanced 2.5G wireless standard. The higher transmission capacity of 2.5G allows users to access higher quality graphics and richer content and interactivity, in comparison with the 2G wireless standard. We also offer a range of services based on the 2G wireless standard. We deliver our 2.5G services through WAP, MMS and Java™ technology platforms and our 2G services through SMS, IVR and CRBT technology platforms.

We were incorporated under the laws of the Cayman Islands on May 6, 2002. Our gross revenues for the year ended December 31, 2003 were \$7.8 million, whereas our gross revenues for the period from May 6, 2002 to December 31, 2002 were \$0.2 million. Our net income for the year ended December 31, 2003 was \$2.4 million, as compared to a net loss of \$0.5 million for the period from May 6, 2002 to December 31, 2002. In the first quarter of 2004, our gross revenues and net income reached \$7.1 million and \$3.1 million, respectively, compared to gross revenues of \$0.7 million and net income of \$97,100 in the first quarter of 2003 and gross revenues of \$3.8 million and net income of \$1.6 million in the fourth quarter of 2003.

For each quarter since our founding, we have devoted significant resources to product development. We have steadily built up our product development team in order to analyze consumer demands and to expand the range of our service offerings to attract new customers and increase usage among our existing customers. The size of our product development team increased from 79 persons as of March 31, 2003 to 149 persons as of December 31, 2003 and to 201 persons as of March 31, 2004. We expect to remain committed in the coming year to enhancing our product development capabilities through a managed enlargement of our product development team while focusing on research for and development of proprietary technology and content.

We have also committed significant resources since our founding to building our sales and marketing team, which we believe has been crucial in promoting our brand and placing our services in the hands of users by building our relationships with mobile operators and distribution channels. The size of our sales, marketing and customer services team increased from 20 persons as of March 31, 2003 to 54 persons as of December 31, 2003 and to 78 persons as of March 31, 2004. In addition to growing our sales and marketing team, we have also participated in joint promotional arrangements to promote our brand and services. We expect our focus on sales and marketing efforts to continue in the coming year.

PRC regulations currently restrict foreign ownership of companies that provide value-added telecommunications services, which include wireless value-added services and Internet content services. According to PRC laws and regulations, as of December 11, 2003, foreign investors are permitted to hold up to 50% of a company in China engaged in value-added telecommunications services.

**Management's discussion and analysis of financial condition and results of operations**

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However, uncertainty exists as to how these regulations will be implemented. The PRC government authorities are still in the process of drafting detailed rules with respect to the procedures for the application for and approval of establishing a foreign-invested value-added telecommunications services enterprise. As a result, we conduct substantially all of our operations through Beijing AirInbox, which is owned by PRC citizens. We have also recently established Beijing Boya Wuji, through which we intend to conduct operations with mobile operators other than China Mobile. We have entered into loan agreements with each of the shareholders of Beijing AirInbox, pursuant to which we provided interest-free loans to each of the shareholders of Beijing AirInbox for a term of 10 years, in an aggregate amount of \$1.2 million (RMB\$10 million) to be invested exclusively in Beijing AirInbox. We have also entered into a series of contractual arrangements with Beijing AirInbox, Beijing Boya Wuji and their shareholders, including the exclusive technical and consulting services agreements and trademark and domain name license agreements pursuant to which we are entitled to receive service and license fees. In addition, we have entered into equity pledge agreements with each of the shareholders of our operating companies, pursuant to which each of the shareholders pledged all of his or her interest in our operating companies to us as security for the performance by each of our operating companies of their obligations under the exclusive technical and consulting services agreements. As a result of these contractual arrangements, under U.S. GAAP, we are the primary beneficiary of the investments in our operating companies and we consolidate their results of operations in our consolidated financial statements. For a description of the PRC regulations restricting foreign ownership of companies that provide wireless value-added services and Internet content services in China, see Regulation. For a description of the contractual arrangements with our operating companies, see Our corporate structure and Related party transactions. For a discussion of the tax implications of charging service fees pursuant to the contractual arrangements with our operating companies, see Taxation. For a description of the consolidation of our financial statements, see note 2 to the audited consolidated financial statements.

We have a limited operating history on which to base an evaluation of our business and prospects. Our prospects should be considered in light of the risks, uncertainties, expenses and difficulties frequently encountered by companies in the early stages of their development, particularly in new and rapidly evolving markets such as wireless value-added services.

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

- Ø Growth of the wireless value-added services consumer market in China;
- Ø Technological advancement of the mobile telecommunications market, including the adoption of 2.5G and subsequent standards of mobile handsets and networks, in China;
- Ø Attractiveness and variety of our services;
- Ø Change in the number, scope and terms of our cooperation arrangements with the mobile operators, content providers, mobile handset manufacturers, mobile handset distributors and other key players in China's mobile telecommunications industry;
- Ø Our product development efforts to capitalize on market opportunities; and
- Ø Expansion of our marketing and promotion activities.

In particular, our business may be adversely affected if the terms or conditions of our contractual arrangements with mobile operators should change with regard to any particular type of service. In order to reduce the risk that our results of operations and financial conditions would be overly dependent upon, and disproportionately impacted by, any particular service offering, technology platform or mobile operator, we have sought to broaden the range of our services, develop new relationships with mobile operators and expand our distribution channels. The growth of our product



**Management's discussion and analysis of financial condition and results of operations**

development and sales and marketing teams underscores our focus on enhancing our ability to bring new services to market quickly and effectively so that we can preserve our leading position on key 2.5G services with China Mobile. Meanwhile, we have also begun developing our relationship with other mobile operators in order to broaden the base of our operation. In addition, we have entered into distribution arrangements with major mobile handset manufacturers to further enhance the distribution of our services and promote our brand.

**REVENUES**

We derive revenues from providing wireless value-added services to mobile phone users, substantially all of whom are customers of China Mobile and its subsidiaries.

The following table sets forth the historical consolidated revenue attributable to services derived from each of our 2.5G and 2G technology platforms in terms of amount and as a percentage of our total gross revenues for the periods indicated:

	For the period from May 6, 2002 to December 31, 2002		For the year ended December 31, 2003		For the three months ended March 31, 2003		For the three months ended March 31, 2004	
	Amount	Percentage of revenue	Amount	Percentage of revenue	Amount	Percentage of revenue	Amount	Percentage of revenue
(in thousands of U.S. dollars, except percentages)								
2.5G services <sup>(1)</sup>	\$131.3	66%	\$5,956.0	76%	\$346.0	49%	\$5,244.4	73%
2G services <sup>(2)</sup>	69.0	34%	1,850.7	24%	357.0	51%	1,903.2	27%
<b>Total gross revenues</b>	<b>\$200.3</b>	<b>100%</b>	<b>\$7,806.7</b>	<b>100%</b>	<b>\$703.0</b>	<b>100%</b>	<b>\$7,147.6</b>	<b>100%</b>

(1) Includes WAP, MMS and Java™.

(2) Includes SMS, IVR and CRBT.

We derive our revenue primarily through contracts with mobile operators that are nationwide in scope or that cover large geographic areas of China. However, we believe that users in Guangdong province and the coastal provinces of China constitute the most significant portion of our user base. As a result, we allocate additional resources to these areas, including establishing sales offices in most of these provinces.

Prior to 2004, we generated all of our revenues from fees paid by mobile phone users who use our services through China Mobile's network. In the first quarter of 2004, we began to receive revenue from services provided on the network of China United Telecommunications Corporation, or China Unicom. We recognize revenue derived from our services before deducting the service fees and the net transmission charges paid to the mobile operators. Fees for our services are either charged on a transaction or monthly subscription basis, and vary according to the type of services delivered. For a description of our fees and arrangements with the mobile operators, see Business Our services Strategic relationships Mobile operators. We recognize all revenues in the period in which the services are performed. For a description of our revenue recognition policy, see Critical accounting policies.

