



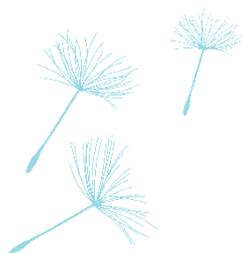
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# Corporate Information

## DIRECTORS

### Executive Directors

Ma Huateng (Chairman)  
Lau Chi Ping Martin  
Zhang Zhidong

### Non-Executive Directors

Antonie Andries Roux  
Charles St Leger Searle

### Independent Non-Executive Directors

Li Dong Sheng  
Iain Ferguson Bruce  
Ian Charles Stone

## AUDIT COMMITTEE

Iain Ferguson Bruce (Chairman)  
Ian Charles Stone  
Charles St Leger Searle

## REMUNERATION COMMITTEE

Antonie Andries Roux (Chairman)  
Li Dong Sheng  
Ian Charles Stone

## AUDITOR

PricewaterhouseCoopers  
*Certified Public Accountants*

## PRINCIPAL BANKER

The Hongkong and Shanghai Banking  
Corporation Limited

## REGISTERED OFFICE

Cricket Square  
Hutchins Drive, P.O. Box 2681  
Grand Cayman KY 1-1111  
Cayman Islands

## HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

Tencent Building  
Kejizhongyi Avenue  
Hi-tech Park  
Nanshan District  
Shenzhen, 518057  
The PRC

## PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Room 3002, 30th Floor  
Far East Finance Centre  
16 Harcourt Road  
Hong Kong

## CAYMAN ISLANDS PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fulcrum Group (Cayman)  
Limited  
Butterfield House  
68 Fort Street, P.O. Box 609  
Grand Cayman KY1-1107  
Cayman Islands

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor  
Services Limited  
Shops 1712-1716, 17th Floor  
Hopewell Centre  
183 Queen's Road East  
Wan Chai, Hong Kong

## COMPANY WEBSITE

[www.tencent.com](http://www.tencent.com)

## STOCK CODE

700

# Financial Summary

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year ended 31 December				2010 RMB'000
	2006 RMB'000	2007 RMB'000	2008 RMB'000	2009 RMB'000	
<b>Revenues</b>	2,800,441	3,820,923	7,154,544	12,439,960	<b>19,646,031</b>
<b>Gross profit</b>	1,983,379	2,703,366	4,984,123	8,550,492	<b>13,325,831</b>
<b>Profit before income tax</b>	1,116,771	1,534,503	3,104,895	6,040,731	<b>9,913,133</b>
<b>Profit for the year</b>	1,063,800	1,568,008	2,815,650	5,221,611	<b>8,115,209</b>
<b>Profit attributable to equity holders of the Company</b>	1,063,800	1,566,020	2,784,577	5,155,646	<b>8,053,625</b>
<b>Total comprehensive income for the year</b>	1,063,800	1,568,008	2,815,650	5,221,611	<b>9,936,338</b>
<b>Total comprehensive income attributable to equity holders of the Company</b>	1,063,800	1,566,020	2,784,577	5,155,646	<b>9,874,754</b>

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	As at 31 December				2010 RMB'000
	2006 RMB'000	2007 RMB'000	2008 RMB'000 (Restated)	2009 RMB'000	
<b>Assets</b>					
<b>Non-current assets</b>	916,138	2,090,312	3,359,696	4,348,823	<b>10,456,373</b>
<b>Current assets</b>	3,734,434	4,835,132	6,495,861	13,156,942	<b>25,373,741</b>
<b>Total assets</b>	4,650,572	6,925,444	9,855,557	17,505,765	<b>35,830,114</b>
<b>Equity and liabilities</b>					
<b>Equity attributable to the Company's equity holders</b>	3,717,756	5,170,396	7,020,926	12,178,507	<b>21,756,946</b>
<b>Non-controlling interests</b>	–	64,661	98,406	120,146	<b>83,912</b>
<b>Total equity</b>	3,717,756	5,235,057	7,119,332	12,298,653	<b>21,840,858</b>
<b>Non-current liabilities</b>	64,969	40,770	644,628	644,033	<b>967,211</b>
<b>Current liabilities</b>	867,847	1,649,617	2,091,597	4,563,079	<b>13,022,045</b>
<b>Total liabilities</b>	932,816	1,690,387	2,736,225	5,207,112	<b>13,989,256</b>
<b>Total equity and liabilities</b>	4,650,572	6,925,444	9,855,557	17,505,765	<b>35,830,114</b>

# Chairman's Statement



Tencent 腾讯



腾讯网  
qq.com

**Ma Huateng**  
Chairman



I am pleased to present our annual report for the year ended 31 December 2010 to the shareholders.

## RESULTS

The Group's audited profit attributable to equity holders of the Company for the year ended 31 December 2010 was RMB8,053.6 million, an increase of 56.2% compared with the results for the previous year. Basic and diluted earnings per share for the year ended 31 December 2010 were RMB4.432 and RMB4.328 respectively.

## BUSINESS REVIEW AND OUTLOOK

2010 witnessed another year of steady development in the Internet market in China. According to the CNNIC, the total number of Internet users increased by 19.1% on a year-on-year basis to 457.3 million at the end of 2010, compared to a growth rate of 28.9% in the previous year. Internet penetration increased to 34.3%, exceeding global average for the first time. Although the growth of China's Internet user base has been slowing down as its scale continues to increase, the Internet has increasingly become an integral part of people's everyday life as users spend more time online. We expect future growth of the industry to be increasingly driven by rising level of Internet usage by users and businesses, as opposed to user growth. In addition, advertising and e-commerce will become more important business models for the industry, in addition to revenue generated from users.

The industry witnessed several significant developments during 2010. First of all, the year saw continued rapid growth of the wireless Internet market. According to the CNNIC, the total number of wireless Internet users in China increased by 29.7% to 302.7 million at the end of 2010, representing 66.2% of the Internet user base. This was mainly driven by better wireless data infrastructure and availability of mobile applications such as WAP portal, IM and social games. Secondly, while traditional SNS continued to develop following a year of strong growth in 2009, microblog enjoyed explosive growth and emerged as a major social media platform in China. Thirdly, although the growth of the online gaming sector slowed down with the increasing scale of the industry, the web game sector experienced rapid growth in 2010.



Meanwhile, the online advertising market benefited from the buoyant economy in China as well as positive impact of major events including the World Cup and the World Expo. In addition, the strong growth momentum of e-commerce and search advertising continued.

In 2010, our businesses delivered a strong set of financial and operating results, riding on the growth of our platforms and our relentless focus on user experience. Our IVAS grew rapidly during the year, thanks to the robust revenue increase of our online gaming business. Community value-added services also registered solid growth. Our MVAS benefited from increased popularity of our bundled SMS packages, mobile social games and mobile music services. Our online advertising business achieved significant growth in revenues and client base, reflecting our expanding platforms, improved brand position and media influence, as well as successful leverage of major events.

For the fourth quarter of 2010, our IVAS business expanded compared to the previous quarter. This primarily reflected the revenue increase of our online gaming business, mainly driven by a full quarter contribution from Qi Xiong Zheng Ba, a web-based MMOG launched in August 2010, and increased monetisation of Cross Fire. Our MVAS business registered revenue growth mainly driven by our bundled SMS packages and mobile social games. Our advertising business also grew during the quarter, reflecting the revenue increase of our search business. Despite weaker seasonality in the fourth quarter, advertising revenues from IM client and portal were broadly stable.

Looking into the first quarter of 2011, we expect more favourable seasonality for our IVAS business, particularly for online games, as users generally spend more during the winter school break and the Chinese New Year holiday. Monthly subscription of IVAS will also benefit from positive seasonality, albeit to a lesser extent. For MVAS, monthly subscription will see a more benign environment as the negative impact of the regulation requiring service providers to conduct double confirmation plus reminder services stabilises. For our online advertising business, the first quarter is traditionally a weaker season as advertisers reduce their activities around the Chinese New Year holiday.

### **New Strategic Investments for the Future**

We are operating in a dynamic and ever-evolving industry where new services and business models emerge, and the competitive landscape changes rapidly. While our user base and leading Internet platforms provide us with a solid foundation for capturing emerging opportunities, we do face significant challenges on a continuous basis. The most notable one is intensifying market competition. Major companies in the industry are all diversifying their businesses and increasing their investments in various sectors. In addition, an increasing number of up-and-coming companies have significantly strengthened their financial resources and competitiveness through initial public offerings and capital raising. Another key challenge is the increasing security threat to our users. This was evidenced by a significant security attack that we encountered in the fourth quarter of 2010, which not only caused substantial disruption to our users and businesses, but also inflicted damage on our corporate image.

In view of the opportunities and challenges, we have initiated a new investment phase, during which we will be making significant investments in our existing platforms including IM, SNS, wireless and gaming, as well as a range of new strategic initiatives, to position ourselves for future growth. One of the new strategic initiatives is our microblog service, which has been growing rapidly since its re-launch in April 2010. With registered user accounts already exceeding 110 million, it has become an important social media platform in the context of our overall strategy, offering synergistic value to other Internet platforms of Tencent, such as IM, Qzone and QQ.com. In 2011, we will continue to focus on growing the user base of our microblog and optimising its user experience. Another strategic area that we are working on is e-commerce. In 2010, Tenpay and Paipai registered robust increase in transaction volumes, riding on the growth of the overall market. To increase our market share, we are extending into lifestyle service categories, such as group buying and travel, and exploring other e-commerce opportunities through investments. For search advertising, we are enhancing our overall competitiveness by investing in our search engine and advertising platform. In addition, we have launched our self-developed mobile search service and are exploring the synergies between SNS and search. We are also stepping up our explorative effort in international expansion. We have been making strategic investments in emerging markets such as Russia, India and South East Asia, and leveraging our technical and operational know-how to deliver quality Internet products and services to users in these markets. Recently, we have acquired a majority stake in Riot Games, a US-based independent developer and publisher of premium online games. This transaction allows us to gain exposure to the global online gaming market, as well as leverage the expertise and resources of a top-class game developer. As for online security, we have been increasing our focus on enhancing the security of QQ software and enhancing our safety products through research and development and co-operation with security software developers in the industry in order to better protect our users. In addition, we are increasing our investments in the marketing of our brand, platforms and products. Subsequent to the security attack in the fourth quarter of 2010, we have embarked on a major advertising program for revamping our corporate image. Another major advertising program focusing on microblog has also been launched.

These strategic initiatives involve significant investments in a range of areas, including research and development, marketing, content acquisition and technological infrastructure, in the coming years. In particular, we expect staff costs to increase significantly as we recruit more talents and strive to provide our staff with the most competitive overall package in the market. In addition, marketing costs will also increase as we aim to promote our new products and services. As we will incur significant costs on these initiatives and many of them will not generate revenue immediately, our profitability will be affected during the investment period. However, we believe we must take a long-term view in building our business, and these initiatives will benefit the Company and our shareholders in the long run.



## Open Platform Strategy

As the Internet becomes more entrenched into our everyday life, users' demands are becoming more diverse and complex. To become a stronger player in the market, we need to significantly enrich the applications and content offered to users in order to cater for their ever-changing needs in communications, information, entertainment and e-commerce. This is only made possible by promoting innovation and collaboration among all participants along the industry value chain. As such, we are striving to create a "win-win-win" ecosystem for users, application developers and ourselves by pursuing an open platform strategy. Such ecosystem should provide an open and sharing platform supporting innovation from all our partners.

Our key platforms have already been playing an essential role for building up a collaborative industry cluster. For instance, Qzone and our microblog enable social sharing on third-party websites, and support third-party applications with open API. Our IM service provides an open platform which enables third-party developers to benefit from our massive user base with web-based and client-based applications. We have also extended the reach of Tenpay into helping small-to-medium enterprises to promote and collect payment for their localised lifestyle services, and opened up API for different industries. As for Discuz!, our bulletin board system solution platform, we facilitate small-to-medium websites to build communities, increase traffic and explore monetisation opportunities.

As one of the key initiatives under our open platform strategy, we announced the establishment of the Tencent Collaboration Fund in January 2011. Aiming to invest up to RMB5 billion in innovative and top-notch Internet and related companies in China over a period of time, it will be operated as an internal fund and will be invested when appropriate opportunities arise. We believe the Fund will stimulate the development of more innovative companies and more quality services for Internet users, and nurture a healthy ecosystem which benefits the users, innovative companies, our open platforms and the Internet industry as a whole.

## IM Platform

In 2010, our core IM platform benefited from the rapid growth of wireless Internet users and expanded further. However, the growth rate decreased compared to the previous year as the increase in Internet users in China slowed down. Active user accounts amounted to 647.6 million at the end of the year, representing a year-on-year increase of 23.8%. PCU grew by 37.1% to 127.5 million. During the year, we continued to enhance the features and user experience of our IM service. We also expanded into broader user groups and deepened the integration of our IM services with other platforms. While we will continue to focus on these initiatives in 2011, we will enhance the anti-hijack and anti-attack capabilities of our IM service in order to protect our users in a challenging security environment.



## **QQ.com**

With significant growth in traffic, QQ.com continued to consolidate its position as the most visited portal in China. We have been successful in leveraging major events including the World Cup, the World Expo, and the Asian Games to enhance our brand image, media influence as well as user loyalty. Going forward, we will build on the positive impact we made in these major events to further enhance the position of QQ.com as a mainstream media platform in China. We will also continue to enhance the breadth and depth of our content, optimise our operations, as well as achieve stronger integration between QQ.com and our microblog platform.

## **IVAS**

Our community value-added services enjoyed solid growth during 2010. For SNS, Qzone maintained its position as the leading social networking platform in China, with its active user base increasing by 26.9% on a year-on-year basis to 492.0 million at the end of 2010. However, compared to the previous year, the growth rate reduced as the scale of the user base increased and the positive impact of social applications lessened over time. During the year, we enriched Qzone with a range of self-developed and third-party applications, as well as enhanced its infrastructure to increase social sharing and interaction. To cater for the differentiated social networking needs of university students and white-collar communities, we upgraded our real-name SNS Xiaoyou to Pengyou in the third quarter of 2010 and promoted the service to a broader user group. At the end of the fourth quarter of 2010, the active user accounts of Pengyou grew rapidly to 84.6 million, representing an increase of 56.1% compared to the previous quarter. With our open platform strategy, we are significantly expanding the portfolio of social applications available on Qzone and Pengyou through closer co-operation with third-party developers. For QQ Membership, user base expanded along with the growth of the active user accounts of our IM service. Throughout the year, we focused on enhancing user value by enriching online and offline lifestyle privileges. User stickiness and loyalty improved as a result. In 2011, we will continue to execute this strategy.

Our online gaming business achieved above-industry growth in 2010, increasing our market share and strengthening our leading position in the market. Our major MMOGs and advanced casual games were the key growth driver. In particular, Cross Fire achieved solid growth in paying users and revenues. During the year, we launched new online games in different genres to further diversify our game portfolio and broaden our user base. Launched in August 2010, Qi Xiong Zheng Ba has become a leading title in the fast growing web game sector. Meanwhile, significant progress was made in the children segment as we introduced Roco Kingdom in July 2010 and achieved over 350,000 in PCU. QQ Game, the largest mini-casual game portal in China, registered healthy growth during 2010 and provided a solid growth platform for other online games of Tencent. Its PCU increased to 6.8 million in the fourth quarter of 2010, primarily reflecting our continued efforts in enriching our game portfolio, as well as the positive impact of tournaments and cross-platform integration.

With slowing industry growth, intensifying competition and increasing sophistication of gamers, the success rate and extent of success for new game titles is expected to decrease. To tackle these challenges, we have put a strong emphasis on leveraging our platforms and operational experience to introduce high quality games to a broader range of market segments via self-development, licensing and investments. For new online games for 2011, we have already launched World of West, a hardcore 3D fantasy MMOG, in the first quarter. We plan to introduce three MMOGs and one advanced casual game for the rest of 2011. As for the industry environment, we believe there will be more regulations going forward as the online gaming market has become a significant component of China's cultural and entertainment industry. While our business may be affected as a result, the additional regulations should foster a healthier industry environment over the longer term.

## **MVAS**

In 2010, our MVAS business benefited from the growth in our bundled SMS packages, mobile social games and mobile music services. The revenue growth was dampened by new regulations such as requiring service providers to conduct double confirmation plus reminder services for monthly subscription and item sales, as well as the suspension of billing for WAP services by China Mobile since 30 November 2009. On the other hand, we continued to make progress in wireless Internet applications. During the year, traffic on our WAP portal registered significant growth, further consolidating its position as the leading wireless portal in China. To prepare ourselves for the opportunities in the wireless Internet market, we will continue to extend our PC-based services, including SNS and microblog, to wireless platforms and customising our applications for a larger variety of terminal devices. In addition, we are strengthening our partnerships with various players in the evolving industry value chain, such as handset vendors, mobile operators and content providers. Looking ahead, we expect the visibility of the industry to remain low as the regulatory environment is still uncertain.

## **Online Advertising**

In 2010, our online advertising business benefited from the buoyant macroeconomic environment. We were successful in leveraging major events, including the World Cup and the World Expo, to generate advertising opportunities and enhance our brand image through major advertising campaigns. As a result, our revenues and client base registered solid growth, demonstrating increased market recognition of the strengths of our Internet platforms and our media influence. On top of the sectors such as food and beverage, online gaming and apparel where we have already established significant presence, we increased our market share in other major sectors such as automobile and finance. Our search advertising business is still in a nascent phase of development as we focus on building our traffic and search advertising platform. In addition to our continued investments in our search engine and advertising platform, we have increased our search distribution partnership to enhance traffic.

## DIVIDEND

The Board has recommended the payment of a final dividend of HKD0.55 per share (2009: HKD0.40 per share) for the year ended 31 December 2010, subject to the approval of the shareholders at the AGM. Such proposed dividend will be payable on 25 May 2011 to the shareholders whose names appear on the register of members of the Company on 11 May 2011.

## APPRECIATION

I would like to extend the Board's sincere gratitude to our employees for their hard work and commitment, which has been, and will continue to be, essential for the Group's success and competitive edge in a market full of challenges and uncertainties. We also thank our shareholders and other stakeholders for their continuous support and confidence in our Group.

**Ma Huateng**

*Chairman*

Hong Kong, 16 March 2011

# Management Discussion and Analysis

## OPERATING INFORMATION

The following table sets forth certain operating statistics relating to our Internet platforms and value-added services as at the dates and for the periods presented:

	<b>As at 31 December 2010</b>	As at 30 September 2010	Percentage change
	<i>(in millions)</i>		
Active IM user accounts	<b>647.6</b>	636.6	1.7%
Peak simultaneous online IM user accounts (for the quarter)	<b>127.5</b>	118.7	7.4%
Average daily IM user hours (for the last 16/15 days of the quarter)	<b>1,885.9</b>	1,816.2	3.8%
Active Qzone user accounts	<b>492.0</b>	481.2	2.2%
Peak simultaneous online QQ Game user accounts (for the quarter)	<b>6.8</b>	6.4	6.3%
Fee-based IVAS registered subscriptions	<b>65.7</b>	67.3	-2.4%
Fee-based MVAS registered subscriptions	<b>24.6</b>	25.3	-2.8%

In the fourth quarter of 2010, we experienced a significant security attack by a program, which we believe to be a malware, called “Kou Kou Bodyguard”, that caused material security risks to QQ users (the “Malware Attack”). Detailed background of the incident has been discussed in the results announcement for the third quarter. To prevent the malware from affecting QQ users on a large scale, we imposed certain usage restrictions on computers which ran the risk of being infected by the malware. The risks subsided after government authorities ordered the creator of the malware to withdraw the program. The incident affected usage of our services primarily during the month of November and part of December, impacting the operating statistics for the fourth quarter.

The active user base of our core IM platform expanded slightly during the quarter. User activity and engagement improved primarily along with growing usage of our IM service on mobile devices. Qzone's active user base registered modest increase during the quarter, primarily as a result of organic growth. Peak simultaneous online user accounts of QQ Game grew on the back of increased user activeness due to new games and upgrade of existing games. For our IVAS, registered subscriptions decreased mainly due to decline in subscribers of Qzone and QQ Show. Subscriber base of QQ Membership was stable compared to the previous quarter. The decrease in registered subscriptions generally reflected the negative impact of the Malware Attack on our QQ services in the fourth quarter. In addition, Qzone's subscriber base was affected by reduced impact of social games as a result of the maturity of QQ Farm, as well as our focus on platform building rather than monetisation. Subscribers of QQ Show were also impacted by reduced promotional activities in the fourth quarter amid the Malware Attack. Registered subscriptions to our MVAS also declined on a quarter-on-quarter basis. This was primarily driven by decline in the subscriber number of our bundled SMS packages as the impact of the regulation requiring service providers to conduct double confirmation plus reminder services came into full effect in the fourth quarter. This was also attributable to the clean-up of inactive user accounts for our bundled SMS packages towards the end of the year.

## FINANCIAL PERFORMANCE HIGHLIGHTS

### Year Ended 31 December 2010

Consolidated revenues for the year ended 31 December 2010 were RMB19,646.0 million, an increase of 57.9% from the year ended 31 December 2009.

Revenues from our IVAS for the year ended 31 December 2010 were RMB15,482.3 million, an increase of 62.4% from the year ended 31 December 2009.

Revenues from our MVAS for the year ended 31 December 2010 were RMB2,715.9 million, an increase of 42.5% from the year ended 31 December 2009.

Revenues from our online advertising business for the year ended 31 December 2010 were RMB1,372.5 million, an increase of 42.6% from the year ended 31 December 2009.

Cost of revenues for the year ended 31 December 2010 were RMB6,320.2 million, an increase of 62.5% from the year ended 31 December 2009.

Selling and marketing expenses for the year ended 31 December 2010 were RMB945.4 million, an increase of 62.6% from the year ended 31 December 2009.

General and administrative expenses for the year ended 31 December 2010 were RMB2,836.2 million, an increase of 40.0% from the year ended 31 December 2009.

Operating profit for the year ended 31 December 2010 was RMB9,838.2 million, representing an increase of 63.4% over the year ended 31 December 2009. As a percentage of revenues, operating profit represented 50.1% for the year ended 31 December 2010, compared to 48.4% for the year ended 31 December 2009.

Profit for the year ended 31 December 2010 was RMB8,115.2 million, representing an increase of 55.4% from the year ended 31 December 2009. As a percentage of revenues, profit for the year represented 41.3% for the year ended 31 December 2010, compared to 42.0% for the year ended 31 December 2009.