As mobile operators do not provide us detailed revenue breakdown on a service-by-service basis, we depend on our internal database system to monitor revenue derived from each of our services. We make our business decisions including research and development of new services and reallocation of resources to popular services based on our internal data, taking into account other factors including strategic considerations.

**Management's discussion and analysis of financial condition and results of operations****COST OF REVENUES**

Our cost of revenues includes the following:

- Ø Service fees due to the mobile operators, which are generally 15% of the gross revenues;
- Ø Payments to content providers for the use of their content, and to mobile handset manufacturers and other industry partners with whom we have cooperation arrangements, in the form of a fixed fee or a percentage of our aggregate net cash received from the mobile operators with respect to services provided through the cooperation arrangements;
- Ø Net transmission charges payable by us to the mobile operators, calculated as the number of messages we send to users in excess of the number of message requests received by us multiplied by a per message transmission fee, which varies depending on the total volume of messages sent in any given month; and
- Ø Bandwidth leasing charges and depreciation and facility costs relating to equipment used to provide wireless-value added services.

Our cost of revenues for the period from May 6, 2002 to December 31, 2002 and the year ended December 31, 2003 was \$84,335 and \$2.3 million, respectively. For the first quarter of 2004, our cost of revenues reached \$2.2 million, compared to \$0.1 million from the first quarter of 2003 and \$1.2 million for the fourth quarter of 2003. Our cost of revenues increased substantially in 2003 as a result of the increase in the volume of our services and our cooperation arrangements with additional business partners; however, we were able to increase our gross margin and operating margin through economies of scale, as certain royalty payments to third party content owners are fixed in amount regardless of how widely we distribute the content and the depreciation and fees associated with server facilities are fixed regardless of the level of utilization. As part of our business strategy, we intend to pursue more cooperation arrangements, which may increase our cost of revenues in the future.

**OPERATING EXPENSES**

Our operating expenses include product development, sales and marketing, general and administrative expenses and amortization of deferred stock compensation.

The following table sets forth certain consolidated operating expenses data in terms of amount and as a percentage of our gross revenues for the periods indicated:

	For the period from May 6, 2002 to December 31, 2002		For the year ended December 31, 2003		For the three months ended March 31, 2003		For the three months ended March 31, 2004	
	Amount	Percentage of revenue	Amount	Percentage of revenue	Amount	Percentage of revenue	Amount	Percentage of revenue
(in thousands of U.S. dollars, except percentages)								
Product development	\$164.2	82.0%	\$1,369.5	17.5%	\$176.2	25.1%	\$716.5	10.0%
Sales and marketing	128.9	64.3%	841.4	10.8%	140.7	20.0%	294.1	4.1%
General and administrative	317.3	158.4%	882.7	11.3%	142.4	20.3%	675.7	9.5%
Amortization of deferred stock compensation		%	22.0	0.3%		%	80.8	1.1%
<b>Total</b>	<b>\$610.4</b>	<b>304.7%</b>	<b>\$3,115.6</b>	<b>39.9%</b>	<b>\$459.3</b>	<b>65.4%</b>	<b>\$1,767.1</b>	<b>24.7%</b>

*Product Development Expenses.* Our product development expenses consist primarily of the compensation and benefits for our product development team, which focuses on developing and improving our services and adapting them for next generation technology platforms. While our product development expenses have increased since our formation due to the increase in the size of our



**Management's discussion and analysis of financial condition and results of operations**

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product development team, our product development expenses as a percentage of our gross revenues have decreased significantly since our inception in May 2002. We expect our product development expenses to increase in absolute terms as our company grows, but expect such expenses to remain stable or decrease slightly as a percentage of our gross revenues.

*Sales and Marketing Expenses.* Our sales and marketing expenses consist primarily of advertising, sales and marketing expenses, including expenses associated with sponsoring promotional events, and the compensation and benefits for our sales, marketing and customer service departments. Our sales and marketing expenses have increased since our inception, primarily due to the growth of our sales and marketing team as well as an expansion of our marketing efforts. We expect that our sales and marketing expenses will increase as we further promote our KongZhong brand name in future periods.

*General and Administrative Expenses.* Our general and administrative expenses consist primarily of business tax, compensation and benefits for general management, finance and administrative personnel, professional fees, lease expenses and other office expenses. Our general and administrative expenses have increased since our inception, but have decreased significantly as a percentage of our gross revenues. We expect our general and administrative expenses to increase as our business expands in future periods and as a result of the increased administrative costs we expect to incur upon becoming a publicly listed company.

*Amortization of Deferred Stock Compensation.* In June 2002, we adopted our 2002 Plan, which governs the stock option grants we have made. We grant options to purchase our shares to our employees and we record a compensation charge for the excess of the fair value of the stock at the measurement date over the amount our employee must pay to acquire the stock. Deferred stock compensation is amortized on a straight-line basis and charged to expense over the vesting period of the underlying options, which is generally over four years. See Management Stock options for a description of our stock option plan and grants.

**CRITICAL ACCOUNTING POLICIES**

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our financial statements. Some of our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Below we have summarized our accounting policies that we believe are both important to the portrayal of our financial results and involve the need to make estimates about the effect of matters that are inherently uncertain. We also have other policies that we consider to be key accounting policies. However, these policies do not meet the definition of critical accounting estimates because they do not generally require us to make estimates or judgments that are difficult or subjective.

**Revenue recognition**

Our revenues are primarily derived from providing wireless interactive entertainment, media and community value-added services to customers of China Mobile and its subsidiaries. The fees for such services are determined by us in consultation with the mobile operators, are charged on a transaction basis or on a monthly subscription basis and vary according to the type of services delivered.

We deliver wireless value-added services to users through the mobile operators' networks and we rely upon the mobile operators to provide us with billing and collection services. We have, however, developed an internal system that records the number of transactions that are sent from our servers, which we then compare to the confirmations received from the relevant mobile operator. Generally, within 15 to 30 days after the end of each month, each of the mobile operators delivers to us a statement confirming the value of the wireless value-added services provided by us for which they

**Management's discussion and analysis of financial condition and results of operations**

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billed to users in that month, and usually within 60 days after the end of each month, the mobile operator will pay us for the wireless value-added services, less their service fees and net transmission charges.

We internally tabulate the value of the wireless value-added services provided based upon individual delivery confirmations sent to us by the mobile operators each time we deliver a service to the mobile operator for delivery to a user. We also receive monthly statements from the mobile operators with respect to the total volume of services delivered to users in that month. Historically, there has been a discrepancy between the value based on the delivery confirmations and the value set forth in the monthly statements. This discrepancy arises for various reasons, including:

- Ø *Late notification of delinquent customers.* The mobile operators may from time to time classify certain customers as delinquent customers for non-payment of services. The mobile operators request all service providers to cease delivering services to customers once they are classified as delinquent. However, time lags often exist between when a customer is classified as delinquent and when we receive such information from the mobile operations. As a result, we occasionally unintentionally provide services to these delinquent customers for which the mobile operators will not make payments to us.
  - Ø *Customer database out of synchronization.* Customers may cancel their subscriptions through the mobile operators. Although we synchronize our and the mobile operators' databases of customer information on an ongoing basis, our databases are not always completely in synchronization with those of the mobile operators. As a result, until our databases are synchronized with the mobile operators, we could provide services to customers who have cancelled their subscriptions, for which we are not entitled to receive revenue.
  - Ø *Duplicate billing.* China Mobile typically generates system identification numbers to identify customers who use our WAP services, rather than directing the real phone numbers to us. Occasionally the platform operators inadvertently generate multiple identification numbers for one mobile number. In such case, the multiple bills for the multiple identification numbers have to be eliminated from the monthly statement the mobile operators provide to us.
  - Ø *Delivery failure.* When mobile operators send us delivery confirmations within 72 hours of our delivery of value-added services, the confirmations will indicate three possible outcomes: success, failure, or unknown. Our internal system recognizes successful confirmations as services provided. As a result, there exist discrepancies between our records and the monthly statement provided by the mobile operators for confirmations marked as unknown where our services were successfully delivered or where the confirmation was incorrect.
- In future periods, we may release our unaudited quarterly financial statements to the market. Due to our past experience with the timing of receipt of the monthly statements from the operators, we expect that we may need to rely on our own internal estimates for the portion of our reported revenues for which we will not have received monthly statements. Our internal estimates will be based on our own internal tabulation of expected revenues from services provided. As the internal tabulation may not be entirely consistent with the actual revenues confirmed by the monthly statements that we eventually receive, we would multiply our internal tabulation of expected revenue by a realization factor determined according to the average discrepancy over the previous 12 months between our internal tabulations of expected revenues and the actual revenues based on the monthly statements. As a result, we may overstate or understate our revenue for the relevant report period. Any difference between our estimated and actual revenue may result in subsequent adjustments to our revenue reported in our financial statements.

**Management's discussion and analysis of financial condition and results of operations**

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Pursuant to the cooperation agreements that we have entered into with China Mobile and its subsidiaries, we generally do not bear credit risk with respect to outstanding receivables from the mobile users, with the exception of our SMS services provided through Chongqing Mobile Telecommunication Corporation, or Chongqing Mobile, for which we bear the risk of customer default. We derived less than 1% of our revenue from SMS services provided through Chongqing Mobile in both 2003 and the three months ended on March 31, 2004.

We evaluate our cooperation arrangements with the mobile operators to determine whether to recognize our revenue on a gross basis or net of the services fees and net transmission charges paid to the mobile operators. Our determination is based upon an assessment of whether we act as a principal or agent when providing our services. We have concluded that we act as a principal in the arrangement. Factors that support our conclusion include:

Ø We are able to establish prices within ranges prescribed by the mobile operators;

Ø We determine the service specifications of the services we will be rendering; and

Ø We are able to control the selection of our content suppliers.

Although the mobile operators must approve the prices of our services in advance, we have been able to adjust our prices from time to time to reflect or react to changes in the market. In addition, the mobile operators usually will not pay us if users do not receive the services or cannot be billed due to transmission and billing failures. As a result, we bear a portion of the delivery and billing risks for our portion of the revenues generated with respect to our services.

Based on these factors, we believe that recognizing revenues on a gross basis is appropriate.

**Stock-based compensation expense**

Our stock-based employee compensation plan is described in more detail under Management Stock options. We grant stock options to our employees and we record a compensation charge for the excess of the fair value of the stock at the measurement date over the amount an employee must pay to acquire the stock. We amortize deferred stock compensation using the straight-line method over the vesting periods of the related options, which are generally four years.

We have recorded deferred stock-based compensation to represent the difference between the deemed fair value of our ordinary shares for accounting purposes and the option exercise price. We determined the deemed fair value of our ordinary shares based upon several factors, including a valuation report from an independent appraiser and the price of our then most recent preferred share placement. We recorded deferred stock-based compensation expense of \$0, \$0.2 million and \$2.2 million for stock options granted to employees for the period from May 6, 2002 to December 31, 2002, the year ended December 31, 2003 and the three months ended March 31, 2004, respectively, and we amortized \$0, \$21,986 and \$80,738 for the period from May 6, 2002 to December 31, 2002, the year ended December 31, 2003 and the three months ended March 31, 2004, respectively. If we had used different assumptions or criteria to determine the deemed fair value of our ordinary shares, materially different amounts of stock-based compensation could have been reported.

Pro forma information regarding net income (loss) and net income (loss) per share is required in order to show our net income (loss) as if we had accounted for employee stock options under the fair value method. We use the Black-Scholes option pricing model to compute the fair value. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected stock price volatility. We use projected volatility rates, which are based upon historical volatility rates experienced by comparable public companies. Because our employee stock options have characteristics significantly different from those of publicly traded

**Management's discussion and analysis of financial condition and results of operations**

options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in our management's opinion the existing models do not necessarily provide a reliable single measure of the fair value of our stock options.

The historical pro forma net income (loss) and pro forma net income (loss) per share that we used in calculating the fair value of the options granted to employees may not be representative of the pro forma effects in future years of net income (loss) and earnings per share for the following reasons:

Ø The number of future shares to be issued under these plans is not known; and

Ø The assumptions used to determine the fair value can vary significantly.

**QUARTERLY RESULTS OF OPERATIONS**

The following table sets forth our supplemental selected unaudited quarterly results of operations for the periods indicated. This information should be read in conjunction with the consolidated financial statements and related notes contained elsewhere in this prospectus. In our management's opinion, we have prepared our quarterly results of operations on substantially the same basis as our audited consolidated financial statements. This information includes all adjustments that we consider necessary for the fair presentation of our financial position and operating results for the periods presented. Due to the relatively new and rapidly evolving nature of the wireless value-added services industry in China, the short history of our company and other factors affecting our business as described under Risk factors, our results of operations in any period are not necessarily indicative of the results that may be expected for any future periods.

	For the three months ended									
	June 30, 2002 <sup>(1)</sup>		September 30, 2002		December 31, 2002		March 31, 2003		June 30, 2003	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
(in thousands of U.S. dollars, except percentages)										
Gross revenues										
2.5G <sup>(2)</sup>	\$		\$ 37.1	85.9%	\$ 94.2	60.0%	\$ 346.0	49.2%	\$ 914.9	74.6%
2G <sup>(3)</sup>			6.1	14.1%	62.9	40.0%	357.0	50.8%	311.5	25.4%
Total gross revenues			43.2	100.0%	157.1	100.0%	703.0	100.0%	1,226.4	100.0%
Cost of revenues			(18.2)	(42.1)%	(66.1)	(42.1)%	(146.5)	(20.8)%	(330.7)	(27.0)%
Gross profit			25.0	57.9%	91.0	57.9%	556.5	79.2%	895.7	73.0%
Operating expenses:										
Product development	(27.6)		(37.1)	(85.9)%	(99.5)	(63.3)%	(176.2)	(25.1)%	(271.3)	(22.1)%
Sales and marketing	(7.1)		(15.0)	(34.7)%	(106.8)	(68)%	(140.7)	(20.0)%	(212.6)	(17.3)%
General and administrative	(44.6)		(70.2)	(162.5)%	(202.5)	(128.9)%	(142.4)	(20.3)%	(175.0)	(14.3)%
Amortization of deferred stock compensation				%		%		%		%
Total operating expenses	(79.3)		(122.3)	(283.1)%	(408.8)	(260.2)%	(459.3)	(65.4)%	(658.9)	(53.7)%
Income (loss) from operations	(79.3)		(97.3)	(225.2)%	(317.8)	(202.3)%	97.2	13.8%	236.8	19.3%
Other expenses				%		%		%		%

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Interest income, net	0.2		%	0.3	0.2%	(0.1)	%	(0.3)	%		
Net income (loss)	\$(79.1)			\$(97.3)	(225.2)%	\$(317.5)	(202.1)%	\$ 97.1	13.8%	\$ 236.5	19.3%

[Additional columns below]

[Continued from above table, first column(s) repeated]