Profit attributable to equity holders of the Company for the year ended 31 December 2010 was RMB8,053.6 million, representing an increase of 56.2% from the year ended 31 December 2009.

#### **Fourth Quarter of 2010**

Unaudited consolidated revenues for the fourth quarter of 2010 were RMB5,524.2 million, an increase of 49.8% over the same period in 2009 and an increase of 5.7% from the third quarter of 2010.

Revenues from our IVAS for the fourth quarter of 2010 were RMB4,383.9 million, an increase of 54.0% over the same period in 2009 and an increase of 6.2% from the third quarter of 2010.

Revenues from our MVAS for the fourth quarter of 2010 were RMB728.5 million, an increase of 32.5% over the same period in 2009 and an increase of 4.8% from the third quarter of 2010.

Revenues from our online advertising business for the fourth quarter of 2010 were RMB388.1 million, an increase of 39.1% over the same period in 2009 and an increase of 1.5% from the third quarter of 2010.

Cost of revenues for the fourth quarter of 2010 was RMB1,832.4 million, an increase of 60.1% over the same period in 2009 and an increase of 9.3% from the third quarter of 2010.

Selling and marketing expenses for the fourth quarter of 2010 were RMB301.8 million, an increase of 45.0% over the same period in 2009 and an increase of 32.5% from the third quarter of 2010.

General and administrative expenses for the fourth quarter of 2010 were RMB840.4 million, an increase of 46.7% over the same period in 2009 and an increase of 12.9% from the third quarter of 2010.

Operating profit for the fourth quarter of 2010 was RMB2,652.5 million, representing an increase of 49.3% over the same period in 2009 and a decrease of 0.5% from the third quarter of 2010. As a percentage of revenues, operating profit represented 48.0% for the fourth quarter of 2010, compared to 48.2% for the same period of 2009 and 51.0% for the third quarter of 2010.

Profit for the fourth quarter of 2010 was RMB2,213.3 million, representing an increase of 44.4% over the same period in 2009 and an increase of 2.1% from the third quarter of 2010. As a percentage of revenues, profit for the period represented 40.1% for the fourth quarter of 2010, compared to 41.6% for the same period of 2009 and 41.5% for the third quarter of 2010.

Profit attributable to equity holders of the Company for the fourth quarter of 2010 was RMB2,200.8 million, an increase of 45.9% over the same period in 2009 and an increase of 2.2% from the third quarter of 2010.

## ANALYSIS OF FINANCIAL PERFORMANCE

### Fourth Quarter of 2010 Compared to Third Quarter of 2010

The following table sets forth the comparative figures for the fourth quarter of 2010 and the third quarter of 2010:

	Unaudited	
	Three months ended	
	31 December 2010	30 September 2010
	RMB'000	RMB'000
Revenues	5,524,163	5,226,628
Cost of revenues	<u>(1,832,362)</u>	<u>(1,676,544)</u>
Gross profit	3,691,801	3,550,084
Interest income	79,467	65,259
Other gains, net	23,437	22,479
Selling and marketing expenses	(301,796)	(227,817)
General and administrative expenses	<u>(840,407)</u>	<u>(744,092)</u>
Operating profit	2,652,502	2,665,913
Finance income	265	3,431
Share of profit of associates	37,127	10,985
Share of profit of a jointly controlled entity	<u>3,399</u>	<u>–</u>
Profit before income tax	2,693,293	2,680,329
Income tax expense	<u>(480,011)</u>	<u>(512,013)</u>
Profit for the period	<u><u>2,213,282</u></u>	<u><u>2,168,316</u></u>
Attributable to:		
Equity holders of the Company	2,200,818	2,153,111
Non-controlling interests	<u>12,464</u>	<u>15,205</u>
	<u><u>2,213,282</u></u>	<u><u>2,168,316</u></u>

Note:

In the fourth quarter of 2010, an income from changes in fair value of available-for-sale financial asset of RMB1,821.1 million was recognised in other comprehensive income, which was not included in the profit for the period. This was related to our investment in Mail.ru, one of the largest Internet companies in the Russian-speaking and Eastern European markets. The IPO of Mail.ru was completed in November 2010.

*Revenues.* Revenues increased by 5.7% to RMB5,524.2 million for the fourth quarter of 2010 from RMB5,226.6 million for the third quarter of 2010. The following table sets forth our revenues by line of business for the fourth quarter of 2010 and the third quarter of 2010:

	<b>Unaudited</b>			
	<b>Three months ended</b>			
	<b>31 December 2010</b>		30 September 2010	
	<b>Amount</b>	<b>% of total revenues</b>	Amount	% of total revenues
	<i>(RMB in thousands, except percentages)</i>			
IVAS	<b>4,383,940</b>	<b>79.4%</b>	4,129,008	79.0%
MVAS	<b>728,516</b>	<b>13.2%</b>	695,057	13.3%
Online advertising	<b>388,126</b>	<b>7.0%</b>	382,542	7.3%
Others	<b>23,581</b>	<b>0.4%</b>	20,021	0.4%
Total revenues	<b><u>5,524,163</u></b>	<b><u>100.0%</u></b>	<u>5,226,628</u>	<u>100.0%</u>

- Revenues from our IVAS increased by 6.2% to RMB4,383.9 million for the fourth quarter of 2010 from RMB4,129.0 million for the third quarter of 2010. Despite weaker seasonality, online gaming revenues increased by 9.0% to RMB2,786.1 million from RMB2,557.2 million for the previous quarter. This was mainly driven by a full quarter contribution of Qi Xiong Zheng Ba, a web-based MMOG launched in August 2010, and increased monetisation of Cross Fire. DNF and QQ Game also registered revenue growth during the quarter. Revenues from our community value-added services increased slightly by 1.7% to RMB1,597.8 million from RMB1,571.8 million for the previous quarter, mainly as a result of growth in Qzone and QQ Membership. Revenues from Qzone grew on the back of an increase in the number of third-party social applications available on our platform. Growth in revenues from QQ Membership benefited from promotional activities focusing on annual subscription.
- Revenues from our MVAS increased by 4.8% to RMB728.5 million for the fourth quarter of 2010 from RMB695.1 million for the third quarter of 2010. This was mainly driven by growth in revenues from our bundled SMS packages and mobile social games.
- Revenues from our online advertising business increased slightly by 1.5% to RMB388.1 million for the fourth quarter of 2010 from RMB382.5 million for the third quarter of 2010. This mainly reflected an increase in revenues from search-based advertising. Albeit weaker seasonality in the fourth quarter, advertising revenues from IM client and portal were broadly stable compared to the previous quarter.

*Cost of revenues.* Cost of revenues increased by 9.3% to RMB1,832.4 million for the fourth quarter of 2010 from RMB1,676.5 million for the third quarter of 2010. This mainly reflected an increase in sharing costs, depreciation and staff costs. As a percentage of revenues, cost of revenues increased to 33.2% for the fourth quarter of 2010 from 32.1% for the third quarter of 2010. The following table sets forth our cost of revenues by line of business for the fourth quarter of 2010 and the third quarter of 2010:

	<b>Unaudited</b>			
	<b>Three months ended</b>			
	<b>31 December 2010</b>		30 September 2010	
	<b>% of segment</b>		% of segment	
	<b>Amount</b>	<b>revenues</b>	Amount	revenues
	<i>(RMB in thousands, except percentages)</i>			
IVAS	<b>1,384,724</b>	<b>31.6%</b>	1,264,751	30.6%
MVAS	<b>279,456</b>	<b>38.4%</b>	267,962	38.6%
Online advertising	<b>138,087</b>	<b>35.6%</b>	114,844	30.0%
Others	<b>30,095</b>	<b>127.6%</b>	28,987	144.8%
Total cost of revenues	<b><u>1,832,362</u></b>		<b><u>1,676,544</u></b>	

- Cost of revenues for our IVAS increased by 9.5% to RMB1,384.7 million for the fourth quarter of 2010 from RMB1,264.8 million for the third quarter of 2010. This primarily reflected an increase in sharing costs as a result of growth in revenues from our licensed games. Other costs also increased along with expansion of our business volume.
- Cost of revenues for our MVAS increased by 4.3% to RMB279.5 million for the fourth quarter of 2010 from RMB268.0 million for the third quarter of 2010. This was mainly attributable to an increase in staff costs as we positioned the business for future growth.
- Cost of revenues for our online advertising business increased by 20.2% to RMB138.1 million for the fourth quarter of 2010 from RMB114.8 million for the third quarter of 2010. This mainly reflected higher sharing costs for the search business due to increased traffic generated from our search distribution partners, as well as an increase in sales commissions paid to advertising agencies.

*Other gains, net.* Other gains, net increased by 4.3% to RMB23.4 million for the fourth quarter of 2010 from RMB22.5 million for the third quarter of 2010. During the fourth quarter, no donation was made to the Tencent Charity Fund and government subsidies increased. On the other hand, loss on foreign exchange forward contracts, which we entered into for the purpose of managing our foreign currency exposure related to our USD-denominated bank borrowings, increased.

*Selling and marketing expenses.* Selling and marketing expenses increased by 32.5% to RMB301.8 million for the fourth quarter of 2010 from RMB227.8 million for the third quarter of 2010. This was primarily driven by an increase in advertising and promotional expenses for our online games and other products. As a percentage of revenues, selling and marketing expenses increased to 5.5% for the fourth quarter of 2010 from 4.4% for the third quarter of 2010.

*General and administrative expenses.* General and administrative expenses increased by 12.9% to RMB840.4 million for the fourth quarter of 2010 from RMB744.1 million for the third quarter of 2010. This primarily reflected higher staff costs and an increase in research and development expenses for pursuing long-term business growth. Other administrative expenses also increased as our business scale continued to expand. As a percentage of revenues, general and administrative expenses increased to 15.2% for the fourth quarter of 2010 from 14.2% for the third quarter of 2010.

*Income tax expense.* Income tax expense decreased by 6.3% to RMB480.0 million for the fourth quarter of 2010 from RMB512.0 million for the third quarter of 2010. This mainly reflected a reversal of income tax expense for a subsidiary which was qualified during the fourth quarter of 2010 to enjoy a lower income tax rate. The decrease was partly offset by an increase in deferred tax liabilities recognised in respect of withholding taxes applicable on unremitted retained earnings expected to be paid by our PRC subsidiaries to their overseas parent companies.

*Profit for the period.* Profit for the period increased by 2.1% to RMB2,213.3 million for the fourth quarter of 2010 from RMB2,168.3 million for the third quarter of 2010. Net margin was 40.1% for the fourth quarter of 2010 compared to 41.5% for the third quarter of 2010.

*Profit attributable to equity holders of the Company.* Profit attributable to equity holders of the Company increased by 2.2% to RMB2,200.8 million for the fourth quarter of 2010 from RMB2,153.1 million for the third quarter of 2010.

**Year Ended 31 December 2010 Compared to Year Ended 31 December 2009**

The following table sets forth the comparative figures for the year ended 31 December 2010 and the year ended 31 December 2009:

	<b>Year ended 31 December</b>	
	<b>2010</b>	2009
	<b>RMB'000</b>	RMB'000
Revenues	<b>19,646,031</b>	12,439,960
Cost of revenues	<b>(6,320,200)</b>	(3,889,468)
Gross profit	<b>13,325,831</b>	8,550,492
Interest income	<b>255,922</b>	136,014
Other gains/(losses), net	<b>38,056</b>	(58,213)
Selling and marketing expenses	<b>(945,370)</b>	(581,468)
General and administrative expenses	<b>(2,836,226)</b>	(2,026,347)
Operating profit	<b>9,838,213</b>	6,020,478
Finance costs	<b>(838)</b>	(1,953)
Share of profit of associates	<b>72,359</b>	22,206
Share of profit of a jointly controlled entity	<b>3,399</b>	–
Profit before income tax	<b>9,913,133</b>	6,040,731
Income tax expense	<b>(1,797,924)</b>	(819,120)
Profit for the year	<b>8,115,209</b>	5,221,611
Attributable to:		
Equity holders of the Company	<b>8,053,625</b>	5,155,646
Non-controlling interests	<b>61,584</b>	65,965
	<b>8,115,209</b>	5,221,611

Note:

In the fourth quarter of 2010, an income from changes in fair value of available-for-sale financial asset of RMB1,821.1 million was recognised in other comprehensive income, which was not included in the profit for the year. This was related to our investment in Mail.ru, one of the largest Internet companies in the Russian-speaking and Eastern European markets. The IPO of Mail.ru was completed in November 2010.

*Revenues.* Revenues increased by 57.9% to RMB19,646.0 million for the year ended 31 December 2010 from RMB12,440.0 million for the year ended 31 December 2009. The following table sets forth our revenues by line of business for the year ended 31 December 2010 and the year ended 31 December 2009:

	Year ended 31 December			
	2010		2009	
	Amount	% of total revenues	Amount	% of total revenues
<i>(RMB in thousands, except percentages)</i>				
IVAS	15,482,301	78.8%	9,530,711	76.6%
MVAS	2,715,931	13.8%	1,905,599	15.3%
Online advertising	1,372,522	7.0%	962,171	7.7%
Others	75,277	0.4%	41,479	0.4%
Total revenues	<u>19,646,031</u>	<u>100.0%</u>	<u>12,439,960</u>	<u>100.0%</u>

- Revenues from our IVAS increased by 62.4% to RMB15,482.3 million for the year ended 31 December 2010 from RMB9,530.7 million for the year ended 31 December 2009. Online gaming revenues grew by 76.6% to RMB9,509.7 million from RMB5,385.4 million for the previous year. This was mainly driven by growth in revenues from our major MMOGs and advanced casual games, including DNF, Cross Fire, QQ Dancer and QQ Speed. The increase was also driven by revenue contribution from new online games launched during 2010 and growth of QQ Game. Revenues from our community value-added services increased by 44.1% to RMB5,972.6 million from RMB4,145.3 million for the previous year, mainly attributable to growth in Qzone, QQ Membership and QQ Show. Qzone registered increase in revenues as we offered more SNS applications, which enhanced user activity and engagement as well as stimulated growth of monthly subscription. Our focus on annual subscription also contributed to the increase. Revenues from QQ Membership grew as its user base expanded, riding on improved online and offline privileges as well as an increase in annual subscription. The increase in revenues from QQ Show was mainly driven by growth in monthly subscription as we focused on enhancing the features and user value of the product.
- Revenues from our MVAS increased by 42.5% to RMB2,715.9 million for the year ended 31 December 2010 from RMB1,905.6 million for the year ended 31 December 2009. This was mainly attributable to growth in revenues from our bundled SMS packages as we improved the functionalities and privileges of our products and services. It also reflected growth in revenues from mobile social games and mobile music services. The increase was partly offset by decline in revenues from WAP services due to the suspension of WAP billing by China Mobile since 30 November 2009, as well as lower revenues from legacy mobile voice value-added services.

- Revenues from our online advertising business increased by 42.6% to RMB1,372.5 million for the year ended 31 December 2010 from RMB962.2 million for the year ended 31 December 2009. The increase mainly reflected growth in our user base, improvements in our advertising platforms, as well as enhancements in our brand position and media influence. This also reflected our focus on leveraging the World Cup and the World Expo to generate business opportunities during the year. Revenues from search-based advertising declined as we transitioned into our self-developed search engine at the end of the third quarter of 2009.

*Cost of revenues.* Cost of revenues increased by 62.5% to RMB6,320.2 million for the year ended 31 December 2010 from RMB3,889.5 million for the year ended 31 December 2009. This primarily reflected an increase in sharing costs, staff costs and telecommunications operators' revenue share. As a percentage of revenues, cost of revenues increased to 32.2% for the year ended 31 December 2010 from 31.3% for the year ended 31 December 2009. The following table sets forth our cost of revenues by line of business for the year ended 31 December 2010 and the year ended 31 December 2009:

	Year ended 31 December			
	2010		2009	
	Amount	% of segment revenues	Amount	% of segment revenues
<i>(RMB in thousands, except percentages)</i>				
IVAS	4,762,435	30.8%	2,789,225	29.3%
MVAS	1,010,858	37.2%	727,747	38.2%
Online advertising	441,302	32.2%	297,608	30.9%
Others	105,605	140.3%	74,888	180.5%
Total cost of revenues	<u>6,320,200</u>		<u>3,889,468</u>	

- Cost of revenues for our IVAS increased by 70.7% to RMB4,762.4 million for the year ended 31 December 2010 from RMB2,789.2 million for the year ended 31 December 2009. This was mainly driven by growth in sharing costs as a result of significant increase in revenues from our licensed games, including Cross Fire and DNF. Other costs also increased due to our business growth.
- Cost of revenues for our MVAS increased by 38.9% to RMB1,010.9 million for the year ended 31 December 2010 from RMB727.7 million for the year ended 31 December 2009. This primarily reflected an increase in telecommunications operators' revenue share as a result of revenue growth. Staff costs also increased as we positioned the business for future growth.

- Cost of revenues for our online advertising business increased by 48.3% to RMB441.3 million for the year ended 31 December 2010 from RMB297.6 million for the year ended 31 December 2009. This mainly reflected an increase in sales commissions paid to advertising agencies and staff costs due to our business expansion.

*Other gains/(losses), net.* We recorded other gains, net of RMB38.1 million for the year ended 31 December 2010, compared to other losses, net of RMB58.2 million for the year ended 31 December 2009. The change mainly reflected an increase in government subsidies and a decrease in donations made to the Tencent Charity Fund from RMB85.0 million for the year ended 31 December 2009 to RMB70.0 million for the year ended 31 December 2010. These factors were partly offset by recognition of fair value gains on financial assets held for trading in the previous year.

*Selling and marketing expenses.* Selling and marketing expenses increased by 62.6% to RMB945.4 million for the year ended 31 December 2010 from RMB581.5 million for year ended 31 December 2009. This primarily reflected an increase in advertising spending on our corporate brand, mainly as a result of our campaigns related to the World Cup and the World Expo. It also reflected higher promotional expenses associated with our online games and an increase in staff costs. As a percentage of revenues, selling and marketing expenses increased slightly to 4.8% for the year ended 31 December 2010 from 4.7% for the year ended 31 December 2009.

*General and administrative expenses.* General and administrative expenses increased by 40.0% to RMB2,836.2 million for the year ended 31 December 2010 from RMB2,026.3 million for the year ended 31 December 2009. This mainly reflected an increase in research and development expenses as we expanded our research and development effort to support our growth strategy. Staff costs for supporting functions and other administrative expenses also increased as our business scale grew. As a percentage of revenues, general and administrative expenses decreased to 14.4% for the year ended 31 December 2010 from 16.3% for the year ended 31 December 2009.

*Income tax expense.* We recorded income tax expense of RMB1,797.9 million for the year ended 31 December 2010 compared to RMB819.1 million for the year ended 31 December 2009. The increase was primarily due to growth in profit before tax as well as an increase in deferred tax liabilities recognised relating to intra-group dividend expected to be paid by our PRC subsidiaries to their overseas parent companies. It also reflected higher tax rates for certain subsidiaries of the Company.

*Profit for the year.* Profit for the year increased by 55.4% to RMB8,115.2 million for the year ended 31 December 2010 from RMB5,221.6 million for the year ended 31 December 2009. Net margin was 41.3% for the year ended 31 December 2010 compared to 42.0% for the year ended 31 December 2009.

*Profit attributable to equity holders of the Company.* Profit attributable to equity holders of the Company increased by 56.2% to RMB8,053.6 million for the year ended 31 December 2010 from RMB5,155.6 million for the year ended 31 December 2009.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2010 and 30 September 2010, we had the following major financial resources in the form of cash and investments:

	<b>Audited</b>	Unaudited
	<b>31 December 2010</b>	30 September 2010
	<b>RMB'000</b>	RMB'000
Cash and cash equivalents	<b>10,408,257</b>	7,712,112
Term deposits with initial term of over three months	<b>11,725,743</b>	9,714,422
	<hr/>	<hr/>
Total financial resources	<b>22,134,000</b>	17,426,534
Unsecured short-term bank borrowings	<b>(4,308,060)</b>	(2,847,353)
	<hr/>	<hr/>
Net financial resources	<b>17,825,940</b>	14,579,181
	<hr/> <hr/>	<hr/> <hr/>

Note:

The above table excludes short-term bank borrowing arrangements with an aggregate principle amount of USD148.6 million as at 31 December 2010 (30 September 2010: USD148.6 million) and restricted cash deposits of RMB1,014.5 million as at 31 December 2010 (30 September 2010: RMB1,014.5 million) pledged as part of these arrangements, as such deposits are scheduled to offset the borrowed amount at the maturity of the loans.

As at 31 December 2010, RMB2,809.5 million of our financial assets (30 September 2010: RMB1,228.0 million) were held in deposits and investments denominated in non-RMB currencies. Since there are no cost-effective hedges against the fluctuation of RMB and no effective manner to generally convert a significant amount of non-RMB currencies into RMB, which is not a freely exchangeable currency, there is a risk that we may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with our deposits and investments.

## CAPITAL EXPENDITURES

For the year ended 31 December 2010, our capital expenditures consisted of additions to fixed assets, construction in progress, land use rights and intangible assets totalling RMB2,007.0 million. For the year ended 31 December 2009, our capital expenditures consisted of similar items totalling RMB1,026.5 million.

# Directors' Report

The directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2010.

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The activities of the subsidiaries are set out in Note 11 to the consolidated financial statements.

The analysis of the Group's revenues and contribution to results by business segments and the Group's revenues by geographical area of operations are set out in Note 5 to the consolidated financial statements.

## RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated statement of comprehensive income on page 71 of this annual report.

The directors have recommended the payment of a final dividend of HKD0.55 per share for the year ended 31 December 2010. The dividend is expected to be payable on 25 May 2011 to the shareholders whose names appear on the register of members of the Company on 11 May 2011. The total dividend for the year under review is HKD0.55 per share.

## RESERVES

The Company's reserves available for distribution comprise share premium and retained earnings. Under the Companies Law of the Cayman Islands, the share premium account is distributable to the shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed the Company will be in a position to pay off its debts as they fall due in the ordinary course of business.

As at 31 December 2010, the Company had distributable reserves amounting to RMB959.3 million (2009: RMB1,801.9 million).

Details of the movements in the reserves of the Group and the Company during the year are set out in Note 21 and Note 22 to the consolidated financial statements.

## FIXED ASSETS

Details of the movements in fixed assets of the Group during the year are set out in Note 6 to the consolidated financial statements.

## SHARE CAPITAL

Details of the movements in the share capital of the Company during the year are set out in Note 21 to the consolidated financial statements.

## SUBSIDIARIES

Particulars of the Company's principal subsidiaries as at 31 December 2010 are set out in Note 11 to the consolidated financial statements.

## BANK LOANS

Particulars of the Group's bank borrowings are set out in Note 28 to the consolidated financial statements.

## DONATION

The donation made by the Group in the year was RMB70.0 million.

## FINANCIAL SUMMARY

A summary of the condensed consolidated results and financial positions of the Group is set out on page 3 of this annual report.

## PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the year ended 31 December 2010, the Company repurchased 2,624,000 shares on the Stock Exchange for an aggregate consideration of approximately HKD354.8 million before expenses. The repurchased shares were subsequently cancelled. The repurchases were effected by the Board for the enhancement of shareholders' value in the long term. Details of the shares repurchased are as follows:

Month of purchase in 2010	No. of shares purchased	Purchase consideration per share		Aggregate consideration paid HKD
		Highest price paid HKD	Lowest price paid HKD	
July	2,624,000	138.50	129.90	354,764,000
Total	2,624,000			354,764,000

Save as disclosed above and in Note 23 to the consolidated financial statements, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares during the year ended 31 December 2010.

## SHARE OPTION SCHEMES

The Company has adopted four share option schemes, namely, the Pre-IPO Option Scheme, the Post-IPO Option Scheme I, the Post-IPO Option Scheme II and the Post-IPO Option Scheme III. No further options will be granted under the Pre-IPO Option Scheme and the Post-IPO Option Scheme I.

As at 31 December 2010, there were a total of 6,820,000 outstanding share options granted to the directors of the Company, details of which are as follows:

Name of director	Date of grant	Exercise price HKD	Number of shares issuable under the options				Exercise period
			As at 1 January 2010	Granted during the year	Exercised during the year	As at 31 December 2010	
Lau Chi Ping Martin	3 February 2005	4.8	703,600	–	703,600	–	3 February 2006 to 23 March 2014 (Note 1)
	20 December 2005	8.35	2,000,000	–	2,000,000	–	20 December 2006 to 23 March 2014 (Note 1)
	23 March 2006	11.55	1,500,000	–	1,500,000	–	23 March 2007 to 23 March 2014 (Note 1)
	4 April 2007	25.26	1,000,000	–	400,000	600,000	4 April 2008 to 23 March 2014 (Note 2)
	5 July 2007	33.05	2,000,000	–	–	2,000,000	5 July 2009 to 4 July 2014 (Note 3)
	5 July 2007	33.05	3,000,000	–	–	3,000,000	5 July 2010 to 4 July 2014 (Note 4)
	24 March 2010	158.5 (Note 6)	–	1,000,000	–	1,000,000	24 March 2015 to 23 March 2020 (Note 5)
	Total:		10,203,600	1,000,000	4,603,600	6,600,000	
Li Dong Sheng	4 April 2007	25.26	100,000	–	–	100,000	4 April 2008 to 23 March 2014 (Note 2)
Iain Ferguson Bruce	4 April 2007	25.26	80,000	–	20,000	60,000	4 April 2008 to 23 March 2014 (Note 2)
Ian Charles Stone	4 April 2007	25.26	60,000	–	–	60,000	4 April 2008 to 23 March 2014 (Note 2)
	Grand Total:		10,443,600	1,000,000	4,623,600	6,820,000	

Notes:

1. For options granted with exercisable date determined based on the grant date of options, the first 25% of the option can be exercised one year after the grant date, and 25% each of the total options will become exercisable in each subsequent year.
2. For options granted with exercisable date determined based on the grant date of options, the first 20% of the option can be exercised one year after the grant date, and 20% each of the total options will become exercisable in each subsequent year.
3. For options granted with exercisable date determined based on the grant date of options, the first 20% of the option can be exercised two years after the grant date, and 20% each of the total options will become exercisable in each subsequent year.
4. For options granted with exercisable date determined based on the grant date of options, the first 20% of the option can be exercised three years after the grant date, and then 20% each of the total options will become exercisable in each subsequent year, except the last 20% of the total options which will become exercisable in the eleventh month after the fourth 20% of the total options become exercisable.
5. For options granted with exercisable date determined based on the grant date of options, the first 25% of the option can be exercised five years after the grant date, and 25% each of the total options will become exercisable in each subsequent year.
6. The closing price immediately before the date on which the options were granted was HKD158.20.
7. The weighted average closing price immediately before the dates on which the options were exercised by each of the directors were as follows:

<b>Name of director</b>	<b>Weighted average closing price (HKD)</b>
Lau Chi Ping Martin	154.83
Iain Ferguson Bruce	170.80

8. No option was cancelled or lapsed during the period.
9. Fair values of the options granted during the period are set out in Note 23 to the consolidated financial statements as included in this annual report.

## SUMMARY OF THE SHARE OPTION SCHEMES

<b>Details</b>	<b>Pre-IPO Option Scheme</b>	<b>Post-IPO Option Scheme I</b>	<b>Post-IPO Option Scheme II</b>	<b>Post-IPO Option Scheme III</b>
1. Purposes	To recognise the contribution that certain individuals have made to the Group, to attract the best available personnel and to promote the success of the Group's business			
2. Qualifying participants	Any eligible employee, including executive directors of the Company	Any employee, consultant or director of any company within the Group	Any employee (whether full time or part time), executive or officer, director (including executive, non-executive and independent non-executive directors) of any member of the Group or any invested entity, which is any entity in which the Group holds an equity interest, and any consultant, adviser or agent of any member of the Board, who have contributed or will contribute to the growth and development of the Group or any invested entity	Any senior executive or senior officer, director (including executive, non-executive and independent non-executive directors) of any member of the Group or any invested entity and any consultant, adviser or agent of any member of the Board, who have contributed or will contribute to the growth and development of the Group or any invested entity

Details	Pre-IPO Option Scheme	Post-IPO Option Scheme I	Post-IPO Option Scheme II	Post-IPO Option Scheme III
3. Maximum number of shares	As at 7 June 2004, options to subscribe for an aggregate of 72,386,370 shares were outstanding. No further option could be granted under the Pre-IPO Option Scheme.	As at 16 May 2007, options to subscribe for an aggregate of 60,413,683 shares were outstanding. No further option could be granted under the Post-IPO Option Scheme I.	The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme II shall be 88,903,654 shares, 5% of the relevant class of securities of the Company in issue as at 16 May 2007. The maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Post-IPO Option Scheme II and any other share option schemes, including the Pre-IPO Option Scheme, the Post-IPO Option Scheme I and the Post-IPO Option Scheme III, must not in aggregate exceed 30% of the issued share capital of the Company from time to time (Note).	The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme III shall be 36,018,666 shares, 2% of the relevant class of securities of the Company in issue as at 13 May 2009. The maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Post-IPO Option Scheme III and any other share option schemes, including the Pre-IPO Option Scheme, the Post-IPO Option Scheme I and the Post-IPO Option Scheme II, must not in aggregate exceed 30% of issued share capital of the Company from time to time (Note).

<b>Details</b>	<b>Pre-IPO Option Scheme</b>	<b>Post-IPO Option Scheme I</b>	<b>Post-IPO Option Scheme II</b>	<b>Post-IPO Option Scheme III</b>
4. Maximum entitlement of each participant	The number of ordinary shares in respect of which options may be granted is not permitted to exceed 10% of the number of ordinary shares issued and issuable under the scheme.	1% of the issued share capital of the Company from time to time within any 12-month period up to the date of the latest grant	1% of the issued share capital of the Company from time to time within any 12-month period up to the date of the latest grant	1% of the issued share capital of the Company from time to time within any 12-month period up to the date of the latest grant
5. Option period	All the options are exercisable in installments from the commencement of the relevant vesting period until 31 December 2011, but on the condition that the Company has been listed in a sizeable securities market. The Board may at their discretion determine the specific vesting and exercise periods.	The option period is determined by the Board provided that the period during which the option may be exercised shall not be less than one year from the date of grant of the options.	The option period is determined by the Board provided that it is not later than the last day of the 7-year period after the date of grant of option. There is no minimum period for which an option must be held before it can be exercised.	The option period is determined by the Board provided that it is not later than the last day of the 10-year period after the date of grant of option. There is no minimum period for which an option must be held before it can be exercised.
6. Acceptance of offer	Options granted must be accepted within 15 days of the date of grant, upon payment of RMB1 per grant.	Options granted must be accepted within 28 days of the date of grant, upon payment of HKD1 per grant.	Options granted must be accepted within 28 days of the date of grant, upon payment of HKD1 per grant.	Options granted must be accepted within 28 days of the date of grant, upon payment of HKD1 per grant.

<b>Details</b>	<b>Pre-IPO Option Scheme</b>	<b>Post-IPO Option Scheme I</b>	<b>Post-IPO Option Scheme II</b>	<b>Post-IPO Option Scheme III</b>
7. Subscription price	Price shall be determined by the Board.	The exercise price must be at least the higher of: (i) the closing price of the securities as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; (ii) the average closing price of the securities as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the share.	The exercise price must be at least the higher of: (i) the closing price of the securities as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; (ii) the average closing price of the securities as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the share.	The exercise price must be at least the higher of: (i) the closing price of the securities as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; (ii) the average closing price of the securities as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the share.
8. Remaining life of the scheme	It will expire on 31 December 2011.	It shall be valid and effective for a period of ten years, commencing on 24 March 2004.	It shall be valid and effective for a period of ten years, commencing on 16 May 2007.	It shall be valid and effective for a period of ten years commencing, on 13 May 2009.

Note:

The total number of shares available for issue under the Post-IPO Option Scheme II and the Post-IPO Option Scheme III is 87,184,307, which is approximately 4.75% of the issued share capital of the Company as at the date of this annual report.

## MOVEMENTS IN THE SHARE OPTIONS

Details of the movements in the share options during the year are set out in Note 23 to the consolidated financial statements.

## VALUATION OF THE SHARE OPTIONS

Details of the valuation of the share options during the year are set out in Note 23 to the consolidated financial statements.

## SHARE AWARD SCHEME

On the Adoption Date, the Board adopted the Scheme in which eligible persons (including any director) of the Group will be entitled to participate. Unless early terminated by the Board, the Scheme shall be valid and effective for a term of 15 years commencing on the Adoption Date. The maximum number of shares which can be awarded under the Scheme and to an Awarded Person are limited to two percent (i.e. 35,755,232 shares) and one percent (i.e. 17,877,616 shares) of the issued share capital of the Company as at the Adoption Date respectively.

Pursuant to the Scheme, the Board shall select the eligible persons for participation in the Scheme and determine the number of shares to be awarded. Shares will be acquired by an independent trustee at the cost of the Company or shares will be allotted to the independent trustee under the general mandate granted or to be granted by the shareholders of the Company at general meetings from time to time and be held in trust for the Awarded Persons, excluding the directors and substantial shareholders of the Group, until the end of each vesting period. Vested shares will be transferred at no cost to the Awarded Persons. The Company shall comply with the relevant Listing Rules when granting the Awarded Shares.

If awards are made to the directors or substantial shareholders of the Group, such awards shall constitute connected transaction under Chapter 14A of the Listing Rules and the Company shall comply with the relevant requirements under the Listing Rules.

The Awarded Shares and the related income derived therefrom are subject to a vesting scale to be determined by the Board at the date of the grant of the award. Vesting of the Awarded Shares will be conditional on the Awarded Persons satisfying all vesting conditions specified by the Board at the time of making the award and, for the majority of the Awarded Persons, the relevant Awarded Shares will be transferred to the Awarded Persons on or about the relevant vesting dates.

During the year, a total of 4,847,788 Awarded Shares were granted and no Awarded Shares was granted to the directors of the Company. Details of the movements in the Scheme during the year are set out in Note 23 to the consolidated financial statements.

## DIRECTORS

The directors of the Company during the year and up to the date of this report were:

### **Executive Directors**

Ma Huateng (Chairman)

Lau Chi Ping Martin

Zhang Zhidong

### **Non-Executive Directors**

Antonie Andries Roux

Charles St Leger Searle

### **Independent Non-Executive Directors**

Li Dong Sheng

Iain Ferguson Bruce

Ian Charles Stone

In accordance with Article 87 of the Articles of Association, Messrs Lau Chi Ping Martin and Antonie Andries Roux will retire at the AGM and, being eligible, will offer themselves for re-election.

The Company has received from each independent non-executive director an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules and the Board considers them to be independent.

## BIOGRAPHICAL DETAILS OF DIRECTORS

**Ma Huateng**, age 39, is an executive director, Chairman of the Board and CEO of the Company. Mr Ma has overall responsibilities for strategic planning and positioning and management of the Group. Mr Ma is one of the core founders and has been employed by the Group since 1999. Prior to his current employment, Mr Ma was in charge of research and development for Internet paging system development at China Motion Telecom Development Limited, a supplier of telecommunications services and products in China. Mr Ma is a member of the 5th Shenzhen Municipal People's Congress. Mr Ma has a Bachelor of Science degree specialising in Computer & its Application obtained in 1993 from Shenzhen University and more than 16 years of experience in the telecommunications and Internet industries. He is also a director of Advance Data Services Limited which has interest in the shares of the Company.

**Lau Chi Ping Martin**, age 37, is an executive director with effect from 21 March 2007. Mr Lau was appointed as the President of the Company in February 2006 to assist Mr Ma Huateng, Chairman of the Board and CEO, in managing the day-to-day operation of the Company. In February 2005, he joined the Company as the Chief Strategy and Investment Officer of the Company, and was responsible for corporate strategies, investment, merger and acquisitions and investor relations. Prior to joining the Company, Mr Lau was an Executive Director at Goldman Sachs (Asia) LLC's investment banking division and the Chief Operating Officer of its Telecom, Media and Technology Group. Prior to that, he worked at McKinsey & Company, Inc. as a management consultant. He has over 14 years' experience in IPO, merger and acquisitions and management consulting. Mr Lau received a Bachelor of Science Degree in Electrical Engineering from the University of Michigan, a Master of Science Degree in Electrical Engineering from Stanford University and a MBA from Kellogg Graduate School of Management, Northwestern University. Mr Lau is currently a non-executive director of Yingli Green Energy Holding Company Limited, a China-based vertically integrated photovoltaic product manufacturer that is listed on the New York Stock Exchange.

**Zhang Zhidong**, age 39, is an executive director and Chief Technology Officer of the Company. Mr Zhang has overall responsibilities for the development of our proprietary technologies, including the basic IM platform and massive-scale online application systems. Mr Zhang is one of the core founders and has been employed by the Group since 1999. Prior to his current employment, Mr Zhang worked at Liming Network Group focusing on software and network application systems research and development. Mr Zhang has a Bachelor of Science degree specialising in Computer & its Application obtained in 1993 from Shenzhen University and a Master's degree in Computer Application and System Structure from South China University of Technology obtained in 1996. Mr Zhang has more than 14 years of experience in the telecommunications and Internet industries. He is also a director of Best Update International Limited which has interest in the shares of the Company.

**Antonie Andries Roux**, age 52, has been a non-executive director since 10 December 2002. Mr Roux is currently CEO of Internet Operations for the MIH group companies, a position he has held since 2002. Mr Roux joined the Naspers group in 1979 and was a founding member of M-Net in 1985. In 1997, he was appointed CEO of M-Web South Africa. Currently, Mr Roux serves on the boards of directors of a number of companies that are subsidiaries of or associated companies with MIH. Mr Roux has more than 32 years of experience in the telecommunications industry.

**Charles St Leger Searle**, age 47, has been a non-executive director since 5 June 2001. Mr Searle is currently the Chief Investment Officer of MIH Internet group companies. Prior to joining the MIH group companies, he held various corporate finance positions at Cable & Wireless plc and Hong Kong Telecom. Prior to joining Cable & Wireless plc, he was a senior corporate finance manager at Deloitte & Touche in London and Sydney. Currently, Mr Searle serves on the boards of directors of a number of companies that are subsidiaries of or associated companies with MIH. Mr Searle graduated from the University of Cape Town in 1987 with a Bachelor of Commerce degree and is a member of the Institute of Chartered Accountants in Australia (1992). Mr Searle has more than 17 years of experience in the telecommunications and Internet industries.

**Li Dong Sheng**, age 54, has been an independent non-executive director since April 2004. Mr Li is the Chairman and CEO of TCL Corporation, the Chairman of the Hong Kong listed TCL Multimedia Technology Holdings Limited and the Chairman of the Hong Kong listed TCL Communication Technology Holdings Limited, all of which produce consumer electronic products. Mr Li graduated from South China University of Technology in 1982 with a Bachelor degree in radio technology and has more than 16 years of experience in the information technology field.

**Iain Ferguson Bruce**, age 70, has been an independent non-executive director since April 2004. Mr Bruce joined KPMG in Hong Kong in 1964 and was elected to its partnership in 1971. He was the Senior Partner of KPMG from 1991 until his retirement in 1996 and served as Chairman of KPMG Asia Pacific from 1993 to 1997. Since 1964, Mr Bruce has been a member of the Institute of Chartered Accountants of Scotland and is a fellow of the Hong Kong Institute of Certified Public Accountants, with over 46 years' experience in the accounting profession. He is also a fellow of The Hong Kong Institute of Directors and a member of The Hong Kong Securities Institute. Mr Bruce is currently an independent non-executive director of Paul Y. Engineering Group Limited, a construction and engineering services company, Sands China Ltd., an operator of integrated resorts and casinos, Vitasoy International Holdings Limited, a beverage manufacturing company, and Wing On Company International Limited, a department store operating and real property investment company; all of these companies are publicly listed companies in Hong Kong. Mr Bruce is also a non-executive director of Noble Group Limited, a commodity trading company that is publicly listed in Singapore, of China Medical Technologies, Inc., a China-based medical device company that is listed on NASDAQ, and of Yingli Green Energy Holding Company Limited, a China-based vertically integrated photovoltaic product manufacturer that is listed on the New York Stock Exchange. Mr Bruce is an independent non-executive director of Citibank (Hong Kong) Limited and is the Chairman of KCS Limited.



**Ian Charles Stone**, age 60, has been an independent non-executive director since April 2004. Mr Stone is currently the Managing Director of International Projects for PCCW Limited. Mr Stone has more than 40 years of experience in the telecom and mobile industries. He was the Chief Executive Officer of SmarTone between 1999 and 2001. Prior to joining SmarTone, he was Senior Adviser to First Pacific/PLDT of the First Pacific Group, Chief Operations Officer of Piltel, Managing Director of Pacific Link and Executive Director of Asialink, the regional telecom investment arm of First Pacific, respectively. Mr Stone has also held senior positions at Cable & Wireless plc and Hong Kong Telecom.

### **DIRECTORS' SERVICE CONTRACTS**

None of the directors who are proposed for re-election at the forthcoming AGM has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

### **DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE**

Save as disclosed in this annual report, no contracts of significance in relation to the Group's business to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## DIRECTORS' INTERESTS IN SECURITIES

As at 31 December 2010, the interests and short positions of the directors and the chief executive of the Company in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they have taken, or are deemed to have taken, under such provisions of the SFO); or (b) were required, pursuant to section 352 of the SFO, to be recorded in the register required to be kept by the Company; or (c) were required, pursuant to the Model Code, to be notified to the Company and the Stock Exchange were as follows:

### (A) Long and short positions in the shares and underlying shares of the Company

Name of Director	Long/short position	Nature of interest	Number of shares/ underlying shares held	Percentage of issued share capital
Ma Huateng	Long position	Corporate (Note 1)	204,892,880	11.16%
	Short position	Corporate (Note 1)	17,480,000	0.95%
Zhang Zhidong	Long position	Corporate (Note 2)	67,250,000	3.66%
Lau Chi Ping Martin	Long position	Personal	10,853,600 (Note 3)	0.59%
Li Dong Sheng	Long position	Personal	100,000 (Note 4)	0.005%
Iain Ferguson Bruce	Long position	Personal	95,000 (Note 5)	0.005%
Ian Charles Stone	Long position	Personal	60,000 (Note 4)	0.003%

Notes:

1. These shares are held by Advance Data Services Limited, a BVI company wholly owned by Ma Huateng.
2. These shares are held by Best Update International Limited, a BVI company wholly owned by Zhang Zhidong.
3. The interest comprises 4,253,600 shares and 6,600,000 underlying shares in respect of the share options granted pursuant to the Post-IPO Option Scheme I, Post-IPO Option Scheme II and Post-IPO Option Scheme III. Details of the share options granted to the directors are set out above under "Share Option Schemes".
4. The interest represents the underlying shares in respect of the share options granted pursuant to the Post-IPO Option Scheme I. Details of the share options granted to the directors are set out above under "Share Option Schemes".
5. The interest comprises 35,000 shares and 60,000 underlying shares in respect of the share options granted pursuant to Post-IPO Option Scheme I. Details of the share options granted to the directors are set out above under "Share Option Schemes".

**(B) Long position in the shares in associated corporations**

<b>Name of director</b>	<b>Name of associated corporation</b>	<b>Nature of interest</b>	<b>Number of shares and class of shares held</b>	<b>Percentage of issued share capital</b>
Ma Huateng	Tencent Computer	Personal	RMB10,857,140 (registered capital)	54.29%
	Shiji Kaixuan	Personal	RMB5,971,427 (registered capital)	54.29%
Zhang Zhidong	Tencent Computer	Personal	RMB4,571,420 (registered capital)	22.86%
	Shiji Kaixuan	Personal	RMB2,514,281 (registered capital)	22.86%

Save as disclosed above, none of the directors or chief executive of the Company and their associates, had interests or short positions in any shares, underlying shares or debentures of the Company and its associated corporations as at 31 December 2010.