	For the three months ended					
	September 30, 2003		December 31, 2003		March 31, 2004	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
(in thousands of U.S. dollars, except percentages)						
Gross revenues						
2.5G <sup>(2)</sup>	\$ 1,604.6	79.0%	\$ 3,090.5	80.3%	\$ 5,244.4	73.4%
2G <sup>(3)</sup>	426.2	21.0%	756.0	19.7%	1,903.2	26.6%
Total gross revenues	2,030.8	100.0%	3,846.5	100.0%	7,147.6	100.0%
Cost of revenues	(651.1)	(32.1)%	(1,155.7)	(30)%	(2,239.0)	(31.3)%
Gross profit	1,379.7	67.9%	2,690.8	70.0%	4,908.6	68.7%
Operating expenses:						
Product development	(390.2)	(19.2)%	(531.8)	(13.8)%	(716.5)	(10.0)%
Sales and marketing	(203.7)	(10.0)%	(284.4)	(7.4)%	(294.1)	(4.1)%
General and administrative	(262.7)	(12.9)%	(302.6)	(7.9)%	(675.7)	(9.5)%
Amortization of deferred stock compensation	(8.8)	(0.4)%	(13.2)	(0.3)%	(80.8)	(1.1)%
Total operating expenses	(865.4)	(42.5)%	(1,132.0)	(29.4)%	(1,767.1)	(24.7)%
Income (loss) from operations	514.3	25.4%	1,558.8	40.6%	3,141.5	44.0%
Other expenses		%		%	(0.7)	%
Interest income, net	0.7	%	0.7	%	1.3	%
Net income (loss)	\$ 515.0	25.4%	\$ 1,559.5	40.6%	\$ 3,142.1	44.0%

(1) We commenced operations in May 2002.

(2) Includes WAP, MMS and Java™. We began to provide WAP, MMS and Java™ services on a paid basis in September 2002, April 2003 and November 2003, respectively.

(3) Includes SMS, IVR and CRBT. We began to provide SMS, IVR and CRBT services on a paid basis in July 2002, December 2003 and October 2003, respectively.

*Gross Revenues.* Our business has grown quickly, which has resulted in significant increases in our gross revenues each quarter throughout the comparison periods. Substantially all of these increases resulted from rapid growth in China's 2.5G wireless value-added services market and the usage volume



**Management's discussion and analysis of financial condition and results of operations**

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of our WAP, MMS, and SMS services. We commercially launched MMS services in April 2003. In addition, during various quarters, we have promoted certain services, which further increased revenues during such quarters. For example, we entered into an exclusive cooperation arrangement to promote the movie *Hero* through WAP and SMS, which generated \$0.2 million in revenues in the first quarter of 2003. We also launched many new services in the first and second quarters of 2003, which resulted in increases in our revenues in that quarter. For example, we launched WAP based ringtone and picture download services in April 2003, which generated \$0.1 million, \$0.3 million, \$0.8 million and \$1.4 million in revenues in the second, third and fourth quarters of 2003 and the first quarter of 2004, respectively. Our gross revenues increased by 86% to \$7.1 million in the first quarter of 2004 from \$3.8 million in the fourth quarter of 2003. This increase was driven by strong growth in our services across both 2G and 2.5G technology platforms, as a result of continuing growth in China's wireless value-added services market.

*Cost of Revenues.* Our cost of revenues has increased substantially each quarter throughout the comparison periods. This increase was primarily due to the increases in the service fees and net transmission charges paid to the mobile operators as a result of the increase in our revenue and usage volume. Our service and other fees paid under our cooperation arrangements with our content and distribution partners also resulted in an increase in our cost of revenues as we increased the number and scope of our cooperation arrangements. For the first quarter of 2004, our cost of revenues increased 94% to \$2.2 million from \$1.2 million in the fourth quarter of 2003. The increase was driven primarily by increases in service fees and transmission charges that we paid to mobile operators and fees that we paid to handset manufacturers and content partners. We expect our cost of revenues will continue to increase, particularly as our newly added distribution channels begin to increase their contribution and we continue to add distribution channels.

*Gross Profit.* Our gross profit has increased throughout the comparison periods. Our gross profit as a percentage of gross revenues, or gross margin, has fluctuated over the periods as a result of certain promotional activities or increases in cooperation arrangements. The major factors affecting the fluctuations in our gross margin include the amount of fees we pay to the mobile operators, content providers and distribution partners, which depends primarily on the number and scope of our cooperation arrangements, economies of scale and net transmission charges we pay to the mobile operators, which may be affected by the proportion of revenues from WAP to total revenues. For the first quarter of 2004, our gross profit increased by 82% to \$4.9 million from \$2.7 million for the fourth quarter of 2003. This increase was driven by the increase in our revenues.

*Operating Expenses.* Our operating expenses have increased throughout the comparison periods, driven primarily by increases in our product development expenses, sales and marketing expenses and general and administrative expenses. For the first quarter of 2004, our total operating expenses increased by 56% to \$1.8 million from \$1.1 million in the fourth quarter of 2003. As a percentage of gross revenues, our operating expenses have declined from our inception through the first quarter of 2004.

Our product development expenses have increased as a result of the expansion of our product development team as our business grew. However, our product development expenses as a percentage of gross revenues have continuously declined from our inception through the first quarter of 2004 as a result of economies of scale.

Our sales and marketing expenses have increased as a result of an expansion in marketing activities to promote our brand name and to establish additional distribution channels. We expect our sales and marketing expenses will continue to increase, particularly as we establish sales presences in additional geographic areas in China.

**Management's discussion and analysis of financial condition and results of operations**

Our general and administrative expenses have increased as a result of the expansion of our business, including an increase in our business tax, the compensation and benefits for general management, finance and administrative personnel, professional fees, lease expenses and other office expenses. In the first quarter of 2004, our general and administrative expenses increased significantly, primarily as a result of increases in professional fees, business tax, salary for general management, finance and administrative personnel, travel expenses, and other office expenses.

We recorded amortization of deferred stock compensation in the third and fourth quarters of 2003 and the first quarter of 2004 as a result of the issuance of stock options to our employees under the 2002 Plan, which also contributed to the increase in our operating expenses.

**Year ended December 31, 2003 compared to the period from May 6, 2002 (date of inception) through December 31, 2002**

The following table sets forth, for the periods presented, certain data from our consolidated results of operations. This information should be read in conjunction with the consolidated financial statements and related notes contained elsewhere in this prospectus.

	For the period from May 6, 2002 to December 31, 2002		For the year ended December 31, 2003	
	Amount	Percentage of revenue	Amount	Percentage of revenue
(in thousands of U.S. dollars, except percentages)				
Gross revenues				
2.5G <sup>(1)</sup>	\$ 131.3	65.6%	\$ 5,956.0	76.3%
2G <sup>(2)</sup>	69.0	34.4%	1,850.7	23.7%
Total gross revenues	200.3	100.0%	7,806.7	100.0%
Cost of revenues	(84.3)	(42.1)%	(2,284.0)	(29.3)%
Gross profit	116.0	57.9%	5,522.7	70.7%
Operating expenses:				
Product development	164.2	82.0%	1,369.5	17.5%
Sales and marketing	128.9	64.3%	841.4	10.8%
General and administrative	317.3	158.4%	882.7	11.3%
Amortization of deferred stock compensation		%	22.0	0.3%
Total operating expenses	610.4	304.7%	3,115.6	39.9%
Income (loss) from operations	(494.4)	(246.8)%	2,407.1	30.8%
Interest income, net	0.5	0.2%	1.0	
Net income (loss)	\$(493.9)	(246.6)%	\$ 2,408.1	30.8%

(1) Includes WAP, MMS and Java<sup>TM</sup>. We began to provide WAP, MMS and Java<sup>TM</sup> services on a paid basis in September 2002, April 2003 and November 2003, respectively.

(2) Includes SMS, IVR and CRBT. We began to provide SMS, IVR and CRBT services on a paid basis in July 2002, December 2003 and October 2003, respectively.