## CONNECTED TRANSACTIONS

Reference is made to the waiver granted by the Stock Exchange regarding the compliance with the applicable disclosure, reporting and shareholders' approval requirements under Chapter 14A of the Listing Rules when the Company was listed in June 2004. The Company's independent non-executive directors had reviewed the Structure Contracts (as defined in the section "Our History and Structure – Structure Contracts" of the IPO prospectus of the Company) and confirmed that the transactions carried out during the financial year had been entered into in accordance with the relevant provisions of the Structure Contracts and, had been operated so as to transfer by the date of this annual report Tencent Computer's and Shiji Kaixuan's Surplus Cash (as defined in the section "Our History and Structure – Structure Contracts" of the IPO prospectus of the Company) as at 31 December 2010 to Tencent Technology, Cyber Tianjin (formerly known as Shidai Zhaoyang Technology (Shenzhen) Company Limited in the IPO prospectus of the Company), Tencent Beijing, Cyber Shenzhen, Tencent Chengdu and Tencent Shanghai. The Company's independent non-executive directors had also confirmed that no dividends or other distributions had been made by Tencent Computer or Shiji Kaixuan and the New OPCOs to the holders of their equity interests and any new Structure Contracts entered into, renewed and/or cloned during the relevant financial period the terms of which are fair and reasonable so far as the Group was concerned and in the interests of the Company's shareholders as a whole. To this extent, similar Structure Contracts were entered into relating to the New OPCOs.

The Auditor had carried out procedures on the transactions pursuant to the Structure Contracts and had provided a letter to the Board confirming that such transactions had been approved by the Board and had been entered into, in all material respects, in accordance with the relevant Structure Contracts and had been operated so as to transfer the Surplus Cash of Tencent Computer, Shiji Kaixuan and the New OPCOs as at 31 December 2010 to the WFOEs and that no dividends or other distributions had been made by Tencent Computer or Shiji Kaixuan or the New OPCOs to the holders of their equity interests.

Transactions carried out during the year ended 31 December 2010, which have been eliminated in the consolidated financial statements of the Group, are set out as follows:

1. Pursuant to the TCS CFC, the parties shall co-operate in the provision of communications services. Tencent Technology and its affiliates shall allow Tencent Computer to use its and its affiliates' assets and to provide services to Tencent Computer. Tencent Computer shall transfer all of its Surplus Cash to Tencent Technology and its affiliates as consideration. The parties also established the TCS Co-operation Committee according to this agreement. During the year, other than the Structure Contracts mentioned below, Tencent Computer purchased technology amounting to approximately RMB121,000,000 from Tencent Technology, and software amounting to approximately RMB206,000 from Cyber Shenzhen. In addition, revenue sharing amounting to approximately RMB6,579,507,000, RMB2,101,610,000, RMB2,145,820,000, and RMB426,499,000 was paid or payable by Tencent Computer to Tencent Technology, Cyber Tianjin, Tencent Beijing, and Tencent Chengdu, respectively.
2. Pursuant to the SKT CFC, the parties shall co-operate in the provision of communications services. Cyber Tianjin and its affiliates shall allow Shiji Kaixuan to use its and its affiliates' assets and to provide services to Shiji Kaixuan. Shiji Kaixuan shall transfer all of its Surplus Cash to Cyber Tianjin and its affiliates as consideration. The parties also established the SKT Co-operation Committee according to this agreement. During the year, services fee amounting to approximately RMB50,948,000 was paid or payable by Shiji Kaixuan to Tencent Shanghai.
3. Pursuant to the amended and restated intellectual property transfer agreement dated 28 February 2004 entered into between Tencent Technology and Tencent Computer, Tencent Computer shall assign to Tencent Technology its principal present and future intellectual property rights, free from encumbrances (except for licences granted in the ordinary course of Tencent Computer's business) in consideration of Tencent Technology's undertaking to provide certain technology and information services to Tencent Computer. During the year, no intellectual property transfer was transacted under such arrangements, save as disclosed elsewhere in this section.
4. Pursuant to the intellectual property transfer agreement dated 28 February 2004 entered into between Cyber Tianjin and Shiji Kaixuan, Shiji Kaixuan shall assign to Cyber Tianjin its principal present and future intellectual property rights, free from encumbrance (except for licences granted in the ordinary course of Shiji Kaixuan's business) in consideration of Cyber Tianjin's undertaking to provide certain technology and information services to Shiji Kaixuan. During the year, no intellectual property transfer was transacted under such arrangements, save as disclosed elsewhere in this section.

5. Pursuant to the domain name licence agreement dated 28 February 2004 entered into between Tencent Technology, as licensor, and Tencent Computer, as licensee, Tencent Technology shall grant to Tencent Computer a non-exclusive license to use specified domain names against payment of annual royalties determined by the TCS Co-operation Committee within a range of percentages of Tencent Computer's annual revenues. During the year, no domain name license was transacted under such arrangements, save as disclosed elsewhere in this section.
6. Pursuant to the domain name licence agreement dated 28 February 2004 entered into between Tencent Technology, as licensor, and Shiji Kaixuan, as licensee, Tencent Technology shall grant Shiji Kaixuan a non-exclusive licence to use specified domain names against payment of annual royalties determined as a percentage of Shiji Kaixuan's annual revenues (which may be adjusted pursuant to the agreement or the SKT CFC). During the year, no domain name licence was transacted under such arrangements, save as disclosed elsewhere in this section.
7. Pursuant to the trademark licence agreement dated 28 February 2004 entered into between Tencent Technology, as licensor, and Tencent Computer, as licensee, Tencent Technology shall grant to Tencent Computer a non-exclusive licence to use specified trademarks against payment of annual royalties determined as a percentage of Tencent Computer's annual revenues (which may be adjusted pursuant to the agreement or the TCS CFC). During the year, no trademark licence was transacted under such arrangements, save as disclosed elsewhere in this section.
8. Pursuant to the trademark licence agreement dated 28 February 2004 entered into between Tencent Technology, as licensor, and Shiji Kaixuan, as licensee, Tencent Technology shall grant Shiji Kaixuan a non-exclusive licence to use specified trademarks against payment of annual royalties determined as a percentage of Shiji Kaixuan's annual revenues (which may be adjusted pursuant to the agreement or the SKT CFC). During the year, no trademark licence was transacted under such arrangements, save as disclosed elsewhere in this section.
9. Pursuant to the information consultancy services agreement dated 28 February 2004 entered into between Tencent Technology, as consultant, and Tencent Computer, Tencent Technology shall provide specified information consultancy services to Tencent Computer against payment of an annual consultancy service fee determined by the TCS Co-operation Committee within a range of percentages of Tencent Computer's annual revenues. During the year, no consultancy service was transacted under such arrangements, save as disclosed elsewhere in this section.

10. Pursuant to the technical consultancy services agreement dated 28 February 2004 entered into between Tencent Technology, as consultant, and Shiji Kaixuan, Tencent Technology shall provide specified technical consultancy services to Shiji Kaixuan against payment of an annual consultancy service fee determined by the SKT Co-operation Committee within a range of percentages of Shiji Kaixuan's annual revenues. During the year, no consultancy service was transacted under such arrangements, save as disclosed elsewhere in this section.
11. Pursuant to the co-operation framework agreement entered into between each of the New OPCOs and one of the WFOEs, the parties shall cooperate in the provision of communications services. For each agreement, the WFOEs shall allow the New OPCOs to use its and its affiliates' assets and provide services to the New OPCOs. The New OPCOs shall transfer all of its Surplus Cash to the WFOE and its affiliates as consideration. Co-operation committees have also been established according to these agreements. During the year, revenue sharing amounting to approximately RMB2,310,000, RMB2,596,000, and RMB158,000 was paid or payable by Beijing Emark to Tencent Technology, Cyber Tianjin, and Tencent Beijing, respectively. Revenue sharing amounting to approximately RMB123,240,000, RMB175,920,000, and RMB407,567,000 was paid or payable by Wang Dian to Tencent Technology, Cyber Tianjin, and Tencent Beijing, respectively. Revenue sharing amounting to approximately RMB38,351,000, RMB105,565,000, RMB49,447,000, and RMB261,277,000 was paid or payable by Beijing BIZCOM to Tencent Technology, Cyber Tianjin, Tencent Beijing, and Tencent Chengdu respectively. Revenue sharing amounting to approximately RMB2,840,000, RMB4,768,000, RMB16,472,000, and RMB17,870,000 was paid or payable by Beijing Starsinhand to Tencent Technology, Cyber Tianjin, Tencent Beijing, and Tencent Chengdu respectively. Revenue sharing amounting to approximately RMB26,000 and RMB21,000 was paid or payable by Guangzhou Yunxun to Tencent Technology and Tencent Beijing.

## INTERESTS OF SUBSTANTIAL SHAREHOLDERS

As at 31 December 2010, the following persons, other than the directors or chief executive of the Company, had an interest or short position in the shares or underlying shares in the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company under section 336 of the SFO, or who was, directly or indirectly, interested in 5% or more of the issued share capital of the Company:

### Long and short positions in the shares or underlying shares of the Company

Name of shareholder	Long/short position	Nature of interest/ Capacity	Number of shares/underlying shares held	Percentage of issued share capital
MIH China	Long position	Corporate (Note 1)	630,240,380	34.33%
Advance Data Services Limited	Long position	Corporate (Note 2)	204,892,880	11.16%
	Short position	Corporate (Note 2)	17,480,000	0.95%
ABSA Bank Limited	Long position	Corporate (Note 3)	185,000,000	10.08%
JPMorgan Chase & Co.	Long position	Beneficial owner	5,655,577	
		Investment manager	34,888,700	
		Custodian corporation/ Approved lending agent	51,354,694	
		Total (Note 4(i)):	91,898,971	5.01%
	Short position	Beneficial owner (Note 4(ii))	4,577,557	0.25%

Notes:

- As MIH China is wholly owned by Naspers Limited through its intermediary companies, MIH (Mauritius) Limited and MIH Holdings Limited. Naspers Limited, MIH (Mauritius) Limited and MIH Holdings Limited are deemed to be interested in the same block of 630,240,380 shares under Part XV of the SFO. Out of the 630,240,380 shares held by MIH China, 185,000,000 shares are pledged to ABSA Bank Limited, as referenced in Note 3 below.
- Advance Data Services Limited is wholly owned by Ma Huateng, who has interests in these shares as disclosed under the section of "Directors' Interests in Securities".

3. As ABSA Bank Limited has a security interest in 185,000,000 shares, which are held by MIH China, and ABSA Bank Limited is wholly owned by Barclays Bank PLC through its intermediary company, ABSA Group Limited, Barclays Bank PLC and ABSA Group Limited are deemed to be interested in the same block of 185,000,000 shares under Part XV of the SFO.
4. (i) Such long position includes derivative interests in 513,260 underlying shares of the Company of which 100 underlying shares are derived from listed and physically settled derivatives and 513,160 underlying shares are derived from unlisted and physically settled derivatives. It also includes 51,354,694 shares in lending pool.  
  
(ii) Such short position includes derivative interests in 1,376,704 underlying shares of the Company of which 47,480 shares are derived from listed and cash settled derivatives, 1,029,224 underlying shares are derived from unlisted and physically settled derivatives and 300,000 underlying shares are derived from unlisted and cash settled derivatives.

Save as disclosed above, the Company had not been notified of any other person (other than a director or chief executive of the Company) who, as at 31 December 2010, had an interest or short position in the shares and underlying shares in the Company as recorded in the register required to be kept under section 336 of the SFO.

## MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company was entered into or existed during the year.

## MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2010, the five largest customers of the Group accounted for approximately 15.89% of the Group's total revenues while the largest customer of the Group accounted for approximately 4.89% of the Group's total revenues. In addition, for the year ended 31 December 2010, the five largest suppliers of the Group accounted for approximately 45.51% of the Group's total purchases while the largest supplier of the Group accounted for approximately 13.48% of the Group's total purchases.

None of the directors, their associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's issued capital) had an interest in any of the major customers or suppliers noted above.

## AUDIT COMMITTEE

The Audit Committee has reviewed the Group's audited financial statements for the year ended 31 December 2010. The Audit Committee has also reviewed the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial reporting matters.

## COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

Save as disclosed in this annual report, none of the directors of the Company is aware of any information which would reasonably indicate that the Company has not, for any part of the year ended 31 December 2010, complied with the CG Code.

As to the deviation from code provisions A.2.1 and A.4.2 of the CG Code, the Board will continue to review the current structure from time to time and shall make necessary changes when appropriate and inform the shareholders accordingly.

## ADOPTION OF CODE OF CONDUCT REGARDING DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding directors' securities transactions on terms no less exacting than the required standard set out in the Model Code. The directors have complied with such code of conduct throughout the financial year covered by this annual report.

## PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Articles of Association, or the laws of Cayman Islands, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

## EMPLOYEE AND REMUNERATION POLICIES

As at 31 December 2010, the Group had 10,692 employees (2009: 7,515), most of whom were based in Shenzhen, the PRC. The number of employees employed by the Group varies from time to time depending on needs and employees are remunerated based on industry practice.

The remuneration policy and package of the Group's employees are periodically reviewed. Apart from pension funds and in-house training programmes, discretionary bonuses, share awards and share options may be awarded to employees according to the assessment of individual performance.

The total remuneration cost (including capitalised remuneration cost) incurred by the Group for the year ended 31 December 2010 was RMB3,146.1 million (2009: RMB2,136.8 million).



## **SUFFICIENCY OF PUBLIC FLOAT**

Based on information that is publicly available to the Company and within the knowledge of its directors, the directors confirm that the Company has maintained during the year the amount of public float as required under the Listing Rules.

## **CLOSURE OF REGISTER OF MEMBERS**

The register of members will be closed from Thursday, 5 May 2011 to Wednesday, 11 May 2011 both days inclusive, during which period no transfer of shares will be registered. In order to be entitled to attend and vote at the forthcoming AGM and to qualify for the proposed final dividend, all duly completed transfer forms accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong for registration not later than 4:30 p.m. on Wednesday, 4 May 2011.

## **AUDITOR**

The financial statements have been audited by PricewaterhouseCoopers who will retire and, being eligible, offer themselves for re-appointment at the forthcoming AGM.

On behalf of the Board

**Ma Huateng**

*Chairman*

Hong Kong, 16 March 2011

# Corporate Governance Report

The Company applied the principles and complied with all code provisions of the CG Code with the deviations in respect of the segregation of the role of the chairman and CEO and the provision regarding the retirement and re-election of directors. The following summarises the Company's corporate governance practices and explains the deviations from the CG Code.

## A. DIRECTORS

### 1. The Board

The Board assumes responsibility for leadership and control of the Company, is collectively responsible for promoting the success of the Company by directing and supervising the Company's affairs and takes decisions objectively in the interests of the Company.

- i) The Board meets quarterly for considering and approving the financial results of the Company and additional Board meeting will be held whenever necessary.
- ii) Attending directors, in person or through electronic means of communication, participated actively in Board meetings. Questions were asked and clarified before any final decision was made.
- iii) Apart from physical meetings, the Board considers and consents through the circulation of written resolutions whenever necessary.
- iv) Draft notices and agendas are circulated to the Board at least 14 days before the day of Board meeting for comments and inclusion of any matters which the Board deems necessary before final notices and agendas are distributed.
- v) The dates of regular Board meetings are proposed, considered and determined by the Board well before the meeting date. For any ad hoc Board meetings or Board committee meetings, Board members were given as much notice as is reasonable and practicable in the circumstances.
- vi) Chief officers are usually invited to attend Board meetings. Other executives will be invited to Board meetings from time to time for making presentations or answering Board's enquiries.



- vii) There exists open atmosphere for the directors to contribute alternative views at meetings and major decisions will only be taken after a full discussion at the Board meetings.
- viii) In every Board meeting, each director declared his interest in the matters to be considered by the Board.
- ix) The directors will abstain from voting on any matters in which they have an interest.
- x) All directors have access to the advice and service of the legal counsel and the company secretary to ensure that all necessary Board procedures and applicable rules and regulations are followed.
- xi) Within reasonable time after the Board meeting date, draft minutes of Board meetings, including details of concerns raised by the directors or dissenting views expressed, are circulated to the Board members, who attended the meeting, for comments before final minutes are confirmed and circulated to all members of the Board for records.
- xii) Minutes of the Board meetings and meetings of the Board committees are kept by the company secretary and such minutes are open for inspection by any director at any time on reasonable notice.
- xiii) Whenever necessary and upon request by the Board, the company secretary will coordinate to seek independent professional advice at the expense of the Company. Advices from external legal advisors, financial advisers and valuers as well as tax advisors are made available to the Board for them to make informed decision.
- xiv) Insurance for the liabilities of the directors and officers of the Company is in place.

## 2. Chairman and CEO

The management of the Board and the day-to-day management of the business of the Company should be separate and a balance of power and authority should be ensured. The roles of the chairman and CEO should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and CEO should be clearly established and set out in writing.

*Note: CG Code A.2.1 is deviated with the following considered reasons.*

- i) Mr Ma Huateng serves as the Chairman and CEO and CG Code A.2.1 is deviated:

The Board considers that an abrupt segregation of the role of the Chairman and CEO will involve a sharing of power and authority of the existing structure which might create turmoil on the daily operations of, and extra cost to, the Company. In addition, the Chairman and CEO must be proficient in IT knowledge and be sensitive to the fast and myriad changes in the business in order to lead the Company to react swiftly to any

market change, make timely decisions in this fast moving IT industry and ensure the sustainable development of the Company. In addition, Mr Lau Chi Ping Martin, the President and an executive director of the Company, assists the CEO to manage the daily operations of the Company. Notwithstanding the above, the Board will review the current structure from time to time and shall make necessary amendments at the appropriate time.

- ii) There are separate roles and responsibilities of the Chairman and CEO set out in writing and approved by the Board.
- iii) Relevant and updated Board information is circulated to the Board to review and consider at least 3 days before the meeting is held.
- iv) The directors are encouraged to make a full and active contribution to the Board's affairs and the Board acts in the best interests of the Company.
- v) The directors, whether executive, non-executive or independent non-executive, communicate among themselves whenever necessary.
- vi) Non-executive directors, including the independent non-executive directors, are invited to share their experience with the executive directors on matters for which views from different angles will be considered.

### **3. Board composition**

There is a balance of skills and experience appropriate for the requirements of the business of the Company. The majority of the Board is non-executive directors (including the independent non-executive directors) so that there is a strong independent element on the Board, which can effectively exercise independent judgement and their views and decisions carry weight in the Board. Changes in the composition of the Board, if any, can be managed without undue disruption.

- i) There are three independent non-executive directors, representing over one-third of the Board, three executive directors and two non-executive directors appointed for the Company.
- ii) In relation to the Internet market in which the Company operates, the wide range of business, financial and management experience of the Board members provides an appropriate balance of skills and experience.
- iii) A list of directors and their respective biographies are set out on pages 34 to 36 of this annual report.
- iv) All the directors are expressly identified, whether executive, non-executive and independent non-executive, as such in all corporate communications that disclose the names of directors.

#### 4. Appointments, re-election and removal

A formal, considered and transparent procedure for the appointment of new directors to the Board should be established. All directors should be subject to re-election at regular intervals and the resignation or removal of any director should be explained with reasons.

*Note: CG Code A.4.2 is deviated with the following considered reasons.*

- i) Except for Mr Ma Huateng, Chairman of the Company, every director is subject to retirement by rotation at least once every three years and CG Code A.4.2 is deviated. According to the Articles of Association, one-third of the directors for the time being (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) shall retire from office by rotation, provided that the Chairman of the Board shall not, whilst holding such office, be subject to retirement by rotation or be taken into account in determining the number of directors to retire in each year. The Chairman of the Board is one of the core founders of the Company and plays a leading role in the growth and development of the Company and his continuing presence adds positive value and assurance to the sustainable development of the Company. The Board considers that the existing provision of retirement and re-election in the Articles of Association, which have been in operation for a number of years, shall not have a material impact on the operation of the Company as a whole.

In compliance with the provisions in the Articles of Association, in the 2010 annual general meeting, two directors retired and were re-elected and the re-election of Mr Lau Chi Ping Martin, who was re-elected in 2007, was not considered in the 2010 annual general meeting and his re-election will be considered in subsequent AGM.

Notwithstanding the above, the Board will review the current provision in the Articles of Association from time to time and shall make necessary amendments at the appropriate time.

- ii) Non-executive directors, including the independent non-executive directors, are appointed with specific terms for one year, subject to the retirement and re-election provisions of the Articles of Association.
- iii) The directors appointed to fill a casual vacancy are subject to election by the shareholders at the first general meeting after their appointment.
- iv) Biographical details of the directors to be re-elected are included in the circulars sent to the shareholders to enable the shareholders to make an informed decision on the respective re-election.

v) Nomination to the Board

- The Board determines the selection, orientation and evaluation of the directors.
- The Board identifies and evaluates the candidates for appointment as directors. Following the appointments of new directors to the Board, orientation programmes will be arranged to facilitate their understanding of the Group.
- There is no nomination committee established for the Company and the Board will review the structure from time to time and establish a nomination committee when necessary.

## 5. Responsibilities of directors

Every director is required to keep abreast of his responsibilities as a director of the Company and of the conduct, business activities and development of the Company. Given the essential unitary nature of the Board, non-executive directors (including the independent non-executive directors) have the same duties of care and skill and fiduciary duties as executive directors.

i) The Board has the following primary responsibilities:

- determines the Group's mission, provides strategic direction to the Group and is responsible for the approval of strategic plans;
- approves the annual business plan and budget proposed by management and financial performance updates are presented to the Board on a quarterly basis;
- retains full and effective control over the Group and monitors management with regard to the implementation of the approved annual budget and business plan;
- establishes Board sub-committees with clear terms of reference and responsibilities as appropriate;
- all policy matters of the Group, material transactions or transactions where there is conflict of interests are reserved for the Board's decisions; and
- defines levels of delegation in respect of specific matters, with required authority to board subcommittees and management.

ii) Every newly appointed director has received a comprehensive, formal and tailored induction on the first occasion of his appointment and a director's handbook to ensure that he was fully aware of his responsibilities under the Listing Rules, applicable legal requirements and other regulatory requirements and the business and governance policies of the Company.

iii) The legal counsel of the Group updates the Board in relation to change in legal obligation of directors of listed companies from time to time.