*Gross Revenues.* Our gross revenues substantially increased to \$7.8 million in 2003 from \$0.2 million for the period from May 6, 2002 to December 31, 2002. The increase in our gross revenues was largely due to the additional services that we provided in 2003, which generated \$2.1 million in revenue in 2003. We offered a total of 470 2.5G based services and 204 2G based services in 2003, as compared to 16 services based on 2.5G platforms and 41 services based on 2G

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**Management's discussion and analysis of financial condition and results of operations**

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platforms in 2002. The increase was also due to the full year effect of our operating results in 2003, during which we expanded our business to develop additional services and establish more distribution channels and partners. The number of subscriptions of our services increased to 10.9 million in 2003 from 0.4 million for the period from May 6, 2002 to December 31, 2002. The number of downloads of our services increased to 8.8 million in 2003 from 0.8 million for the period from May 6, 2002 to December 31, 2002.

*Cost of Revenues.* Our cost of revenues increased substantially to \$2.3 million in 2003 from \$84,335 for the period from May 6, 2002 to December 31, 2002. This increase was driven by the increase in the service fees and net transmission charges paid to the mobile operators as a result of the increase in our revenue and usage volume. An increase in the service fees relating to our cooperation arrangements with other business partners also resulted in an increase in our cost of revenues as we increased the number and scope of our cooperation arrangements.

*Gross Profit.* Our gross profit in 2003 increased substantially from 2002 primarily due to a substantial increase in the volume of our services and related revenues. We achieved a gross profit of \$5.5 million in 2003 as compared to \$0.1 million in 2002. As our gross revenues have increased at a higher rate than our cost of revenues, our gross margin increased in 2003.

*Operating Expenses.* Our operating expenses increased substantially to \$3.1 million in 2003 from \$0.6 million for the period from May 6, 2002 to December 31, 2002. This increase was primarily driven by an increase in our product development expenses and sales and marketing expenses. Increases in our general and administrative expenses and amortization of deferred stock compensation also contributed to the increase in our operating expenses. Our total number of employees increased to 229 as of December 31, 2003 from 51 as of December 31, 2002.

Our product development expenses increased to \$1.4 million in 2003 from \$0.2 million for the period from May 6, 2002 to December 31, 2002, primarily due to the expansion of our product development team as our business grew. We expanded our product development team to 149 employees as of December 31, 2003 from 27 employees as of December 31, 2002.

Our sales and marketing expenses increased to \$0.8 million in 2003 from \$0.1 million for the period from May 6, 2002 to December 31, 2002 as a result of an increase in marketing activities to promote our brand name and to establish additional distribution channels. We expanded our sales, marketing and customer services team to 54 employees as of December 31, 2003 from 14 employees as of December 31, 2002.

Our general and administrative expenses increased to \$0.9 million in 2003 from \$0.3 million for the period from May 6, 2002 to December 31, 2002 as a result of the expansion of our business, including increases in our professional fees, business tax, the compensation and benefits for general management, finance and administrative personnel, travel expenses, lease expenses and other office expenses. Our general and administrative staff grew to 18 employees as of December 31, 2003 from 8 employees as of December 31, 2002.

Our amortization of deferred stock compensation increased to \$21,986 in 2003 from \$0 for the period from May 6, 2002 to December 31, 2002 as a result of the issuance of stock options to our employees under the 2002 Plan.

**Management's discussion and analysis of financial condition and results of operations****Three months ended March 31, 2004 compared to three months ended March 31, 2003**

The following table sets forth, for the periods presented, certain data from our unaudited consolidated results of operations. This information should be read in conjunction with the consolidated financial statements and related notes contained elsewhere in this prospectus.

	For the three months ended March 31, 2003		For the three months ended March 31, 2004	
	Amount	Percentage of revenues	Amount	Percentage of revenues
(in thousands of U.S. dollars, except for percentage)				
Gross revenues				
2.5G <sup>(1)</sup>	\$ 346.0	49.2%	\$ 5,244.4	73.4%
2G <sup>(2)</sup>	357.0	50.8%	1,903.2	26.6%
Total gross revenues	703.0	100.0%	7,147.6	100.0%
Cost of revenues	(146.5)	(20.8)%	(2,239.0)	(31.3)%
Gross profit	556.5	79.2%	4,908.6	68.7%
Operating expenses:				
Product development	176.2	25.0%	716.5	10.0%
Sales and marketing	140.7	20.1%	294.1	4.1%
General and administrative	142.4	20.2%	675.7	9.5%
Amortization of deferred stock compensation		%	80.8	1.1%
Total operating expenses	459.3	65.3%	1,767.1	24.7%
Income (loss) from operations	97.2	13.8%	3,141.5	44.0%
Other expenses		%	(0.7)	%
Interest income, net		%	1.3	%
Net income (loss)	\$ 97.2	13.8%	\$ 3,142.1	44.0%

(1) Includes WAP, MMS and Java™. We began to provide WAP, MMS and Java™ services on a paid basis in September 2002, April 2003 and November 2003, respectively.

(2) Includes SMS, IVR and CRBT. We began to provide SMS, IVR and CRBT services on a paid basis in July 2002, December 2003 and October 2003, respectively.

**Gross Revenues.** Our gross revenues substantially increased to \$7.1 million for the three months ended March 31, 2004 compared to \$0.7 million for the same period in 2003. This increase in our gross revenues was largely due to the rapid growth in China's 2.5G wireless value-added services market and the usage volume of our WAP, MMS and SMS services. We commercially launched our MMS services in April 2003 and our Java™ services in November 2003. We also launched our WAP services in September 2002 and introduced a number of additional WAP services in 2003. The number of subscriptions of our services increased to 7.7 million for the three months ended March 31, 2004 from 1.3 million for the same period in 2003.

**Cost of Revenues.** Our cost of revenues increased substantially to \$2.2 million for the three months ended March 31, 2004 from \$0.1 million for the same period in 2003. This increase was primarily driven by an increase in the service fees and net transmission charges paid to the mobile

operators as a result of the increase in our revenue and usage volume. An increase in the service fees relating to our cooperative arrangements with other business partners also contributed to the increase in our cost of revenues as we increased the number and scope of our cooperation arrangements.

**Management's discussion and analysis of financial condition and results of operations**

*Gross Profit.* Our gross profit for the three months ended March 31, 2004 increased substantially from the same period in 2003 primarily due to a substantial increase in the volume of our services and related revenues. We achieved a gross profit of \$4.9 million for the three months ended March 31, 2004 as compared to \$0.6 million for the same period in 2003.

*Operating Expenses.* Our operating expenses increased substantially to \$1.8 million for the three months ended March 31, 2004 from \$0.5 million for the same period in 2003. This increase was primarily driven by an increase in our product development expenses and general and administrative expenses. Increases in our sales and marketing expenses and amortization of deferred stock compensation also contributed to the increase in our operating expenses. Our total number of employees increased to 314 as of March 31, 2004 from 79 as of March 31, 2003.

Our product development expenses increased to \$0.7 million for the three months ended March 31, 2004 from \$0.2 million for the same period in 2003, primarily due to the expansion of our product development team as our business grew. We expanded our product development team to 201 employees as of March 31, 2004 from 49 employees as of March 31, 2003.

Our sales and marketing expenses increased to \$0.3 million for the three months ended March 31, 2004 from \$0.1 million for the same period in 2003 as a result of an increase in marketing activities to promote our brand name and to establish additional distribution channels. We expanded our sales, marketing and customer services team to 78 employees as of March 31, 2004 from 20 employees as of March 31, 2003.