- iv) Non-executive directors and independent non-executive directors participate in the Board meetings actively, raise queries and clarify outstanding issues, if any, before their approvals to proposals are granted.
- v) The Board has delegated the day-to-day responsibility to management which includes the chief officers, President and the Executive Vice-Presidents. In addition, new members are recruited to management for strengthening the daily operation and meeting the future challenges, if required.
- vi) Management meets fortnightly and is responsible for the formulation of policies for consideration of the Board, and in carrying out and implementing the policies laid down by the Board. Management is delegated with the authority from the Board to administer, enforce, interpret and supervise compliance with those parts of the internal rules and operational procedures of its subsidiaries, other than the Listing Rules, and conduct regular reviews of the same, recommend, and advise on appropriate amendments which do not involve policy matters for the approval by the Boards of the respective subsidiaries. Management reports to the Board on a regular basis and communicates with the Board whenever required.
- vii) A director will abstain from voting on matters in which he has an interest.
- viii) No executive directors are member of the Audit Committee and the Remuneration Committee, which are composed of non-executive and independent non-executive directors only.
- ix) The directors attended Board meetings in person or through electronic means of communication.
- x) The attendance records of all Board meetings held in 2010 are set out below:

<b>Number of Board meetings</b>	<b>6</b>
<i>Executive Directors</i>	
Ma Huateng (Chairman)	6/6
Lau Chi Ping Martin	6/6
Zhang Zhidong	6/6
<i>Non-Executive Directors</i>	
Antonie Andries Roux	6/6
Charles St Leger Searle	6/6
<i>Independent Non-Executive Directors</i>	
Li Dong Sheng	2/6
Iain Ferguson Bruce	6/6
Ian Charles Stone	6/6

- xi) Model Code
  - The Company has adopted the Model Code.
  - All directors have confirmed, following specific enquiry by the Company, full compliance with the Model Code throughout the year 2010.
  - The Board has adopted a staff code for their dealing in the securities of the Company on no less exacting terms than the Model Code for staff who is likely to be in possession of unpublished price sensitive information in relation to the Company or its securities.
  - Details of securities interests in the Company held by the directors are set out in the Directors' Report on pages 37 to 38 of this annual report.
- xii) Each director updates the Company quarterly regarding their directorships in other companies.

## 6. Supply of and access to information

The directors should be provided in a timely manner with appropriate information in such form and of such quality as will enable them to make an informed decision and to discharge their duties and responsibilities as directors of the Company.

- i) For regular Board or Board committee meetings, Board papers that contain analysis and background materials together with the agenda, are sent to all the directors at least three days before the date of the Board meeting or Board committee meeting.
- ii) Management manages to supply the Board and its committees with adequate, complete and reliable information in a timely manner to enable the Board and its committees to make informed decisions.
- iii) Where queries are raised by directors, steps will be taken to respond as promptly and fully as possible.
- iv) The Board and each director have separate and independent access to management of the Company.

## B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

### 1. The level and make-up of remuneration and disclosure

Information relating to the remuneration policy and other remuneration related matters of the directors should be disclosed. There should be formal and transparent procedure for setting policy on the remuneration for executive directors and for fixing the remuneration packages for all directors. Level of remuneration should be sufficient to attract and retain the directors needed to run the Company successfully. No director should be involved in deciding his own remuneration.

- i) The Remuneration Committee, of which Mr Antonie Andries Roux, a non-executive director and Messrs Li Dong Sheng and Ian Charles Stone, independent non-executive directors, are members, has been established.
- ii) The Remuneration Committee has been established with specific written terms of reference which deal clearly with its authority and duties.
- iii) The terms of reference of the Remuneration Committee are posted on the Company Website.
- iv) The principal responsibilities of the Remuneration Committee include formulation of the remuneration policy, reviewing and recommending to the Board the annual remuneration policy, and determination of the remuneration of the Board and management of the Company. The objective of the remuneration policy is to ensure that the Company is able to attract, retain, and motivate a high-caliber team which is essential to the success of the Company.
- v) The Remuneration Committee considers and benchmarks the prevailing market conditions, labour market conditions and refers to reports from professional human resources bodies in determining the remuneration packages for the executive directors, which are generally linked to corporate and individual performance.
- vi) No director can determine his own remuneration.
- vii) The chairman of the Remuneration Committee reports findings and recommendations to the Board after each Remuneration Committee meeting.
- viii) Details of the remuneration of the directors for the year ended 31 December 2010 are set out in Note 36 to the consolidated financial statements.
- ix) The Remuneration Committee is provided with sufficient resources to discharge its duties.

## 2. Major Work done by the Remuneration Committee in 2010

- i) Reviewed the remuneration policy of the Company and determined the remuneration packages for the Board and the general staff by benchmarking similar positions in peer companies in the industry so as to make sure that offers from the Company remain competitive in the labour market for recruitment of new staff and retaining existing core staff.
- ii) Reviewed the implementation and execution of the compensation award schemes of the Company.
- iii) Considered and approved the compensation awards to be granted to management, which had been made in recognition of their past performance and contribution and to motivate their future performance for the sustained growth and development of the Company.
- iv) The attendance of individual members at the Remuneration Committee meetings held in 2010 is set out below:

<b>Number of meetings</b>	<b>3</b>
<i>Non-Executive Director</i>	
Antonie Andries Roux (Chairman)	3/3
<i>Independent Non-Executive Directors</i>	
Li Dong Sheng	0/3
Ian Charles Stone	3/3

## C. ACCOUNTABILITY AND AUDIT

### 1. Financial reporting

The Board should present a balanced, clear and comprehensible assessment of the performance, position and prospects of the Company.

- i) In relation to the approval of the financial results of the Company, an Audit Committee meeting, in which the financial information, the internal audit and internal control affairs and other related matters will be considered and discussed, will be held usually one week before the date of the Board meeting, in which the draft financial information will be considered and approved, when appropriate, by the Board.
- ii) In the Audit Committee meetings, queries raised by the members will be clarified, followed up and recorded. Solutions to these queries will be provided to the Audit Committee within reasonable time.

- iii) Updated financial information and explanation, which will enable the Board to make an informed assessment of the financial and other information of the Company, will be sent to the Audit Committee and the Board at least three days before the date of the respective meeting.
- iv) The chairman of the Audit Committee reports to the Board regarding the discussion and decisions made in Audit Committee meetings and informs the Board if there is any matter of which the Board should be aware.
- v) A report to the Board will be signed by the chairman of the Audit Committee by authority of the Audit Committee and will be sent to the Board for reference and information before the date of the Board meeting.
- vi) The Board takes responsibility to present a balanced, clear and understandable assessment on annual reports, interim reports and quarterly announcements, price sensitive announcements and other disclosures required under the Listing Rules and reports to regulators.
- vii) The Board is not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue on a going concern basis.
- viii) The Company has appointed external auditor, PricewaterhouseCoopers, to perform reviews on its interim financial statements and an audit of its annual financial statements which are prepared in accordance with the International Financial Reporting Standards.
- ix) The Company announces and publishes its annual and interim results within three months and two months respectively after the end of the relevant periods.

## 2. Internal controls

The Board should ensure that the Company maintains sound and effective internal controls to safeguard the shareholders' investment and the Company's assets.

- i) The Board has the ultimate responsibility for the Group's internal control system.
- ii) The Company has various approval matrices, which are applicable to different managerial levels and are subject to review from time to time. These matrices aim to:
  - help the achievement of business objectives, safeguard assets against unauthorised use or disposition;
  - ensure the maintenance of proper accounting records for the provision of reliable financial information for internal use or for publication; and
  - ensure compliance with relevant legislation and regulations.

- iii) The key procedures that the Board established to provide effective internal controls are as follows:
- A distinct organisational structure exists with defined lines of authority and control responsibilities. Relevant division or department heads are involved in preparing the strategic plan which lays down the corporate strategies to be pursued in the following year for achieving the annual operational and financial targets. Both the strategic plan and the annual operating plan lay down the foundation for the preparation of the annual budget by which resources are allocated in accordance with identified and prioritised business opportunities. The annual operating plan and budget are approved by the Board on an annual basis.
  - Variances against budgets are analysed, and explained, and appropriate actions are taken, if necessary, to rectify deficiencies noted.
  - The IA performs independent reviews of the operational areas and presents the findings and the prospective audit plan to the Audit Committee on a quarterly basis.
  - The IC facilitates management to ensure controls in operational processes are efficient and effective, and regularly communicates to the Audit Committee.
- iv) Reviews of different business and functional operations and activities will be conducted by the IA with audit resources being focused on higher risk areas. Ad hoc reviews will also be conducted by the IA on areas of concern identified by management.
- v) Division or department heads will be notified of the deficiencies noted for rectification, and the IA will follow up with the implementation of audit recommendations. Significant internal control weaknesses are brought to the attention of the Audit Committee and, if necessary, to the Board, and to management for remedial actions.
- vi) The IC provides advisory of setting and implementing policies, process and controls on key and high risk business areas based on the COSO Framework.
- vii) In 2010, the Company engaged a professional consulting firm to perform a high level review of the Group's existing internal controls by benchmarking the COSO Framework, as well as performing an internal control review of one significant business unit. Recommendations with prioritisation have been proposed and management has developed a remedial plan to improve the internal control procedures.
- viii) Based on the internal control review report of the professional consulting firm and the prevailing system and information, no material discrepancies have been found.

- ix) Mr Lo John Shek Hon, Deputy Chief Financial Officer of the Group, has the overall responsibilities for finance and accounting functions of the Group. He is a Fellow of CPA Australia, a Fellow of Hong Kong Institute of Certified Public Accountants and a Member of the Chartered Institute of Management Accountants. A majority of the managers of the Finance Division of the Company are members of The Chinese Institute of Certified Public Accountants or Association of Chartered Certified Accountants or equivalent approved society or Chartered Financial Analysts. Staff of the Finance Division are required to attend relevant training programmes provided by professional accounting firms arranged by the Group from time to time. The Board considers that the resources, qualifications and experience of staff of the Finance Division, their training programmes and budget are adequate.
- x) The Board, with the recommendation of the Audit Committee, is satisfied that the Group has complied with the provisions regarding internal controls as required under the CG Code. The Board is not aware of any significant issues that would have an adverse impact on the effectiveness and adequacy of the internal control system.

### 3. Audit Committee

The Board should establish formal and transparent arrangements for considering how it will apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the auditor of the Company. The Audit Committee established pursuant to the Listing Rules should have clear terms of reference.

- i) Among the three members of the Audit Committee, namely Mr Iain Ferguson Bruce (Chairman) and Messrs Ian Charles Stone and Charles St Leger Searle, two members have accounting qualifications. Mr Bruce is a member of the Institute of Chartered Accountants of Scotland and is a fellow of the Hong Kong Institute of Certified Public Accountants and Mr Searle is a member of the Institute of Chartered Accountants in Australia.
- ii) Two out of the three members of the Audit Committee are independent non-executive directors and no member of the Audit Committee is a former partner of the existing Auditor.
- iii) Members of the Audit Committee have unrestricted access to the external auditor and internal auditor. Senior representatives of the external auditor and members of management are invited to attend the meetings when necessary.
- iv) Draft notices and agendas of Audit Committee meetings are circulated to all members of the Audit Committee for comments and inclusion of any matters, which the Audit Committee deems necessary, before final notice and agendas are circulated.
- v) Within reasonable time after the Audit Committee meetings, draft minutes of the meetings are circulated to the members of the Audit Committee, who attended the meeting, for comments before final minutes are confirmed and circulated to all members of the Audit Committee for records.

- vi) Final minutes of the Audit Committee meetings are kept at the office of the company secretary.
- vii) The terms of reference of the Audit Committee are on no less exacting terms than the requirements set out in CG Code C.3.3.
- viii) The terms of reference of the Audit Committee are made available on the Company Website.
- ix) The Audit Committee is provided with sufficient resources to discharge its duties.
- x) In the absence of management, the Audit Committee members have a separate meeting with the auditor of the Company at least once a year.
- xi) In 2010, the fees paid or payable to the Company's external auditor for non-audit related activities amounted to approximately RMB3,564,000.
- xii) The principal responsibilities of and work done by the Audit Committee in 2010 include:
  - To serve as a focal point for communication between other directors, the external auditor and internal auditor in respect of the duties relating to financial and other reporting, internal controls, external and internal audits, and such other matters as the Board determines from time to time.
  - To assist the Board in fulfilling its responsibilities by providing an independent review and supervision of financial reporting.
  - To review the scope and results of internal audit procedures, ensure coordination between the internal and external auditor and ensure that the internal audit function is adequately resourced and has appropriate standing within the Group.
  - To review, approve and monitor the progress of the annual audit plans of both the external auditor and internal auditor.
  - To review and consider updates from external auditor, the IA and the IC, of which compliance and corporate governance measures and practices will usually be covered, on a quarterly basis.
  - To review and consider the adequacy of the supporting resources provided to the IA and the IC.
  - To review the appointment of external auditor on an annual basis including a review of the audit scope and approval of the audit fees.
  - To review the annual and interim financial statements prior to their approval by the Board, and recommend application of accounting policies and changes to financial reporting requirements.

- To ensure continuing auditor objectivity and to safeguard independence of the external auditor. The Audit Committee has granted authorisation of non-audit services for which the external auditor may provide.

xiii) The attendance of individual members at the Audit Committee meetings held in 2010 is set out below:

<b>Number of meetings</b>	<b>5</b>
<i>Independent Non-Executive Directors</i>	
Iain Ferguson Bruce (Chairman)	5/5
Ian Charles Stone	5/5
<i>Non-Executive Director</i>	
Charles St Leger Searle	5/5

## D. DELEGATION BY THE BOARD

### 1. Management functions

The Company should have a formal schedule of matters specifically reserved to the Board for its decision. The Board should give clear directions to the management team as to the matters that must be approved by the Board before decisions are made on behalf of the Company.

- i) The Board delegates authorities to management in accordance with the prevailing approval matrices of the Group, which are reviewed and revised on a timely basis and whenever necessary. Management manages the operation of the Group in accordance with the prevailing approval matrices of the Group and for transactions which are outside the limits indicated in the approval matrices, management will report back to and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Company.
- ii) The Board meets at least on a quarterly basis and is updated on the recent development of the Group and its outlook in future in each Board meeting.

### 2. Board committees

Board committees should be formed with specific written terms of reference which deal clearly with the authorities and duties of the committees.

- i) The Board establishes several Board committees, which include the Audit Committee and the Remuneration Committee, all the members of which are members of the Board.

- ii) The Audit Committee, the Remuneration Committee and the Investment Committee are established with terms of reference, which are prepared based on the relevant legal and regulatory requirements and as reviewed by the Board from time to time, to enable such committees to discharge their function properly.
- iii) The terms of references of the Audit Committee and the Remuneration Committee are posted on the Company Website.
- iv) Chairmen of the Audit Committee and Remuneration Committee update the Board in Board meetings regarding discussion and decisions made in previous meetings of the respective Committee.
- v) Endorsement of relevant Board committees is available for the Board to make informed decision.

## **E. COMMUNICATION WITH SHAREHOLDERS**

### **1. Effective communication**

The Board should endeavour to maintain an on-going dialogue with the shareholders and in particular, use annual general meetings or other general meetings to communicate with the shareholders and encourage their participation.

- i) The 2010 annual general meeting of the shareholders had been held in May 2010.
- ii) Notice and circular regarding the matters to be dealt with in the 2010 annual general meeting, prepared in accordance with the applicable rules and regulations, were sent to the shareholders timely.
- iii) Chairmen of the Audit Committee and the Remuneration Committee attended the shareholders' meetings in 2010.
- iv) In the 2010 annual general meeting, the shareholders were encouraged to clear their queries regarding the matters to be dealt with in the meetings and separate resolutions were put to vote by poll by the shareholders.
- v) A question and answer session was in place for the shareholders to communicate with management openly.

### **2. Voting by poll**

The Company should ensure that the shareholders are familiar with the detailed procedures for conducting a poll.

- i) At the commencement of the annual general meeting, detailed procedures for conducting a poll have been explained.
- ii) An external scrutineer has been appointed to monitor and count the votes cast by poll at the annual general meeting.
- iii) Questions from the shareholders regarding voting by way of a poll, if any, have been answered before the poll voting started.

## INDEPENDENT AUDITOR'S REPORT



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**TO THE SHAREHOLDERS OF TENCENT HOLDINGS LIMITED**

(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Tencent Holdings Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 64 to 189, which comprise the consolidated and company statements of financial position as at 31 December 2010, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

**DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS**

The directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**AUDITOR'S RESPONSIBILITY**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

## INDEPENDENT AUDITOR'S REPORT

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2010, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

### OTHER MATTERS

This report, including the opinion, has been prepared for and only for you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### **PricewaterhouseCoopers**

Certified Public Accountants

Hong Kong, 16 March 2011

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

As at 31 December 2010

		As at 31 December	
		2010	2009
		RMB'000	RMB'000
	Note		
<b>ASSETS</b>			
<b>Non-current assets</b>			
Fixed assets	6	<b>3,292,828</b>	2,517,202
Construction in progress	7	<b>386,943</b>	105,771
Investment properties	8	<b>37,229</b>	68,025
Land use rights	9	<b>229,890</b>	35,296
Intangible assets	10	<b>572,981</b>	268,713
Investment in associates	12	<b>1,070,633</b>	477,622
Investment in a jointly controlled entity	13	<b>74,542</b>	–
Deferred income tax assets	30	<b>219,019</b>	301,016
Held-to-maturity investments	15	–	341,410
Available-for-sale financial assets	16	<b>4,126,878</b>	153,462
Prepayments, deposits and other assets	18	<b>445,430</b>	80,306
		<b>10,456,373</b>	4,348,823
<b>Current assets</b>			
Accounts receivable	17	<b>1,715,412</b>	1,229,436
Prepayments, deposits and other assets	18	<b>487,872</b>	373,642
Term deposits with initial term of over three months	19	<b>11,725,743</b>	5,310,168
Restricted cash	28	<b>1,036,457</b>	200,000
Cash and cash equivalents	20	<b>10,408,257</b>	6,043,696
		<b>25,373,741</b>	13,156,942
<b>Total assets</b>		<b>35,830,114</b>	17,505,765

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

		As at 31 December	
		2010	2009
		RMB'000	RMB'000
<b>EQUITY</b>			
<b>Equity attributable to the Company's equity holders</b>			
Share capital	21	198	197
Share premium	21	1,100,302	1,244,425
Shares held for share award scheme	21	(258,137)	(123,767)
Share-based compensation reserve	21	1,199,663	703,563
Other reserves	22	1,919,695	(166,364)
Retained earnings		17,795,225	10,520,453
		<b>21,756,946</b>	<b>12,178,507</b>
<b>Non-controlling interests</b>		<b>83,912</b>	<b>120,146</b>
<b>Total equity</b>		<b>21,840,858</b>	<b>12,298,653</b>
<b>LIABILITIES</b>			
<b>Non-current liabilities</b>			
Deferred income tax liabilities	30	967,211	369,983
Long-term payables	27	–	274,050
		<b>967,211</b>	<b>644,033</b>

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

As at 31 December 2010

		<b>As at 31 December</b>	
		<b>2010</b>	2009
		<b>RMB'000</b>	RMB'000
	Note		
<b>Current liabilities</b>			
Accounts payable	24	<b>1,380,464</b>	696,511
Other payables and accruals	25	<b>2,997,808</b>	1,626,051
Derivative financial instruments	26	<b>17,964</b>	–
Short-term bank borrowings	28	<b>5,298,947</b>	202,322
Current income tax liabilities	39(a)	<b>341,103</b>	85,216
Other tax liabilities	39(b)	<b>225,188</b>	216,978
Deferred revenue	29	<b>2,760,571</b>	1,736,001
		<hr/> <b>13,022,045</b> <hr/>	<hr/> 4,563,079 <hr/>
<b>Total liabilities</b>		<hr/> <b>13,989,256</b> <hr/>	<hr/> 5,207,112 <hr/>
<b>Total equity and liabilities</b>		<hr/> <b>35,830,114</b> <hr/> <hr/>	<hr/> 17,505,765 <hr/> <hr/>
<b>Net current assets</b>		<hr/> <b>12,351,696</b> <hr/> <hr/>	<hr/> 8,593,863 <hr/> <hr/>
<b>Total assets less current liabilities</b>		<hr/> <b>22,808,069</b> <hr/> <hr/>	<hr/> 12,942,686 <hr/> <hr/>

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 64 to 189 were approved by the Board of Directors on 16 March 2011 and were signed on its behalf.

**Ma Huateng**  
*Director*

**Zhang Zhidong**  
*Director*

**STATEMENT OF FINANCIAL POSITION - THE COMPANY**

As at 31 December 2010

		As at 31 December	
		2010	2009
		RMB'000	RMB'000
	Note		
<b>ASSETS</b>			
<b>Non-current assets</b>			
Fixed assets		342	445
Intangible assets		4,809	3,245
Investments in subsidiaries	11(a)	2,834,852	1,981,736
Available-for-sale financial assets		–	14,758
Contribution to Share Scheme Trust	11(c)	287	794
Amounts due from subsidiaries	11(b)	–	341,410
		<u>2,840,290</u>	<u>2,342,388</u>
<b>Current assets</b>			
Amounts due from subsidiaries	11(b)	708,074	1,060,822
Prepayments, deposits and other receivables		4,584	8,349
Term deposits with initial term of over three months	19	635	–
Cash and cash equivalents	20	237,525	102,081
		<u>950,818</u>	<u>1,171,252</u>
<b>Total assets</b>		<u><u>3,791,108</u></u>	<u><u>3,513,640</u></u>
<b>EQUITY</b>			
<b>Equity attributable to the Company's equity holders</b>			
Share capital	21	198	197
Share premium	21	1,100,302	1,244,425
Shares held for share award scheme	21	(258,137)	(123,767)
Share-based compensation reserve	21	1,199,663	703,563
(Accumulated deficit)/retained earnings		(140,999)	557,521
<b>Total equity</b>		<u><u>1,901,027</u></u>	<u><u>2,381,939</u></u>

## STATEMENT OF FINANCIAL POSITION - THE COMPANY

As at 31 December 2010

		As at 31 December	
		2010	2009
		RMB'000	RMB'000
	Note		
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Amounts due to subsidiaries	11(b)	1,833,802	1,107,184
Other payables and accruals		56,279	24,517
		<u>1,890,081</u>	<u>1,131,701</u>
<b>Total equity and liabilities</b>		<u><b>3,791,108</b></u>	<u>3,513,640</u>
<b>Net current (liabilities)/assets</b>		<u><b>(939,263)</b></u>	<u>39,551</u>
<b>Total assets less current liabilities</b>		<u><b>1,901,027</b></u>	<u>2,381,939</u>

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 64 to 189 were approved by the Board of Directors on 16 March 2011 and were signed on its behalf.