Our general and administrative expenses increased to \$0.7 million for the three months ended March 31, 2004 from \$0.1 million for the same period in 2003 as a result of the expansion of our business, including increases in our professional fees, business tax, the compensation and benefits for general management, finance and administrative personnel, travel expenses and other office expenses. Our general and administrative staff grew to 23 employees as of March 31, 2004 from 10 employees as March 31, 2003.

Our amortization of deferred stock compensation increased to \$80,738 from \$0 for the same period in 2003 as a result of the issuance of stock options to our employees under the 2002 Plan.

**LIQUIDITY AND CAPITAL RESOURCES****Cash flows and working capital**

The following table sets forth our cash flows with respect to operating, investing and financing activities for the periods indicated.

	For the period from May 6, 2002 to December 31, 2002	For the year ended December 31, 2003	For the three months ended March 31, 2003	For the three months ended March 31, 2004
(in thousands of U.S. dollars)				
Net cash provided by (used in) operating activities	\$ (579.7)	\$ 1,959.8	\$ (246.6)	\$ 2,243.7
Net cash used in investing activities	(292.3)	(863.9)	(69.4)	(370.8)
Net cash provided by financing activities	3,520.3			120.8
Effect of exchange rate changes	(2.0)	0.6	0.3	(0.1)
Net increase in cash and cash equivalents	2,646.2	1,096.4	(315.7)	1,993.6
Cash and cash equivalents, beginning of period		2,646.2	2,646.2	3,742.6
Cash and cash equivalents, end of period	\$ 2,646.2	\$ 3,742.6	\$ 2,330.5	\$ 5,736.2

**Management's discussion and analysis of financial condition and results of operations**

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Our primary sources of liquidity have historically been capital contributions from our founders, private placements of preferred shares to investors and cash generated from operating activities. In the future, we anticipate that our primary sources of liquidity will come from cash flow from operating activities and the proceeds of this offering. As of December 31, 2003 and March 31, 2004, our cash and cash equivalents were \$3.7 million and \$5.7 million, respectively.

We do not bill or collect payment from users of our services directly, but instead depend on the billing systems and records of China Mobile and other mobile operators to record the volume of our services provided, charge our users, collect payments and remit to us our revenue, less transmission fees and service fees. If China Mobile ceases to continue to cooperate with us, we will explore further cooperation with other mobile service providers and explore alternative billing systems to collect bills from users.

Net cash provided by operating activities was \$2.0 million in 2003 compared to net cash used in operating activities of \$0.6 million for the period from May 6, 2002 to December 31, 2002, and our net cash provided by operating activities was \$2.2 million for the first quarter of 2004, as compared to net cash used in operating activities of \$0.2 million for the same period in 2003. This difference was primarily due to the net income we generated.

Net cash used in investing activities increased significantly to \$0.9 million in 2003 from \$0.3 million for the period from May 6, 2002 to December 31, 2002. For the first quarter of 2004, our net cash used in investing activities reached \$0.4 million, as compared to \$69,000 for the same period in 2003. Our net cash used in investing activities has primarily been used to purchase computer, transmission and office equipment in connection with the expansion of our business.

We had no cash provided by or used in financing activities in 2003. Net cash provided by financing activities in the first quarter of 2004 was \$0.1 million, as a result of the contribution by Yunfan Zhou and Zhen Huang to the registered capital of our affiliate, Beijing Boya Wuji. For the period from May 6, 2002 to December 31, 2002, cash provided by financing activities was \$3.5 million, which consisted of the proceeds from our issuance of ordinary shares, Series A preferred shares and Series B preferred shares to investors.

We believe that our current cash and cash equivalents, cash flow from operations and the proceeds from this offering will be sufficient to meet our anticipated cash needs, including for working capital purposes, capital expenditures and various contractual obligations, for at least the next 12 months. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these sources are insufficient to satisfy our cash requirements, we may seek to sell debt securities or additional equity or to obtain a credit facility. The sale of convertible debt securities or additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in incurring debt service obligations and could result in operating and financial covenants that would restrict our operations. Given our short operating history, we currently do not have any lines of credit or loans with any commercial banks. As a result, we are unlikely to rely on any bank loans to meet our liquidity needs. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

**Indebtedness**

As of March 31, 2004, we did not have any indebtedness, and we did not have any material debt securities, material contingent liabilities or material mortgages or liens.

We intend to meet our future funding needs through cash flow generated from operating activities and the proceeds of this offering. Our treasury objective is to maintain safety and liquidity of our cash.



**Management's discussion and analysis of financial condition and results of operations**

Therefore, we intend to keep our cash and cash equivalents in short-term deposits and short-term government bills or bonds.

The following table sets forth our indebtedness as of the dates indicated:

	As of December 31, 2002	As of December 31, 2003	As of March 31, 2004
	(in thousands of U.S. dollars)		
Short-term debt	\$5.0	\$90.0	\$
Total debt	\$5.0	\$90.0	\$

As of March 31, 2004, we did not have any outstanding loan capital issued or agreed to be issued, bank overdrafts, loans, debt securities or other similar indebtedness, liabilities under acceptance (other than normal trade bills) or acceptance credits, debentures, mortgages, charges, finance leases or purchase commitments, guarantees or other material contingent liabilities. In addition, there has not been any material change in our indebtedness, commitments and contingent liabilities since March 31, 2004.

**Contractual obligations and commercial commitments**

The following table sets forth our contractual obligations as of March 31, 2004:

	Payments due by period				
	Total	Within 2004	2005	2006	Thereafter
	(in thousands of U.S. dollars)				
Short-term debt	\$	\$	\$	\$	\$
Operating lease obligations	243	225	18		
Other contractual commitments*	13	13			
Total	\$256	\$238	\$ 18	\$	\$

\* Represents facility service fees.

We have entered into certain leasing arrangements relating to our office premises. Pursuant to our additional leasing arrangements entered into in May 2004, as of May 31, 2004, our operating lease obligations are \$0.6 million, \$1.0 million and \$0.4 million in 2004, 2005 and 2006, respectively, and \$1.9 million in total. As of March 31, 2004, we do not have any long-term debt obligations or purchase obligations.

**Capital Expenditures**

Our total capital expenditures for plant and equipment in 2003 and for the period from May 6, 2002 to December 31, 2002 were \$0.9 million and \$0.3 million, respectively. Our total capital expenditures for the first quarter of 2004 were \$0.4 million. We currently have approximately \$0.2 million worth of capital expenditures in progress, which will primarily be used in China. Our capital expenditures in progress are financed primarily from cash flows from operating activities, as well as capital contributions by our founders and proceeds from the issuance of shares in our company to investors. We have not had any material capital divestitures and do not have any in progress.

Our capital expenditure is spent primarily on servers, transmission equipment and personal computers. In general, there is a positive correlation between our revenue and the amount of traffic that passes through our servers and transmission equipment. From time to time we need to purchase additional

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## Management's discussion and analysis of financial condition and results of operations

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servers and transmission equipment as a result of increased business traffic. Our purchase of personal computers is primarily driven by headcount increases.

As mobile operators do not provide us detailed revenue breakdown on a service-by-service basis, we depend on our internal database system to monitor revenue derived from each of our services. We make our business decisions based on our internal data, taking into account other factors including strategic considerations.

### Off-balance sheet arrangements

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

### Quantitative and qualitative disclosures about market risk

#### Interest rate risk

Our exposure to market risk for changes in interest rates relates primarily to the interest income generated by our cash deposits with our banks. We have not used any derivative financial instruments in our investment portfolio. 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 currency risk

While our reporting currency is the U.S. dollar, to date, virtually all of our revenues and costs are denominated in Renminbi and the majority of our assets and all of our liabilities are denominated in Renminbi. Following this offering, most of our assets will be denominated in U.S. dollars. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be impacted by fluctuations in the exchange rate between U.S. dollars and Renminbi. If the Renminbi depreciates against the U.S. dollar, the value of our Renminbi revenues and assets as expressed in our U.S. dollar financial statements will decline. See Risk factors Risks relating to the People's Republic of China Fluctuation of the Renminbi could materially affect the value of our ADSs.