**Ma Huateng**  
*Director*

**Zhang Zhidong**  
*Director*

**CONSOLIDATED INCOME STATEMENT**

For the year ended 31 December 2010

		Year ended 31 December	
		2010	2009
		RMB'000	RMB'000
	Note		
<b>Revenues</b>			
Internet value-added services		15,482,301	9,530,711
Mobile and telecommunications value-added services		2,715,931	1,905,599
Online advertising		1,372,522	962,171
Others		75,277	41,479
	5	<u>19,646,031</u>	<u>12,439,960</u>
Cost of revenues	31, 34	<u>(6,320,200)</u>	<u>(3,889,468)</u>
<b>Gross profit</b>		<b>13,325,831</b>	8,550,492
Interest income	32	255,922	136,014
Other gains/(losses), net	33	38,056	(58,213)
Selling and marketing expenses	34	(945,370)	(581,468)
General and administrative expenses	34	<u>(2,836,226)</u>	<u>(2,026,347)</u>
<b>Operating profit</b>		<b>9,838,213</b>	6,020,478
Finance costs, net	38	(838)	(1,953)
Share of profit of associates		72,359	22,206
Share of profit of a jointly controlled entity		3,399	–
<b>Profit before income tax</b>		<b>9,913,133</b>	6,040,731
Income tax expense	39(a)	<u>(1,797,924)</u>	<u>(819,120)</u>
<b>Profit for the year</b>		<b><u>8,115,209</u></b>	<b><u>5,221,611</u></b>
<b>Attributable to:</b>			
Equity holders of the Company		8,053,625	5,155,646
Non-controlling interests		<u>61,584</u>	<u>65,965</u>
		<b><u>8,115,209</u></b>	<b><u>5,221,611</u></b>

**CONSOLIDATED INCOME STATEMENT**

For the year ended 31 December 2010

		<b>Year ended 31 December</b>	
		<b>2010</b>	2009
		<b>RMB'000</b>	RMB'000
	Note		
<b>Earnings per share for profit attributable to equity holders of the Company during the year (expressed in RMB per share)</b>			
– basic	41(a)	<b>4.432</b>	2.862
– diluted	41(b)	<b>4.328</b>	2.791
<b>Dividend per share</b>			
Final dividend proposed	42	<b>HKD0.55</b>	HKD0.40

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2010

	Year ended 31 December	
	2010 RMB'000	2009 RMB'000
<b>Profit for the year</b>	<b>8,115,209</b>	5,221,611
<b>Other comprehensive income:</b>		
Income from changes in fair value of available-for-sale financial assets	1,821,129	–
<b>Other comprehensive income for the year, net of tax</b>	<b>1,821,129</b>	–
<b>Total comprehensive income for the year</b>	<b>9,936,338</b>	5,221,611
<b>Attributable to:</b>		
Equity holders of the Company	9,874,754	5,155,646
Non-controlling interests	61,584	65,965
<b>Total comprehensive income for the year</b>	<b>9,936,338</b>	5,221,611

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

	Attributable to equity holders of the Company								
	Share capital	Share premium	Shares held for share award scheme	Share-based compensation reserve	Other reserves	Retained earnings	Total	Non-controlling interests	Total equity
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
<b>Balance at 1 January 2010</b>	197	1,244,425	(123,767)	703,563	(166,364)	10,520,453	12,178,507	120,146	12,298,653
<b>Comprehensive income</b>									
Profit for the year	-	-	-	-	-	8,053,625	8,053,625	61,584	8,115,209
Other comprehensive income									
- income from changes in fair value of available-for-sale financial assets	-	-	-	-	1,821,129	-	1,821,129	-	1,821,129
<b>Total comprehensive income for the year</b>	-	-	-	-	1,821,129	8,053,625	9,874,754	61,584	9,936,338
<b>Transactions with owners</b>									
Employee share option schemes:									
- value of employee services	-	-	-	139,621	-	-	139,621	-	139,621
- proceeds from shares issued	1	199,248	-	-	-	-	199,249	-	199,249
Employee share award scheme:									
- value of employee services	-	-	-	356,479	-	-	356,479	-	356,479
- shares purchased for share award scheme	-	-	(167,519)	-	-	-	(167,519)	-	(167,519)
- vesting of awarded shares	-	(33,149)	33,149	-	-	-	-	-	-
Profit appropriations to statutory reserves	-	-	-	-	8,237	(8,237)	-	-	-
Dividend (Note 42)	-	-	-	-	-	(639,264)	(639,264)	(66,723)	(705,987)
Repurchase and cancellation of shares	-	(310,222)	-	-	-	-	(310,222)	-	(310,222)
Reversal of the liabilities in respect of put options granted to non-controlling interest owners	-	-	-	-	94,246	-	94,246	-	94,246
Acquisition of additional interests in a subsidiary (Note 44)	-	-	-	-	154,198	(123,103)	31,095	(31,095)	-
Transfer	-	-	-	-	8,249	(8,249)	-	-	-
<b>Total transactions with owners for the year</b>	1	(144,123)	(134,370)	496,100	264,930	(778,853)	(296,315)	(97,818)	(394,133)
<b>Balance at 31 December 2010</b>	198	1,100,302	(258,137)	1,199,663	1,919,695	17,795,225	21,756,946	83,912	21,840,858

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2010

	Attributable to equity holders of the Company								
	Shares held						Total	Non-controlling interests	Total equity
	Share capital	Share premium	for share award scheme	Share-based compensation reserve	Other reserves	Retained earnings			
RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
<b>Balance at 1 January 2009</b>	195	1,155,209	(21,809)	381,439	(433,038)	5,938,930	7,020,926	98,406	7,119,332
Profit/Total comprehensive									
Income for the year	-	-	-	-	-	5,155,646	5,155,646	65,965	5,221,611
<b>Transactions with owners</b>									
Employee share option schemes:									
- value of employee services	-	-	-	167,178	-	-	167,178	-	167,178
- proceeds from shares issued	2	165,446	-	-	-	-	165,448	-	165,448
Employee share award scheme:									
- value of employee services	-	-	-	154,946	-	-	154,946	-	154,946
- shares purchased for share award scheme	-	-	(103,618)	-	-	-	(103,618)	-	(103,618)
- vesting of awarded shares	-	(1,660)	1,660	-	-	-	-	-	-
Profit appropriations to									
statutory reserves	-	-	-	-	2,193	(2,193)	-	-	-
Dividend (Note 42)	-	-	-	-	-	(554,604)	(554,604)	(32,088)	(586,692)
Repurchase and cancellation									
of shares	-	(74,570)	-	-	-	-	(74,570)	-	(74,570)
Equity interest purchased for									
an employee restricted									
equity interest plan in a									
non-wholly owned subsidiary	-	-	-	-	-	(17,326)	(17,326)	(11,856)	(29,182)
Exercise of put option granted to									
non-controlling interest owners	-	-	-	-	281	-	281	(281)	-
Reversal of the liabilities in respect									
of the put options granted to									
non-controlling interest owners	-	-	-	-	264,200	-	264,200	-	264,200
<b>Total transactions with owners</b>									
<b>for the year</b>	2	89,216	(101,958)	322,124	266,674	(574,123)	1,935	(44,225)	(42,290)
<b>Balance at 31 December 2009</b>	197	1,244,425	(123,767)	703,563	(166,364)	10,520,453	12,178,507	120,146	12,298,653

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**

For the year ended 31 December 2010

		Year ended 31 December	
		2010	2009
		RMB'000	RMB'000
	Note		
<b>Cash flows from operating activities</b>			
Cash generated from operations	45(a)	<b>13,191,728</b>	8,854,813
Income tax paid		<b>(872,435)</b>	(456,448)
		<hr/>	<hr/>
Net cash flows generated from operating activities		<b>12,319,293</b>	8,398,365
<b>Cash flows from investing activities</b>			
Payments for business combinations		<b>(268,852)</b>	(140)
Purchase of fixed assets, construction in progress and investment properties		<b>(1,488,220)</b>	(788,824)
Proceeds from disposals of fixed assets	45(a)	<b>1,574</b>	595
Payments for investment in associates		<b>(511,967)</b>	(148,417)
Payment for investment in a jointly controlled entity		<b>(71,143)</b>	–
Purchase of intangible assets		<b>(114,638)</b>	(31,950)
Prepayment for online game licenses		<b>(187,193)</b>	–
Payments for land use rights		<b>(456,555)</b>	–
Purchase of available-for-sale financial assets		<b>(2,179,096)</b>	(68,782)
Payment for acquisition of non-controlling interests in a non-wholly owned subsidiary		<b>(118,260)</b>	(717)
Proceeds from the redemption of held-to-maturity investments		<b>341,410</b>	68,346
Payments for held-to-maturity investments		–	(341,795)
Receipt from the repayments of term deposits with initial term of over three months		<b>114,662</b>	564,729
Payments for term deposits with initial term of over three months		<b>(6,530,237)</b>	(4,212,396)
Payment for the restricted cash		<b>(836,457)</b>	(200,000)
Receipt from loan made to a related party		<b>54,700</b>	18,394
Interest received		<b>219,937</b>	116,162
Dividend received		<b>15,338</b>	–
		<hr/>	<hr/>
Net cash flows used in investing activities		<b>(12,014,997)</b>	(5,024,795)

**CONSOLIDATED STATEMENT OF CASH FLOWS**

For the year ended 31 December 2010

	Year ended 31 December	
	2010 RMB'000	2009 RMB'000
<b>Cash flows from financing activities</b>		
Proceeds from short-term bank borrowings	5,298,947	202,322
Repayment of short-term bank borrowings	(202,322)	–
Proceeds from issuance of ordinary shares	199,249	165,448
Payments for repurchase of shares	(310,222)	(74,570)
Payment for purchase of shares for share award scheme	(167,519)	(103,618)
Dividend paid to the Company's shareholders	(639,264)	(554,604)
Dividends paid to non-controlling interests	(66,723)	(32,088)
	<hr/>	<hr/>
Net cash flows generated from/(used in) financing activities	4,112,146	(397,110)
	<hr/>	<hr/>
<b>Net increase in cash and cash equivalents</b>	4,416,442	2,976,460
Cash and cash equivalents at beginning of the year	6,043,696	3,067,928
Exchange losses on cash and cash equivalents	(51,881)	(692)
	<hr/>	<hr/>
<b>Cash and cash equivalents at end of the year</b>	<b>10,408,257</b>	<b>6,043,696</b>
	<hr/> <hr/>	<hr/> <hr/>

The notes on pages 76 to 189 are an integral part of these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 1 GENERAL INFORMATION

Tencent Holdings Limited (the “Company”) was incorporated in the Cayman Islands. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY 1-1111, Cayman Islands. The shares of the Company have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) since 16 June 2004.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the “Group”) are principally engaged in the provision of Internet value-added services, mobile and telecommunications value-added services and online advertising services to users in the People’s Republic of China (the “PRC”).

The operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited (“Tencent Computer”), a limited liability company established in the PRC by certain shareholders of the Company on 11 November 1998. Tencent Computer is legally owned by the core founders of the Company who are PRC citizens (the “Registered Shareholders”).

The PRC laws and regulations limit foreign ownership of companies providing value-added telecommunications services, which include activities and services operated by Tencent Computer. In order to enable certain foreign companies to make investments into the business of the Group, the Company established a subsidiary, Tencent Technology (Shenzhen) Company Limited (“Tencent Technology”), which is a wholly foreign owned enterprise incorporated in the PRC, on 24 February 2000. The foreign investors of the Company then subscribed to additional equity interest in the Company.

Certain contractual arrangements (“Structure Contracts”) have been made among the Company, Tencent Technology, Tencent Computer and the Registered Shareholders in order that the decision-making rights and operating and financing activities of Tencent Computer are ultimately controlled by the Company. The Company and Tencent Technology are also entitled to substantially all of the operating profits and residual benefits generated by Tencent Computer under these arrangements. In particular, the Registered Shareholders are required under their contractual arrangements with the Group to transfer these interests in Tencent Computer to the Group or the Group’s designee upon the Group’s request at a pre-agreed nominal consideration. Similar arrangements were also made with other PRC operating companies acquired or formed by the Group, namely Shiji Kaixuan Technology Company Limited (“Shiji Kaixuan”), Beijing Emark Information and Technology Company Limited, Nanjing Wang Dian Technology Company Limited (“Wang Dian”), Beijing BIZCOM Technology Company Limited (“Beijing BIZCOM”), Beijing Starsinhand Technology Company Limited (“Beijing Starsinhand”), Shenzhen Shijitianyou Technology Company Limited, Tianjin Shouzhongwanwei Network Company Limited and Guangzhou Yunxun Technology Company Limited (together with Tencent Computer, collectively known as “the PRC Operating Companies”).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 1 GENERAL INFORMATION (Cont'd)

As a result, Tencent Computer is accounted for as a subsidiary and the formation of the Group in 2000 was accounted for as a business combination between entities under common control under a method similar to the uniting of interests method for recording all assets and liabilities at predecessor carrying amounts. This approach was adopted because in management's belief it best reflected the substance of the formation. Similarly, all the financial statements of the PRC Operating Companies have also been consolidated by the Company (see Note 11 (a)(ii) for details).

These consolidated financial statements have been approved for issue by the Board of Directors (the "Board") on 16 March 2011.

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### 2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared under the historical cost convention, as modified by available-for-sale financial assets, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

IAS 1 (Revised) prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All 'non-owner changes in equity' are required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). The Group elected to present two performance statements (the income statement and statement of comprehensive income) from 1 January 2010.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.1 Basis of preparation (Cont'd)

- (a) New and amended standards adopted by the Group

The following new standards and amendments to existing standards are mandatory for the first time for the financial year beginning 1 January 2010.

- IAS 27 (Revised), 'Consolidated and Separate Financial Statements'

IAS 27 (Revised) requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. This is consistent with the Group's existing policy. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss.

IAS 27 (Revised) contained consequential amendments to IAS 28, 'Investments in associates', and IAS 31, 'Interests in joint ventures'.

The Group has applied this revised standard prospectively from 1 January 2010 and management has assessed that this revised standard does not have a significant impact on the Group's consolidated financial statements.

- IFRS 2 (Amendment), 'Group Cash-settled Share-based Payment Transaction'

In addition to incorporating IFRIC 8, "Scope of IFRS 2" and IFRIC 11, "IFRS 2 - Group and treasury share transactions", the amendments expand on the guidance in IFRIC 11 to address the accounting in the separate financial statements of a subsidiary when its suppliers/employees will receive cash payments from the parent that are linked to the price of the equity instruments of an entity in the group. The parent, and not the entity, has the obligation to deliver cash. The amendments state that the entity shall account for the transaction with its suppliers/employees as equity-settled, and recognise a corresponding increase in equity as a contribution from its parent. The subsidiary shall remeasure the cost of the transaction subsequently for any changes resulting from non-market vesting conditions not being met in accordance with paragraphs 19 to 21 in IFRS 2. This differs from the measurement of the transaction as cash-settled in the consolidated financial statements of the Group.

The Group has applied this amendment from 1 January 2010 and management has assessed that this amendment has no significant impact on the Group's consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.1 Basis of preparation (Cont'd)

(a) New and amended standards adopted by the Group (Cont'd)

- IFRS 3 (Revised), 'Business Combinations'

The revised standard continues to apply the acquisition method to business combinations but with some significant changes compared with IFRS 3. For example, all payments made to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice on an acquisition by acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed.

In addition, in relation to an acquisition achieved in stage or a step acquisition (i.e. there is a previously held equity interest when obtaining control), the IFRS 3 (revised) requires that the previously held interest is measured to fair value at the acquisition date and a gain or loss is recognised in the income statement, which is treated as if the previously held interest has been disposed of in return, along with the other consideration transferred, for the controlling interest in the acquired subsidiary.

The Group has applied this revised standard prospectively from 1 January 2010 and see Note 43 for further details of the business combination that occurred in 2010.

The Group also adopted the IASB's improvements to IFRS published in May 2008 and April 2009, which are relevant to the Group and effective from 1 January 2010. Such amendments have no material impact to the financial statements of the Group.

The following new and amended standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2010 but not currently relevant to the Group (although they may affect the accounting for future transactions and events).

- |                      |   |
|----------------------|---|
| • IAS 17 (Amendment) | Leases  |
| • IAS 39 (Amendment) | Financial Instruments: Recognition and Measurement - Eligible Hedged Item |
| • IFRIC 17           | Distributions of Non-cash Assets to Owners                                |
| • IFRS 5 (Amendment) | Non-current assets held for sale and discontinued operations              |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.1 Basis of preparation (Cont'd)

- (b) New standard which has been issued but is not effective for the financial year beginning 1 January 2010 and have not been early adopted

The following new standard has been issued and mandatory for the Group's accounting periods beginning on or after 1 January 2013 or later periods, but the Group has not yet early adopted it.

- IFRS 9, 'Financial Instrument' (effective from 1 January 2013)

Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

An entity shall classify all financial liabilities as subsequently measured at amortised cost using the effective interest method, except for financial liabilities at fair value through profit or loss; financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies; financial guarantee contracts and commitments to provide a loan at a below-market interest rate.

An instrument is subsequently measured at amortised cost only if it is a debt instrument, and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.

All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than the income statement. There is to be no recycling of fair value gains and losses to the income statement. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in the income statement, as long as they represent a return on investment.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.1 Basis of preparation (Cont'd)

- (b) New standard which has been issued but is not effective for the financial year beginning 1 January 2010 and have not been early adopted (Cont'd)

This standard is effective for annual periods beginning on or after 1 January 2013 and to be applied retrospectively. However, if adopted before 1 January 2012, comparative periods do not need to be restated. In addition, entities adopting this standard before 1 January 2011 are allowed to designate any date between then and the date of issuance of IFRS 9, as the date of initial application that will be the date upon which the classification of financial assets will be determined. The Group has not yet determined when to apply this standard at current stage.

- (c) New standards, amendments and interpretations have been issued but are not effective and not relevant for the Group's operation.

The following new standards, amendments and interpretations have been issued and are mandatory for the Group's accounting periods beginning on or after 1 January 2011 or later periods, but not relevant for the Group's operation.

- IAS 32 (Amendment) Classification of Rights Issue (effective from 1 February 2010)
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective from 1 July 2010)
- IAS 24 (Revised) Related Party Disclosures (effective from 1 January 2011)
- Amendment to IFRIC 14 Prepayments of A Minimum Funding Requirement (effective from 1 January 2011)
- IAS 12 (Amendment) Deferred Tax: Recovery of underlying assets (effective from 1 January 2012)

- (d) IASB's improvement to IFRS published in May 2010

In May 2010, IASB published its third annual improvements project, which made some amendments to IFRSs to clarify some accounting treatments/disclosure requirements under new/revised IFRSs and eliminate inconsistency. Management do not expect these amendments have a material impact on the Group's financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31 December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are de-consolidated from the date that control ceases.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the consolidated income statement (Note 2.8).

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.2 Consolidation (Cont'd)

#### (a) Subsidiaries (Cont'd)

In the Company's statement of financial position, the investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments. Cost also includes direct attributable costs of investment. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable. In addition, the contribution to the Company's share award scheme, a controlled special purpose entity, is stated at cost in "Contribution to Share Scheme Trust" first, and then will be transferred to the "Shares held for share award scheme" under equity when the contribution is used for the acquisition for the shares of the Company.

#### (b) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchase from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposal to non-controlling interests are also recorded in equity.

#### (c) Associates

Associates are all entities over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of loss in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.2 Consolidation (Cont'd)

(c) Associates (Cont'd)

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) Jointly controlled entities

The Group's interests in jointly controlled entities are accounted for by the equity method. The Group's share of its jointly controlled entities' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of loss in a jointly controlled entity equals or exceeds its interest in the jointly controlled entity, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity.

(e) Business combination achieved in stages

For a business combination achieved in stages, it applies acquisition method at the acquisition date. The previously held interest is remeasured to fair value at the acquisition date and a gain or loss is recognised in the consolidated income statement. Goodwill is calculated by deducting the fair value of identifiable net assets from the fair value of the previously held interest, the consideration and non-controlling interest.

The cost of an associate/a jointly controlled entity acquired in stages is measured as the sum of the fair value of the interest previously held plus the fair value of any additional consideration transferred as of the date when the associate/jointly controlled entity became an associate/a jointly controlled entity. A gain or loss on re-measurement of the previously held interest is taken to the income statement. Any other comprehensive income recognised in prior periods in relation to the previously held interest is also taken to the income statement. Any acquisition-related costs are expensed in the period in which the costs are incurred.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.2 Consolidation (Cont'd)

(f) Partial disposals

When the group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the income statement.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to the income statement where appropriate.

### 2.3 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments and making strategic decisions. The chief operating decision-makers mainly include the executive directors.

### 2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in RMB, which is both the functional currency of the Company and presentation currency of the Group.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale financial assets are analysed between translation differences resulting from changes in the amortised cost of the securities, and other changes in the carrying amount of the securities. Translation differences related to changes in the amortised cost and interest income are recognised in the income statement, and other changes in carrying amount are recognised in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in the income statement as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.4 Foreign currency translation (Cont'd)

(c) Group companies

The results and financial position of all group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency of RMB are translated into the presentation currency as follows:

- (i) assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognised as a separate component of other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

#### 2.5 Fixed assets

All fixed assets are stated at historical costs less accumulated depreciation and accumulated impairment charge. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.5 Fixed assets (Cont'd)

Depreciation is calculated on the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	20 - 50 years
Computer equipment	3 - 5 years
Furniture and office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	the shorter of their useful lives and the lease terms

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Construction in progress represents buildings under construction, which is stated at actual construction cost less any impairment loss. Construction in progress is transferred to fixed assets when completed and ready for use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.10).

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised within "Other gains/(losses), net" in the income statement.

### 2.6 Investment properties

Investment properties are held for long-term rental yields and are not occupied by the Group. Investment properties are carried at historical costs less accumulated depreciation and accumulated impairment charges. Historical costs include expenditures that are directly attributable to the acquisition of the items.

Depreciations are calculated on the straight-line method to allocate their costs to their residual values over their estimated useful lives of 50 years.

Investment properties' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Investment properties' carrying amounts are written down immediately to their recoverable amount if its carrying amounts are greater than their estimated recoverable amounts.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.7 Land use rights

Land use rights are up-front payments to acquire long-term interest in land. These payments are stated at cost and charged to the income statement on a straight-line basis over the remaining period of the lease or capitalised in construction in progress upon completion of construction.

#### 2.8 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and is tested for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units ("CGU") for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose identified according to operating segment.

(b) Other intangible assets

Other intangible assets mainly include licence, computer software and technology and non-compete agreements. They are initially recognised and measured at cost or estimated fair value of intangible assets acquired through business combinations.