We have experienced *de minimis* foreign exchange gains or losses to date. We do not engage in any hedging activities, and may in the future experience economic loss as a result of any foreign currency exchange rate fluctuations.

#### Inflation

In recent years, China has not experienced significant inflation, and thus inflation has not had a significant effect on our business since our inception. According to the China Statistical Bureau, China's overall national inflation rate, as represented by the general consumer price index, was approximately 1.2%, (0.8%) and 0.7% in 2003, 2002 and 2001, respectively.

#### Taxation

The Cayman Islands currently do not levy any 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.

**Management's discussion and analysis of financial condition and results of operations**

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In addition, pursuant to Section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, we have obtained an undertaking from the Governor-in-Council that (i) no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciation shall apply to us or our operations and (ii) no tax to be levied on profits, income gains or appreciations or which is in the nature of estate duty or inheritance tax shall be payable by us on or in respect of our shares, debentures or other obligations or by way of the withholding in whole or in part of any relevant payment as defined in Section 6(3) of the Tax Concessions Law (1999 Revision). This undertaking is for a period of 20 years from May 21, 2002.

KongZhong Beijing, Beijing AirInbox and Beijing Boya Wuji are incorporated in the PRC and subject to the Income Tax Law of the PRC Concerning Foreign Investment and Foreign Enterprises and various local income tax laws. Generally, PRC companies are subject to an enterprise income tax of 33%. However, KongZhong Beijing benefits from preferential tax treatment as a high technology enterprise, pursuant to which its net income is tax exempt until 2005, subject to a 7.5% enterprise income tax for the following three years and subject to a 15% enterprise income tax thereafter. Beijing AirInbox also benefits from preferential tax treatment as a high technology enterprise, pursuant to which its net income is tax exempt until the end of this year, subject to a 7.5% enterprise income tax for the following three years and subject to a 15% enterprise income tax thereafter. Beijing AirInbox will need to apply for confirmation of the 7.5% enterprise income tax treatment at the end of this year. Beijing Boya Wuji has been certified as a high technology enterprise, pursuant to which it will be entitled to preferential tax treatment similar to that Beijing AirInbox currently enjoys. Each of KongZhong Beijing, Beijing AirInbox and Beijing Boya Wuji's high technology enterprise status is subject to periodic review by the relevant PRC governmental authority. If any of these entities is found not to qualify as a high technology enterprise for PRC tax purposes, then such entity will not be eligible for the preferential tax treatment.

KongZhong Beijing and Beijing AirInbox have recorded net losses in the past, which they may carry forward for five years from the end of the period in which the loss was recorded to offset future net income for tax purposes. We cannot, however, give any assurances that KongZhong Beijing and Beijing AirInbox will record sufficient net income within the carry forward periods to realize the full tax benefit of these past net losses, and therefore, have recorded a full valuation allowance on the deferred tax asset balance. For a discussion of our deferred tax valuation allowance accounting policy, see Critical accounting policies. The tax losses carried forward as of December 31, 2003 amounted to \$1.1 million and will expire by 2008.

In addition, our revenues are subject to business taxes. Since August 2003, both Beijing AirInbox and Beijing Boya Wuji are subject to a 3% business tax for wireless value-added services and a 5% business tax for other services. KongZhong Beijing is subject to a 5% business tax. In future periods, we expect that a substantial portion of our revenues will be generated through Beijing AirInbox and Beijing Boya Wuji. In addition, pursuant to the arrangements that KongZhong Beijing has entered into with each of Beijing AirInbox and Beijing Boya Wuji, Beijing AirInbox and Beijing Boya Wuji pay us service and license fees. The amount of such payments will be subject to the 5% business tax payable by KongZhong Beijing. See Related party transactions Other related party agreements.

**Recent accounting pronouncements**

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. The Statement establishes standards for how an issuer classifies and measures certain financial instruments. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Statement requires that certain financial instruments that, under previous guidance, issuers could account for as equity be classified as liabilities

**Management's discussion and analysis of financial condition and results of operations**

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(or assets in some circumstances) in statements of positions or consolidated balance sheets, as appropriate. The financial instruments within the scope of this Statement are: (i) mandatorily redeemable shares that an issuer is obligated to buy back in exchange for cash or other assets; (ii) financial instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets; and (iii) financial instruments that embody an obligation that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such as a market index, or varies inversely with the value of the issuer's shares (excluding certain financial instruments indexed partly to the issuer's equity shares and partly, but not predominantly, to something else). This Statement does not apply to features embedded in a financial instrument that is not a derivative in its entirety. The Statement also requires disclosures about alternative ways of settling the instruments and about capital structure of entities all of whose shares are mandatorily redeemable. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position, cash flows or results of operations.

In November 2002, the FASB issued Interpretation Number (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation requires certain disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of FIN No. 45 are effective for interim and annual periods ending after December 15, 2002 and have been adopted in the financial statements. The initial recognition and initial measurement requirements of FIN No. 45 are effective prospectively for guarantees issued or modified after December 31, 2002. The adoption of the recognition and initial measurement requirements of FIN No. 45 did not have a material impact on the Company's financial position, cash flows or results of operations.

In January 2003, the FASB issued FIN 46. FIN 46 clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements* and provides guidance on the identification of entities for which control is achieved through means other than voting rights (variable interest entities or VIEs) and how to determine when and which business enterprise should consolidate the VIEs. This new model for consolidation applies to an entity in which either: (1) the equity investors (if any) lack one or more characteristics deemed essential to a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. FIN 46 was applicable for periods ending December 15, 2003. In December 2003 the FASB issued FIN 46R which provides for the deferral of the implementation date to the end of the first reporting period after December 15, 2004 unless the Company has a special purpose entity in which case the provisions must be applied for fiscal years ending December 31, 2003. However, the Company has retroactively adopted the provisions as of 2002.

In November 2002, the Emerging Issue Task Force (EITF) reached a consensus on Issue No. 00-21 (EITF No. 00-21), *Revenue Arrangements with Multiple Deliverables*. EITF No. 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. EITF No. 00-21 will be effective for fiscal periods beginning after June 15, 2003. The Company has adopted EITF No. 00-21 and it did not have a material impact on the Company's financial position, cash flows or results of operations.

## Industry overview

### OVERVIEW

#### The telecommunications industry in China

In recent years, the telecommunications industry in China has grown at a rapid pace, particularly in the mobile telecommunications market segment. China is now the largest mobile telecommunications market in the world, with over 268.7 million mobile phone users as of the end of 2003, according to data published by China's MII. Chinese consumers have been quick to adopt and use new wireless value-added services as a means of communication, as well as a source of information and entertainment, partly due to the proliferation of mobile phones as a more accessible alternative to both fixed-line phone services and personal computer-based Internet services in China.

The table below sets forth certain data with respect to demographics, mobile and fixed-line phone users and Internet users in China for the periods indicated:

	As of or for the year ended December 31,							
	2000		2001		2002		2003	
	Amount	Penetration rate <sup>(1)</sup>	Amount	Penetration rate <sup>(1)</sup>	Amount	Penetration rate <sup>(1)</sup>	Amount	Penetration rate <sup>(1)</sup>
	(in millions, except per capita amounts and percentages)							
Population	1,267.4		1,276.3		1,284.5		1,292.3	
GDP per capita	\$856.1		\$924.4		\$988.8		\$1,091.1	
Mobile phone users	84.5	6.7%	145.2	11.3%	206.0	16.1%	268.7	20.8%
Fixed-line phone users	144.8	11.4%	180.4	14.1%	214.2	16.1%	263.3	20.4%
Internet users	22.5	1.8%	33.7	2.6%	59.1	4.6%	79.5	6.2%

(1) Determined by dividing the number of users by the total population of China.