Other intangible assets are being amortised over their estimated useful lives (generally three to seven years).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.9 Shares held for share award scheme

Where the Tencent Share Award Scheme (“Share Scheme Trust”) purchases the Company’s shares from the market, the consideration paid, including any directly attributable incremental cost, is presented as “Shares held for share award scheme” and deducted from total equity.

When the Share Scheme Trust transfers the Company’s shares to the awardees upon vesting, the related costs of the awarded shares vested are credited to “Shares held for share award scheme”, with a corresponding adjustment to the share premium.

#### 2.10 Impairment of non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset’s fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

Impairment testing of the investments in subsidiaries or associates is required upon receiving dividends from these investments if the dividend exceeds the total comprehensive income of the subsidiary or associate in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee’s net assets including goodwill.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.11 Financial assets

(a) Classification

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired, management's intentions and whether the assets are quoted in an active market. Management determines the classification of its financial assets at initial recognition.

(i) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the end of the reporting period which are classified as non-current assets. Loans and receivables are classified as "Accounts receivable", "Other receivables", "Term deposits with initial term of over three months", "Restricted cash" and "Cash and cash equivalents" in the statement of financial position.

(iii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the end of the reporting period which are classified as current assets.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.11 Financial assets (Cont'd)

(a) Classification (Cont'd)

(iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other category. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the end of the reporting period.

(b) Recognition and measurement

Regular way purchases and sales of investments are recognised on trade-date the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the “Financial assets at fair value through profit or loss” category are presented in the income statement within “Other gains/(losses), net” in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement as part of other income when the Group’s right to receive payments is established.

Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognised in other comprehensive income.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the income statement as gains and losses from investment securities.

Dividends on available-for-sale equity instruments are recognised in the income statement when the Group’s right to receive payments is established.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.12 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liabilities simultaneously.

#### 2.13 Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the group, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becomes probable that the borrower will enter into bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot be identified with the individual financial assets in the portfolio, including:
  - (i) adverse changes in the payment status of borrowers in the portfolio; and
  - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.13 Impairment of financial assets (Cont'd)

(a) Assets carried at amortised cost (Cont'd)

The Group first assesses whether objective evidence of impairment exists.

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the consolidated income statement.

(b) Assets classified as available for sale

The Group assesses at the end of the reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the securities below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement - is removed from other comprehensive income and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.14 Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

During the year ended 31 December 2010, the Group did not hold any derivative instruments designated as a hedging instrument but held certain derivative instruments which did not qualify for hedge accounting. The derivative instruments, which do not qualify for hedge accounting, are accounted for at fair value through profit or loss. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement within "Other gains/(losses), net".

#### 2.15 Accounts receivable

Accounts receivable is amounts due from customers or agents for merchandise sold or services performed in the ordinary course of business. If collection of accounts receivable and other receivables is expected in one year or less, they are classified as current assets. Otherwise, they are presented as non-current assets.

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

#### 2.16 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with initial maturities of three months or less.

#### 2.17 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or share options are shown in equity as a deduction from the proceeds.

Where any group company purchases the Company's equity share capital (treasury share), the considerations paid, including any directly attributable incremental costs, is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received (net of any directly attributable incremental transaction costs) is included in equity attributable to the Company's equity holders.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.18 Accounts payable

Accounts payable is obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable is classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Accounts payable is recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

#### 2.19 Put option liabilities

Put option is the financial instrument granted by the Group that the counterparty may have the right to request the Group to purchase its own equity instruments for cash or other financial assets when certain conditions are met. If the Group does not have the unconditional right to avoid delivering cash or another financial assets under the put option, it has to recognise a financial liability at the present value of the estimated future cash outflows under the put option. The financial liability is initially debited to equity at fair value. Subsequently, if the Group revises its estimates of payments, the Group will adjust the carrying amount of the financial liability to reflect actual and revised estimated cash outflows. The Group will recalculate the carrying amount by computing the present value of revised estimated future cash outflows at the financial instrument's original effective interest rate and the adjustments will be recognised as income or expenses in the income statement. If the put option expires without delivery, the carrying amount of the liability is reclassified as equity.

The put option liabilities are current liabilities unless the put option can only be exercised 12 months after the end of the reporting period.

#### 2.20 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost with any difference between proceeds (net of transaction costs) and the redemption value recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.21 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company's subsidiaries and jointly controlled entities operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction neither accounting nor taxable profit or loss is affected. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.22 Employee benefits

(a) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the end of the reporting period. Employee entitlements to sick and maternity leave are not recognised until the time of leave.

(b) Pension obligations

The Group contributes on a monthly basis to various defined contribution benefit plans organised by the relevant governmental authorities. The Group's liability in respect of these plans is limited to the contributions payable in each period. Contributions to these plans are expensed as incurred. Assets of the plans are held and managed by government authorities and are separate from those of the Group.

(c) Share-based compensation benefits

The Group adopted four share option schemes and a share award scheme (see Note 23). The fair value of the employee services received in exchange for the grant of options and awarded shares is recognised as an expense and credited to share-based compensation reserve under equity. For grant of share options, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted by using an option-pricing model - Black-Scholes valuation model (the "BS Model"), excluding the impact of any service condition and non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become vested. For grant of award shares, the total amount to be expensed over the vesting period is determined by reference to the market price of the Company's shares at the grant date.

From the perspective of the Company, the Company grants the share options/shares to its subsidiaries' employees to exchange for their service provided to the subsidiaries. Accordingly, in the Company's statement of financial position, the share-based compensation expenses, which are recognised in the consolidated financial statement, are treated as part of the "Investment in subsidiaries".

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.22 Employee benefits (Cont'd)

(c) Share-based compensation benefits (Cont'd)

At each end of the reporting period, the Group and the Company revise its estimates of the number of options and awarded shares that are expected to ultimately vest. It recognises the impact of the revision of original estimates, if any, in the income statement of the Group and in the "Investment in subsidiaries" of the Company, and a corresponding adjustment to equity over the remaining vesting period.

When the options are exercised, the proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium.

#### 2.23 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for further operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.24 Revenue recognition

The Group principally derives revenues from provision of Internet value-added services, mobile and telecommunications value-added services and online advertising services in the PRC.

(a) Internet value-added services and mobile and telecommunications value-added services

Revenues from Internet value-added services are derived principally from the provision of community and online gaming services across various Internet platforms.

Mobile and telecommunications value-added services revenues are derived principally from providing users with mobile instant messaging services, mobile chat services, and other mobile value-added services such as mobile interactive voice response services, ringback tone services, music and image/picture downloads, mobile news and information content services and mobile game services.

Internet value-added services and mobile and telecommunications value-added services are either billed on a monthly subscription basis or on a per transaction/message basis. Certain of these services are delivered to the Group's customers through the platforms of various subsidiaries of telecommunication operators in the PRC, namely China Mobile Communications Corporation ("China Mobile"), China United Communications Corporation ("China Unicom") and China Telecommunications Corporation ("China Telecom"), and these operators also collect certain service fees (the "Internet and Mobile Service Fees") on behalf of the Group.

In collecting the Internet and Mobile Service Fees on behalf of the Group, these telecommunication operators are entitled to a fixed commission, which is calculated based on agreed percentages of the Internet and Mobile Service Fees received/receivable by them, plus, in certain cases, a fixed per-message adjustment for the excess of messages sent over messages received between the platforms of the Group and these operators (collectively defined as "Mobile and Telecom Charges"). The Mobile and Telecom Charges are withheld and deducted from the gross Internet and Mobile Service Fees collected by the operators from the users, with the net amounts remitted to the Group.

The Internet and Mobile Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by these operators to the Group on a monthly basis. The Group recognises the Internet and Mobile Service Fees as revenue on a gross basis and treats the Mobile and Telecom Charges as cost of revenues.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

### 2.24 Revenue recognition (Cont'd)

- (a) Internet value-added services and mobile and telecommunications value-added services (Cont'd)

For the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on the historical data. The historical data used in estimating revenues includes the most recent three-month history of the Internet and Mobile Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between the network gateways of the Group and the mobile operators. Adjustments are made in subsequent periods in the event that the actual revenue amounts are different from the original estimates.

In addition, the Internet value-added services can also be paid by way of prepaid cards and tokens (represented a specific amount of payment unit) sold by the Group through non-mobile channels such as sales agents appointed by the Group, telecommunication operators, broadband service providers, Internet cafes and banks. The end users can register the prepaid cards and tokens to their user accounts in the Group's platforms and then access the Group's online products or relevant services. Receipts from the sales of prepaid cards and tokens are deferred and recorded as "Deferred revenue" in the statement of financial position (see Note 29). The amounts are then recognised as revenue based on the actual utilisation of the payment unit: (i) when the payment unit is used to purchase services, the revenue is recognised when the related services are rendered; (ii) when the payment unit is used to purchase virtual products/items in the Group's Internet platform, the revenue is recognised over the estimated lifespan of the respective virtual products/items.

- (b) Online advertising

Online advertising revenues are mainly derived from fees for selling advertising space on the Group's websites, instant messaging client and game portal in the forms such as banners, links and logos, and delivery of search-based advertising by various means throughout the community created by the Group. Commissions payable to advertising agencies are recognised as a component of the cost of revenues.

For advertising contracts based on the actual time period that the advertisements appear on the Group's websites, instant messaging client or game portal, the revenues are recognised ratably over the period in which the advertisements are displayed.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 2 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (Cont'd)

#### 2.24 Revenue recognition (Cont'd)

(c) Interest income

Interest income is recognised on a time proportion basis, taking into account of the principal outstanding and the effective interest rate over the period to maturity, when it is determined that such income will accrue to the Group.

(d) Dividend income

Dividend income is recognised when the right to receive payment is established.

#### 2.25 Government grants/subsidies

Grants/subsidies from government are recognised at their fair value where there is a reasonable assurance that the grants/subsidies will be received and the Group will comply with all attached conditions.

Under these circumstances, the grants/subsidies are recognised as income or matched with the associated costs which the grants/subsidies are intended to compensate.

#### 2.26 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by lessors are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

#### 2.27 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group and Company's financial statements in the period in which the dividend is approved by the Company's shareholders.

#### 2.28 Research and development expenses

Research expenditure is recognised as an expense as incurred.

Costs incurred on development projects (relating to the design and testing of new or improved products) are capitalised as intangible assets when recognition criteria are fulfilled and tests for impairment are performed annually. Other development expenditures that do not meet those criteria are recognised as expenses as incurred. Development costs previously recognised as expenses are not recognised as an assets in subsequent periods. Capitalised development costs are amortised from the point at which the assets are ready for use on a straight-line basis over their useful lives, not exceeding five years.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT

#### 3.1 Financial risk factors

The Group is subject to a variety of financial risks: market risk (including foreign exchange risk, price risk and interest rate risk) and credit risk. The Group's overall risk management strategy seeks to minimise the potential adverse effects on the financial performance of the Group. Risk management is carried out by the senior management of the Group, including the executive directors of the Group.

(a) Market risk

*i) Foreign exchange risk*

The Group mainly operates in the PRC with most of the transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government. Therefore, to maintain the flexibility in the Company's activities including payment of dividends, share repurchases and offshore investments, the Group holds some monetary assets denominated in USD or HKD subject to certain thresholds stated in its treasury mandate, and borrows some bank loans denominated in USD from time to time. This exposes the Group to foreign exchange risk.

There is no other written policy to manage the foreign exchange risk in relation to USD and HKD as management considers that such risk could not be effectively reduced in a low-cost way. However, the Group had entered into certain foreign exchange forward contracts arrangements for managing our foreign exchange risk in relation to banks loans denominated in USD. Details are disclosed in Note 26.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

i) Foreign exchange risk (Cont'd)

As at 31 December 2010, the Group and the Company's non-RMB monetary assets and liabilities are listed below.

**Group**

	Currency denomination	As at 31 December	
		2010 RMB'000	2009 RMB'000
<b>Monetary assets</b>			
<i>Non-current assets</i>			
Held-to-maturity investments	USD	–	341,410
<i>Current assets</i>			
Term deposits with initial term of over three months	USD	<b>15,664</b>	187,483
Term deposits with initial term of over three months	HKD	<b>34,054</b>	–
Cash and cash equivalents	USD	<b>2,528,206</b>	358,586
Cash and cash equivalents	HKD	<b>231,608</b>	202,224
<b>Monetary liabilities</b>			
<i>Non-current liabilities</i>			
Long-term payables	USD	–	25,606
<i>Current liabilities</i>			
Accounts payable	USD	<b>502,427</b>	50,657
Short-term bank borrowings	USD	<b>3,973,620</b>	–

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 3 FINANCIAL RISK MANAGEMENT (Cont'd)

## 3.1 Financial risk factors (Cont'd)

## (a) Market risk (Cont'd)

## i) Foreign exchange risk (Cont'd)

## Company

	Currency denomination	As at 31 December	
		2010 RMB'000	2009 RMB'000
<b>Monetary assets</b>			
<i>Current assets</i>			
Term deposits with initial term of over three months	USD	<b>635</b>	–
Cash and cash equivalents	USD	<b>35,281</b>	3,123
Cash and cash equivalents	HKD	<b>202,244</b>	98,913

During the year ended 31 December 2010, the Group reported exchange gains of approximately RMB34,189,000 (2009: exchange loss of RMB1,953,000) as a result of RMB appreciation against USD. The gains were recorded in finance costs, net in the consolidated income statement for the year ended 31 December 2010.

At 31 December 2010, if USD and HKD had strengthened/weakened by 5% (2009: 5%) against RMB with all other variables held constant, the profit for the year would have been approximately RMB83,326,000 lower/higher (2009: RMB50,672,000 higher/lower), mainly as a result of foreign exchange gains/losses on translation of monetary assets and liabilities denominated in USD and HKD.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

*ii) Price risk*

The Group is exposed to price risk because of investments held by the Group, which are classified as available-for-sale financial assets. The Group is not exposed to commodity price risk. To manage its price risk arising from the investments, the Group diversifies its portfolio. The investment made by the Group is either for the purpose of improving investment yield and maintaining high liquidity level simultaneously, or for strategic purpose. Each investment is managed by senior management, including the executive directors, on a case-by-case basis.

The available-for-sale financial assets are held for strategic rather than trading purposes. The Group does not actively trade these investments.

The sensitivity analysis is determined based on the exposure to equity price risks of available-for-sale financial assets at the end of the reporting period. If equity prices of the respective instruments held by the Group had been 5% (2009: 5%) higher/lower as at 31 December 2010, the other comprehensive income would have been approximately RMB206,344,000 (2009: RMB7,673,000) higher/lower.

*iii) Interest rate risk*

The Group has interest-bearing assets including term deposits with initial term of over three months and cash and cash equivalents, details of which have been disclosed in Notes 19 and 20.

The Group's interest rate risk arises from borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the group to fair value interest rate risk. There is no other written policy on managing the interest rate risk and management is to minimise its impact on the income statement.

As mentioned in foreign exchange risk above, the Group had extended bank loans denominated in USD having fixed interest rate as at 31 December 2010. Concurrently upon the draw-down of these loans, the Group entered into forward foreign exchange contracts to buy USD by selling RMB at designated future periods which substantially coincide with the respective loan maturity dates (see Note 28 for details).

Other financial assets and liabilities do not have material interest rate risk.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.1 Financial risk factors (Cont'd)

(a) Market risk (Cont'd)

*iii) Interest rate risk (Cont'd)*

For the year ended 31 December 2010, if the average interest rate on term deposits with initial term of over three months, cash and cash equivalents and short-term bank borrowings had been 5% (2009: 5%) higher/lower with all other variables held constant, the profit for the year would have been approximately RMB11,045,000 (2009: RMB6,801,000) higher/lower as a result of higher/lower interest income.

The Company only had interest-bearing assets (term deposits with initial term of over three months and cash and cash equivalents) but no interest-bearing liabilities as at 31 December 2010 (2009: same).

(b) Credit risk

The Group is exposed to credit risk in relation to its cash and deposits (including restricted cash) placed with banks and financial institutions, financial assets held for trading, and other investments, as well as accounts and other receivables.

The carrying amount of each class of the above financial assets represents the Group's maximum exposure to credit risk in relation to the corresponding class of financial assets.

To manage this risk, deposits are mainly placed with state-owned financial institutions in the PRC and reputable international financial institutions outside of the PRC. There has been no recent history of default in relation to these financial institutions.

For accounts receivable, as mentioned in Note 2.24(a), a large portion of Internet and Mobile Service Fees is derived from the co-operative arrangements with China Mobile, China Unicom and China Telecom. If the strategic relationship with the telecommunications operators is terminated or scaled-back; or if the telecommunications operators alter the co-operative arrangements; or if they experience financial difficulties in paying us, the Group's mobile and telecommunications value-added services and Internet value-added services might be adversely affected in terms of recoverability of receivables.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.1 Financial risk factors (Cont'd)

(b) Credit risk (Cont'd)

To manage this risk, the Group maintains frequent communications with the telecommunication operators to ensure the relevant co-operation is running effectively and smoothly. In view of our history of co-operation with the telecommunication operators and the sound collection history of the receivables due from them, management believes that the credit risk inherent in the Group's outstanding accounts receivable balances from these telecommunications operators is low (see Note 17 for details).

For accounts receivable from advertising customers, which are mainly advertising agencies, the credit quality of each customer is assessed, which takes into account its financial position, past experience and other factors. Normally, prepayments representing a certain percentage of the total service fees for each advertising service are required.

(c) Liquidity risk

The Group aims to maintain sufficient cash and cash equivalents and marketable securities. Due to the dynamic nature of the underlying businesses, the Group's finance department maintains flexibility in funding by maintaining adequate cash and cash equivalent.

The table below analyses the Group's and the Company's financial liabilities and net-settled derivative financial liabilities by relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 3 FINANCIAL RISK MANAGEMENT (Cont'd)

## 3.1 Financial risk factors (Cont'd)

(c) Liquidity risk (Cont'd)

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
<b>Group</b>					
<b>At 31 December 2010</b>					
Short-term bank borrowings	5,298,947	-	-	-	5,298,947
Derivative financial instruments	17,964	-	-	-	17,964
Accounts payable, other payables and accruals (excluding prepayments received from customers)	4,303,649	-	-	-	4,303,649
Total	<u>9,620,560</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,620,560</u>
<b>At 31 December 2009</b>					
Short-term bank borrowings	202,322	-	-	-	202,322
Long-term payables	-	111,747	174,892	-	286,639
Accounts payable, other payables and accruals (excluding prepayment received from customers)	2,250,626	-	-	-	2,250,626
Total	<u>2,452,948</u>	<u>111,747</u>	<u>174,892</u>	<u>-</u>	<u>2,739,587</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.1 Financial risk factors (Cont'd)

(c) Liquidity risk (Cont'd)

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
<b>Company</b>					
<b>At 31 December 2010</b>					
Amounts due to subsidiaries	1,833,802	-	-	-	1,833,802
Other payables and accruals	56,279	-	-	-	56,279
Total	<u>1,890,081</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,890,081</u>
<b>At 31 December 2009</b>					
Amounts due to subsidiaries	1,107,184	-	-	-	1,107,184
Other payables and accruals	24,517	-	-	-	24,517
Total	<u>1,131,701</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,131,701</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to enhance shareholders' value in the long term.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or redeem the Company's shares.

The Group monitors capital by regularly reviewing the gearing ratio. The gearing ratio is calculated as total liabilities divided by total assets. The total capital is the "total equity" of the Group as shown in the consolidation statement of financial position, which is also equal to total assets less total liabilities.

The gearing ratios as at 31 December 2010 and 2009 were as follows:

	<b>2010</b>	2009
	<b>RMB'000</b>	RMB'000
Total liabilities	<b>13,989,256</b>	5,207,112
Total assets	<b>35,830,114</b>	17,505,765
	<hr/>	<hr/>
Gearing ratio	<b>39%</b>	30%
	<hr/> <hr/>	<hr/> <hr/>

The increase in gearing ratio as at 31 December 2010 was mainly due to the increase in bank borrowings.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.3 Fair value estimation

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table presents the Group's assets and liabilities that are measured as at fair value at 31 December 2010.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
<b>Assets</b>				
Available-for-sale financial assets				
– equity securities	3,869,033	–	257,845	4,126,878
Total	<u>3,869,033</u>	<u>–</u>	<u>257,845</u>	<u>4,126,878</u>
<b>Liabilities</b>				
Financial liabilities				
at fair value through profit or loss				
– derivative financial instruments	–	17,964	–	17,964
Total	<u>–</u>	<u>17,964</u>	<u>–</u>	<u>17,964</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.3 Fair value estimation (Cont'd)

The following table presents the Group's assets that are measured as at fair value at 31 December 2009.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
<b>Assets</b>				
Available-for-sale financial assets				
– equity securities	–	–	153,462	153,462
Total	–	–	153,462	153,462

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- Dealer quotes for similar instruments.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the end of the reporting period, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for financial instruments.

There were no transfers of financial assets between level 1 and level 2 fair value hierarchy classifications.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 3 FINANCIAL RISK MANAGEMENT (Cont'd)

#### 3.3 Fair value estimation (Cont'd)

The following table presents the changes in level 3 instruments for the year ended 31 December 2010:

	<b>Available-for-sale financial assets RMB'000</b>
Opening balance	153,462
Additions	131,192
Transfer to investment in associates	<u>(26,809)</u>
Closing balance	<u><u>257,845</u></u>

The following table presents the changes in level 3 instruments for the year ended 31 December 2009:

	Available-for-sale financial assets RMB'000
Opening balance	86,180
Additions	<u>67,282</u>
Closing balance	<u><u>153,462</u></u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### 4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

- (a) Recognition of Internet value-added services and mobile and telecommunications value-added services

As mentioned in Note 2.24(a), for the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the accounts receivable based on the historical data.

As at 31 December 2010, the balance of accounts receivable not yet confirmed by China Mobile, China Unicom and China Telecom and their subsidiaries was estimated to be RMB479,134,000 (2009: RMB379,698,000).

Were the actual outcome to differ by 5% (2009: 5%) from management's estimates, the Group would need to:

- reduce the revenue and accounts receivable by RMB23,957,000 (2009: RMB18,985,000) if unfavourable; or
- increase the revenue and accounts receivable by RMB23,957,000 (2009: RMB18,985,000) if favourable.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont'd)

#### 4.1 Critical accounting estimates and assumptions (Cont'd)

(b) Recognition of share-based compensation expenses

As mentioned in Note 2.22(c), the Group has granted share options to its employees. The directors have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement on parameters, such as risk free rate, dividend yield and expected volatility, is required to be made by the directors in applying the BS Model (Note 23).