Source: Data in respect of China's population and GDP is derived from information published by the National Bureau of Statistics of China; data in respect of mobile phone and fixed-line phone users is derived from information published by the MII; data in respect of Internet users is derived from information published by the China Internet Network Information Center, or CNNIC.

While the growth in the number of users and penetration rate in the fixed-line segment has been significant in recent years, the annual growth rate of fixed-line users is expected to be significantly lower than that of mobile phone users. Norson Telecom Consulting, an independent research agency, projects that fixed-line phone users will grow to 318.2 million by the end of 2005, representing a compound annual growth rate of 8.8% from 2003. International Data Corporation, or IDC, estimates that China will have 361.5 million mobile phone users by the end of 2005, representing a compound annual growth rate of 14.3% from 2003. Despite significant growth in mobile phone users, the mobile phone penetration rate in China remains low compared to the rate in other countries, such as Korea, Japan, the United Kingdom and the United States.

**Industry overview**

The table below sets forth comparative industry and economic information for certain countries and regions.

As of or for the year ended December 31, 2002

	Population	GDP per capita	Mobile subscribers	Mobile penetration
	(in millions)		(in thousands)	
India	1,046.1	\$ 480	10,480	1.0%
Indonesia	214.2	807	11,573	5.4%
Brazil	172.5	2,500	33,188	19.2%
Philippines	84.5	993	15,280	18.1%
United States	287.7	36,406	141,477	49.2%
Japan	127.5	31,457	73,243	57.4%
South Korea	47.6	10,739	32,342	67.9%
Germany	82.4	24,301	59,159	71.8%
United Kingdom	60.1	26,002	50,934	84.7%
Hong Kong	6.8	23,730	6,219	91.6%
Singapore	4.2	20,921	3,245	78.0%

*Source:* Data in respect of population, mobile subscribers and mobile penetration is derived from information published by Gartner Dataquest, except for (i) the population data for the United States and Brazil, which are derived from information published by the Economist Intelligence Unit, 2004 and (ii) the mobile penetration data for the United States and Brazil, which are calculated from the population and subscriber data set forth in this table. Data in respect of GDP per capita is derived from information published by the Economist Intelligence Unit, 2004.

**THE PRC WIRELESS VALUE-ADDED SERVICES MARKET****Introduction**

The wireless value-added services market, which provides services that allow mobile phone users to receive and transmit text, images and other forms of digital data or voice content via their mobile handsets, represents a new and fast-growing sector within China's rapidly evolving telecommunications industry. Analysys Consulting Ltd., or Analysys, estimates that total wireless value-added services revenue in China rose from \$211.5 million in 2002 to \$452.5 million in 2003 and is expected to grow to \$800.4 million in 2004. Wireless value-added service providers deliver their services through the telecommunications infrastructure of mobile operators and rely on the mobile operators for billing and payment collection services. Wireless value-added services are provided to mobile phone users through the cooperation of several players in the value chain. Content providers, such as the media, create the basic content, which service providers, such as ourselves, produce, aggregate and repackage as wireless value-added services to be delivered through the mobile operators' networks. Mobile phone users

## Industry overview

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receive services through mobile phones produced by mobile handset manufacturers. The following figure illustrates the wireless value-added services industry value chain:

The 2.5G wireless value-added services market reflects the evolution of wireless data services in China as handsets and wireless networks become more sophisticated and are able to handle higher data transmission speeds. This enables users to access richer and more complex content via their mobile phones with higher levels of interactivity. China Mobile and China Unicom have only begun to introduce 2.5G wireless data services over their networks in the last two years. Analysys estimates that the number of users of WAP and MMS increased by 454% between 2002 and 2003 and that the market for WAP and MMS will grow to \$180.6 million in 2004, from \$53.5 million in 2003, representing a 237% increase over the same time period.

China Mobile launched its Monternet™ platform for wireless value-added services in November 2000 and China Unicom launched its Uni-Info™ platform in May 2001 using a business model similar to the model used in Japan and Korea. The industry development experienced in Japan and Korea is described below:

- Ø ***i-mode in Japan.*** In Japan, NTT DoCoMo Inc., the country's largest mobile operator, launched its highly successful i-mode service, a packet-based service for mobile phones offered by NTT DoCoMo Inc., in February 1999. The i-mode business model is based upon the mobile operator providing a platform for third party service providers to offer services to customers of the mobile operator. This model encouraged the development of innovative and popular content that capitalized on the distinct cultural characteristics and preferences of Japanese consumers. Japan's youth are entertainment and technology oriented and view early adoption of new services as a sign of being current and popular. As a result, wireless value-added services flourished in Japan, and according to Pyramid Research, an independent research organization, the revenue generated from such services grew from \$1.1 billion in 1999 to \$12.0 billion in 2002. i-mode provides a high quality user experience similar to 2.5G. NTT DoCoMo Inc. became the first mobile operator in the world to offer commercial service based on third generation, or 3G, technology in 2001.
- Ø ***n.TOP in Korea.*** SK Telecom, Korea's sole wireless provider until 1996, was able to use its dominant market position to further the growth of wireless data services. In particular, SK Telecom sought to capitalize on the popularity of the Internet in Korea, which has the world's highest broadband penetration rate. In 1999, SK Telecom launched its highly successful n.TOP wireless data and Internet service, which allows subscribers to access information, send and receive Internet e-mail and effect e-commerce transactions. According to Pyramid Research, the total value of Korea's wireless value-added services market grew from \$85 million in 1999 to \$949 million in 2002. According to Pyramid Research, in 2000, SK Telecom launched the world's first Code Division Multiple Access 1X, or CDMA 1x, RTT high speed data network.



## Industry overview

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### Key market characteristics

The following describes key characteristics of China's wireless value-added services market:

- Ø **Rapid expansion of China's mobile telecommunications industry.** With the rapid development of mobile telecommunications infrastructure to provide cheaper and more accessible alternatives to fixed-line phone services, mobile telecommunications services are becoming an increasingly important medium of communication and source of information and entertainment. Despite the substantial growth in recent years, the mobile phone penetration rate in China remains low compared to the penetration rate in more developed countries, providing a potential for continued growth. IDC estimates that the number of mobile phone users in China will reach 493.0 million by the end of 2008, representing a compound annual growth rate of 11.8% from 2003 to 2008.
- Ø **Increasing user receptivity.** Given the rapid growth of the economy and the rise of GDP per capita in China, Chinese consumers have more disposable income to purchase advanced mobile phones and to spend on wireless value-added services. As disposable income increases and users become more receptive to adopting more advanced wireless value-added services as a means of communication and sources of information and entertainment, the market for 2.5G wireless value-added services is expected to continue growing.
- Ø **Availability of more advanced handsets in the Chinese market.** Global System for Mobile Communication, or GSM, network is the 2G digital technology used by China Mobile for its network. While the penetration rate of 2.5G mobile phones is relatively low in China currently, Gartner estimates that 48% and 60% of the handsets based on General Packet Radio Services, or GPRS, a packet-based wireless communications services on GSM networks, sold in 2004 and 2005, respectively, will utilize the 2.5G wireless standard, creating opportunities for growth in more advanced wireless value-added services. The advancement of mobile handsets from 2G to 2.5G has led to an evolution in the wireless value-added services market over the past few years, from simple point-to-point text messaging via SMS to more advanced services delivered over the 2.5G wireless standard that