The fair value of options granted for the year ended 31 December 2010 determined using the BS Model was approximately HKD251,307,000 (2009: HKD116,915,000).

In addition, the Group has also granted awarded shares to its employees at the fair value of HKD666,732,000 during 2010 (2009: HKD849,595,000).

The Group has to estimate the expected yearly percentage of grantees of share options/awarded shares who will stay within the Group at the end of the vesting periods ("Expected Retention Rate of Grantees") to determine the amount of share-based compensation expenses charged into the income statement. As at 31 December 2010, the Expected Retention Rate of Grantees is assessed to be 91% (2009: 91%).

If the Expected Retention Rate of Grantees had been increased/decreased by 5% (2009: 5%), the amount of share-based compensation expenses would be increased/decreased by RMB32,315,000 (2009: RMB20,595,000).

(c) The estimates of the lifespan of virtual products/items provided in the Group's Internet platform

As mentioned in Note 2.24(a), the end users purchase certain virtual products/items provided in the Group's Internet platforms and the relevant revenue is recognised based on the lifespan of the virtual products/items. The Group uses the available information, including the historical user pattern and behavior and the stipulated period of validity of the relevant virtual products/items, to estimate the lifespan of these products/items.

The Group will continue to monitor the average lifespan of the virtual products/items (provided and to be provided), which may differ from the historical period, and any change in the estimates may result in the revenue being recognised on a different basis than in prior periods.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont'd)

#### 4.1 Critical accounting estimates and assumptions (Cont'd)

(d) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact current income tax and deferred income tax liabilities in the period in which such determination is made.

Were the actual final outcome (on the judgement areas) to differ by 5% from management's estimates, the group would need to:

- Increase the income tax liabilities by RMB17,055,000 and the deferred tax liabilities by RMB48,361,000, if unfavourable; or
- Decrease the income tax liabilities by RMB17,055,000 and the deferred tax liabilities by RMB48,361,000, if favourable.

#### 4.2 Critical judgments in applying the Group's accounting policies

Recognition of deferred tax assets

Certain intra-group software and technology sales have been transacted within the Group. The self-developed software and technology purchased by two subsidiary companies, Tencent Computer and Shiji Kaixuan, from other group companies have been initially recorded at the purchase prices as costs and then amortised over their contracted useful lives (the "Amortisation") in their local statutory financial statements, while these transactions were eliminated at the group level.

The Amortisation has been treated as a deductible expense in ascertaining the assessable profits of Tencent Computer and Shiji Kaixuan for tax reporting purposes while the costs of purchase of these assets were eliminated in preparation of the consolidated financial statements of the Group. As a result, deferred tax assets have been recognised, based on temporary differences arising from the accounting base (at the group level, which is zero) and the tax base of the software and technology involved in these intragroup transactions, at the respective enacted corporate income tax rates of Tencent Computer and Shiji Kaixuan.

As at 31 December 2010, the relevant deferred tax assets were approximately RMB219,019,000 (2009: RMB301,016,000) (Note 30), which are expected to be recovered by the tax profits to be generated from Tencent Computer and Shiji Kaixuan in future.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 5 SEGMENT INFORMATION

The chief operating decision-makers mainly include executive directors of the Company. They review the Group's internal reporting in order to assess performance and allocate resources, and determine the operating segments based on these reports.

The Group has following reportable segments for the years ended 31 December 2010 and 2009:

- Internet value-added services;
- Mobile and telecommunications value-added services;
- Online advertising; and
- Others.

Other segments of the Group are mainly comprised of the provision of online payments services and trademark licensing.

The chief operating decision-makers assess the performance of the operating segments based on segment revenue and gross profit/(loss) of each operating segment. The selling and marketing expenses and general and administrative expenses are common costs incurred for the operating segments as a whole and therefore, they are not included in the measure of the segments' profit that is used by the chief operating decision-makers as a basis for the purpose of resource allocation and assessment of segment performance. Interest income, other gains/(losses), net, finance costs, net and income tax expense are also not allocated to individual operating segments.

There were no inter-segment sales during the year ended 31 December 2010 and 2009. The revenues from external customers reported to the executive directors are measured in a manner consistent with that in the consolidated income statement.

Other information, together with segment information, provided to the chief operating decision-makers, is measured in a manner consistent with that in the annual report. There were no segment assets and segment liabilities information provided to the chief operating decision-makers.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 5 SEGMENT INFORMATION (Cont'd)

The segment information provided to the chief operating decision-makers for the reportable segments for the years ended 31 December 2010 and 2009 is as follows:

Year ended 31 December 2010	Internet value-added services RMB'000	Mobile and telecom- munications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
<b>Segment revenues</b>					
<b>(revenues from external customers)</b>	<b>15,482,301</b>	<b>2,715,931</b>	<b>1,372,522</b>	<b>75,277</b>	<b>19,646,031</b>
Gross profit/(loss)	<b>10,719,866</b>	<b>1,705,073</b>	<b>931,220</b>	<b>(30,328)</b>	<b>13,325,831</b>
Depreciation	<b>374,991</b>	<b>35,264</b>	<b>21,884</b>	<b>13,923</b>	<b>446,062</b>
Amortisation	<b>37,033</b>	–	–	–	<b>37,033</b>
Share of profit of associates	<b>67,563</b>	<b>4,796</b>	–	–	<b>72,359</b>
Year ended 31 December 2009	Internet value-added services RMB'000	Mobile and telecom- munications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
<b>Segment revenues</b>					
<b>(revenues from external customers)</b>	<b>9,530,711</b>	<b>1,905,599</b>	<b>962,171</b>	<b>41,479</b>	<b>12,439,960</b>
Gross profit/(loss)	<b>6,741,486</b>	<b>1,177,852</b>	<b>664,563</b>	<b>(33,409)</b>	<b>8,550,492</b>
Depreciation	141,427	17,956	7,063	7,114	173,560
Amortisation	73,772	–	–	–	73,772
Share of profit of associates	15,957	6,249	–	–	22,206

The reconciliation of operating profit to profit before tax is shown in the consolidated income statement.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 5 SEGMENT INFORMATION (Cont'd)

The Company is domiciled in the Cayman Islands while the Group mainly operates its businesses in the PRC. For the year ended 31 December 2010, revenues from external customers in the PRC (excluding Hong Kong) were RMB19,632,117,000 (2009: RMB12,434,311,000), and revenues from external customers in other areas were RMB13,914,000 (2009: RMB5,649,000).

The Group also held financial instruments as investments which were traded in other territories, and the geographical information on the total assets is as follows:

	Total assets	
	2010 RMB'000	2009 RMB'000
Operating assets		
– The PRC	27,720,196	15,807,881
– United States	13,772	7,176
Investments		
– The PRC (excluding Hong Kong)	446,608	90,244
– Hong Kong	2,734,762	564,321
– Other Asian countries	886,024	644,784
– United States	159,719	49,949
– Europe	3,869,033	341,410
Consolidated	<b>35,830,114</b>	<b>17,505,765</b>

Assets outside the PRC are mainly investments in associates, investment in a jointly controlled entity, available-for-sale financial assets, term deposits with initial term of over three months and cash and cash equivalents. As at 31 December 2010, the total of non-current assets other than financial instruments and deferred tax assets located in the PRC was RMB5,282,748,000 (2009: RMB3,007,274,000), and the total of these non-current assets located in other countries was RMB827,728,000 (2009: RMB465,355,000).

All the revenues derived from any single external customer were less than 10% of the Group's total revenues for the year ended 31 December 2010.

Turnover consists of revenues generated by the Group, which were RMB19,646,031,000 and RMB12,439,960,000 for the years ended 31 December 2010 and 2009, respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 6 FIXED ASSETS

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
<b>At 1 January 2009</b>						
Cost	170,410	1,402,087	43,171	7,049	117,826	1,740,543
Accumulated depreciation and impairment	(8,102)	(472,929)	(15,676)	(4,489)	(74,299)	(575,495)
Net book amount	<u>162,308</u>	<u>929,158</u>	<u>27,495</u>	<u>2,560</u>	<u>43,527</u>	<u>1,165,048</u>
<b>Year ended 31 December 2009</b>						
Opening net book amount	162,308	929,158	27,495	2,560	43,527	1,165,048
Additions	1,128,661	595,703	30,998	1,069	4,662	1,761,093
Disposals	–	(552)	(634)	–	(2,452)	(3,638)
Depreciation	(38,734)	(353,488)	(9,557)	(1,109)	(2,413)	(405,301)
Closing net book amount	<u>1,252,235</u>	<u>1,170,821</u>	<u>48,302</u>	<u>2,520</u>	<u>43,324</u>	<u>2,517,202</u>
<b>At 31 December 2009</b>						
Cost	1,299,071	1,955,282	68,837	8,118	90,368	3,421,676
Accumulated depreciation and impairment	(46,836)	(784,461)	(20,535)	(5,598)	(47,044)	(904,474)
Net book amount	<u>1,252,235</u>	<u>1,170,821</u>	<u>48,302</u>	<u>2,520</u>	<u>43,324</u>	<u>2,517,202</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 6 FIXED ASSETS (Cont'd)

	Buildings RMB'000	Computer equipment RMB'000	Furniture and office equipment RMB'000	Motor vehicles RMB'000	Leasehold improvements RMB'000	Total RMB'000
<b>Year ended</b>						
<b>31 December 2010</b>						
Opening net book amount	1,252,235	1,170,821	48,302	2,520	43,324	2,517,202
Business combinations	–	2,174	316	–	–	2,490
Additions	68,761	1,273,450	57,135	575	42,486	1,442,407
Disposals	–	(338)	(23)	(75)	(255)	(691)
Depreciation	(59,458)	(574,870)	(17,072)	(1,065)	(16,115)	(668,580)
Closing net book amount	<u>1,261,538</u>	<u>1,871,237</u>	<u>88,658</u>	<u>1,955</u>	<u>69,440</u>	<u>3,292,828</u>
<b>At 31 December 2010</b>						
Cost	1,368,462	3,185,873	125,816	7,636	130,305	4,818,092
Accumulated depreciation and impairment	(106,924)	(1,314,636)	(37,158)	(5,681)	(60,865)	(1,525,264)
Net book amount	<u>1,261,538</u>	<u>1,871,237</u>	<u>88,658</u>	<u>1,955</u>	<u>69,440</u>	<u>3,292,828</u>

For the year ended 31 December 2010, depreciation of RMB446,062,000 (2009: RMB173,560,000), RMB12,198,000 (2009: RMB5,377,000) and RMB210,320,000 (2009: RMB226,364,000) were charged in cost of revenues, selling and marketing expenses and general and administrative expenses, respectively.

### 7 CONSTRUCTION IN PROGRESS

	2010 RMB'000	2009 RMB'000
Opening net book amount	105,771	875,897
Additions	410,362	323,673
Transfer to fixed assets	(129,190)	(1,093,799)
Closing net book amount	<u>386,943</u>	<u>105,771</u>

As at 31 December 2010, the construction in progress mainly represented the construction costs and other direct development costs of properties under construction located in Tianjin, the PRC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 8 INVESTMENT PROPERTIES

	2010 RMB'000	2009 RMB'000
Opening net book amount	68,025	64,981
Additions	247	68,183
Transfer to fixed assets	(29,763)	(64,564)
Depreciation	(1,280)	(575)
	<hr/>	<hr/>
Closing net book amount	<b>37,229</b>	68,025
	<hr/> <hr/>	<hr/> <hr/>

The following amounts have been recognised in the consolidated income statement:

	2010 RMB'000	2009 RMB'000
Rental income	2,166	3,060
Direct operating expenses arising from investment properties that generates rental income	(1,267)	(729)
	<hr/> <hr/>	<hr/> <hr/>

The investment properties as at 31 December 2010 mainly represented certain units in office buildings in Chengdu, the PRC.

The fair value of the investment properties was estimated to be approximately RMB53,492,000 (2009: RMB80,425,000) as at 31 December 2010, which was based on current prices in an active market for similar buildings in the same district.

The period of leases whereby the Group leases its investment properties under operating leases is within 3 years.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 8 INVESTMENT PROPERTIES (Cont'd)

The future aggregate minimum rentals receivable under non-cancellable operating leases are as follows:

	2010 RMB'000	2009 RMB'000
Not later than one year	1,107	4,500
Later than one year and no later than five years	<u>2,400</u>	<u>10,400</u>
	<u><u>3,507</u></u>	<u><u>14,900</u></u>

### 9 LAND USE RIGHTS

	2010 RMB'000	2009 RMB'000
Opening net book amount	35,296	36,046
Additions	198,318	–
Amortisation		
– capitalised in construction in progress	–	(284)
– charge to income statement	<u>(3,724)</u>	<u>(466)</u>
Closing net book amount	<u><u>229,890</u></u>	<u><u>35,296</u></u>

The land use rights all relate to land in the PRC with a lease period of 50 years. For the year ended 31 December 2010, RMB3,724,000 (2009: RMB466,000) of the amortisation were charged to general and administrative expenses.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 10 INTANGIBLE ASSETS

	Goodwill RMB'000	Computer software and technology RMB'000	Licences RMB'000	Others RMB'000	Total RMB'000
<b>At 1 January 2009</b>					
Cost	62,234	231,075	196,206	111,286	600,801
Accumulated amortisation and impairment	–	(58,417)	(65,927)	(106,143)	(230,487)
Net book amount	<u>62,234</u>	<u>172,658</u>	<u>130,279</u>	<u>5,143</u>	<u>370,314</u>
<b>Year ended 31 December 2009</b>					
Opening net book amount	62,234	172,658	130,279	5,143	370,314
Additions	–	30,172	600	1,178	31,950
Disposals	–	(1,654)	–	–	(1,654)
Amortisation charge	–	(51,109)	(79,213)	(1,575)	(131,897)
Closing net book amount	<u>62,234</u>	<u>150,067</u>	<u>51,666</u>	<u>4,746</u>	<u>268,713</u>
<b>At 31 December 2009</b>					
Cost	62,234	257,817	196,806	14,497	531,354
Accumulated amortisation and impairment	–	(107,750)	(145,140)	(9,751)	(262,641)
Net book amount	<u>62,234</u>	<u>150,067</u>	<u>51,666</u>	<u>4,746</u>	<u>268,713</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

**10 INTANGIBLE ASSETS (Cont'd)**

	<b>Goodwill</b>	<b>Computer software and technology</b>	<b>Licences</b>	<b>Others</b>	<b>Total</b>
	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>	<b>RMB'000</b>
<b>Year ended 31 December 2010</b>					
Opening net book amount	62,234	150,067	51,666	4,746	268,713
Business combinations	240,467	32,134	324	26,116	299,041
Additions	–	87,887	25,000	1,751	114,638
Amortisation charge	–	(39,091)	(62,975)	(7,345)	(109,411)
	<u>302,701</u>	<u>230,997</u>	<u>14,015</u>	<u>25,268</u>	<u>572,981</u>
Closing net book amount	<u>302,701</u>	<u>230,997</u>	<u>14,015</u>	<u>25,268</u>	<u>572,981</u>
<b>At 31 December 2010</b>					
Cost	302,701	377,838	222,130	42,364	945,033
Accumulated amortisation and impairment	–	(146,841)	(208,115)	(17,096)	(372,052)
	<u>302,701</u>	<u>230,997</u>	<u>14,015</u>	<u>25,268</u>	<u>572,981</u>
Net book amount	<u>302,701</u>	<u>230,997</u>	<u>14,015</u>	<u>25,268</u>	<u>572,981</u>

Amortisation of RMB72,378,000 (2009: RMB58,125,000) and RMB37,033,000 (2009: RMB73,772,000) were charged to general and administrative expenses and cost of revenues respectively for the year ended 31 December 2010.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 10 INTANGIBLE ASSETS (Cont'd)

#### Impairment tests for goodwill

Goodwill is allocated to the Group's CGUs identified according to operating segments. Most of the goodwill is related to the operating segment of Internet value-added services.

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rate stated below. The growth rate does not exceed the long-term average growth rate for the Internet value-added services business in which the CGU operates.

The key assumptions used for value-in-use calculations in 2010 for the goodwill arising from the business combination mentioned in Note 43 are as follows:

Gross margin	60%
Growth rate	3%
Discount rate	17%

Based on the assessment made by management, no impairment on goodwill was required as at 31 December 2010.

### 11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY

#### (a) Investments in subsidiaries

The amount represents investments in equity interests in subsidiaries of the Company. Details are as follows:

	2010 RMB'000	2009 RMB'000
Investments in subsidiaries:		
– investments in equity interests - at cost, unlisted	52	48
– deemed investments arising from share-based compensation (Note i)	1,199,663	703,563
– advance to subsidiaries (Note iv)	1,635,137	1,278,125
	<u>2,834,852</u>	<u>1,981,736</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

#### (a) Investments in subsidiaries (Cont'd)

The following is a list of principal subsidiaries of the Company as at 31 December 2010:

Name	Place and date of establishment and nature of legal entity	Particulars of issued/paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2010		2009		
			Direct	Indirect	Direct	Indirect	
Tencent Computer	Established on 11 November 1998 in the PRC, private limited liability company	RMB20,000,000	-	100% (Note ii)	-	100% (Note ii)	Provision of Internet and mobile and telecommunications value-added services, and Internet advertisement services
Tencent Technology	Established on 24 February 2000 in the PRC, wholly foreign owned enterprise	USD2,000,000	-	100%	-	100%	Development of computer software and provision of information service
Shiji Kaixuan	Established on 13 January 2004 in the PRC, private limited liability company	RMB11,000,000	-	100% (Note ii)	-	100% (Note ii)	Provision of Internet advertisement service
Tencent Cyber (Tianjin) Company Limited ("Cyber Tianjin")	Established on 8 February 2004 in the PRC, wholly foreign owned enterprise	USD80,000,000	-	100%	-	100%	Development of computer software and provision of information technology services
Tencent Asset Management Limited	Established on 7 July 2004 in BVI, private limited liability company	USD100	100%	-	100%	-	Asset management
Tencent Technology (Beijing) Company Limited ("Tencent Beijing")	Established on 30 March 2005 in the PRC, wholly foreign owned enterprise	USD1,000,000	-	100%	-	100%	Development of computer software and provision of information technology services
Shenzhen Tenpay Technology Limited ("Tenpay Technology")	Established on 25 August 2006 in the PRC, private limited liability company	RMB100,000,000	-	100% (Note iii)	-	100% (Note iii)	Provision of e-Commerce, electronic payment and settlement services
Wang Dian	Established on 5 January 2000 in the PRC, private limited liability company	RMB10,290,000	-	100% (Note ii)	-	100% (Note ii)	Provision of mobile and telecommunications value-added services

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

### (a) Investments in subsidiaries (Cont'd)

The following is a list of principal subsidiaries of the Company as at 31 December 2010: (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2010		2009		
			Direct	Indirect	Direct	Indirect	
Beijing BIZCOM	Established on 11 June 2002 in the PRC, private limited liability company	RMB16,500,000	-	100% (Note ii)	-	100% (Note ii)	Provision of mobile and telecommunications value-added services
Beijing Starsinhand	Established on 13 July 2005 in the PRC, private limited liability company	RMB10,000,000	-	100% (Note ii)	-	100% (Note ii)	Provision of mobile and telecommunications value-added services
Beijing Yonghang Technology Company Limited ("Beijing Yonghang")	Established on 21 January 2005 in the PRC, private limited liability company	RMB15,000,000	-	63.9% (Note iii)	-	63.9% (Note iii)	Development of online games
Shenzhen Domain Computer Network Company Limited ("Shenzhen Domain")	Established on 28 April 1997 in the PRC, private limited liability company	RMB10,000,000	-	100% (Note iii)	-	60.2% (Note iii)	Development and provision of online games
Beijing Comsenz Technologies Limited	Established on 21 October 2010 in the PRC, private limited liability company	RMB10,000,000	-	100% (Note iii)	-	-	Technology development
Tencent Cyber (Shenzhen) Company Limited ("Cyber Shenzhen")	Established on 17 January 2007 in the PRC, wholly foreign owned enterprise	USD30,000,000	-	100%	-	100%	Development of computer software
Tencent Technology (Shanghai) Company Limited ("Tencent Shanghai")	Established on 23 July 2008 in the PRC, wholly foreign owned enterprise	USD5,000,000	-	100%	-	100%	Development of computer software and provision of Internet information services

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

#### (a) Investments in subsidiaries (Cont'd)

The following is a list of principal subsidiaries of the Company as at 31 December 2010: (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/paid-in capital	Percentage of equity interest attributable to the Company				Principal activities
			2010		2009		
			Direct	Indirect	Direct	Indirect	
Tencent Technology (Chengdu) Company Limited ("Tencent Chengdu")	Established on 10 July 2008 in the PRC, wholly foreign owned enterprise	USD30,000,000	-	100%	-	100%	Development of computer software and provision of information technology services
Shenzhen Tencent Business Management Limited	Established on 24 December 2009 in the PRC, private limited liability company	RMB10,000,000	-	100% (Note iii)	-	100% (Note iii)	Provision of enterprise consultation management, lease of investment properties and consultation of property information

Notes:

- (i) The amount represents share-based compensation expenses arising from grant of share options and awarded shares of the Company to employees of subsidiaries in exchange for their services provided to the subsidiaries, which were deemed to be investment made by the Company into these subsidiaries.
- (ii) As described in Note 1, the Company does not have legal ownership in equity of these subsidiaries. Nevertheless, under certain contractual agreements entered into with the registered owners of these subsidiaries, the Company and its other legally owned subsidiaries control these companies by way of controlling the voting rights, governing their financial and operating policies, appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. In addition, such contractual agreements also transfer the risks and rewards of these companies to the Company and/or its legally owned subsidiaries. As a result, they are presented as consolidating subsidiaries of the Company.
- (iii) These equity interests are directly owned by Tencent Computer or Shiji Kaixuan or Beijing BIZCOM, in which the Company has indirect beneficial interests through the contractual arrangements described in Note (ii) above.
- (iv) These mainly represent loans from equity owners extended to Cyber Tianjin, Tencent Chengdu and investment in associates. All these balances are unsecured and interest-free and their repayments are neither planned nor likely to occur in the foreseeable future.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 11 INVESTMENT IN SUBSIDIARIES, AMOUNT DUE FROM/(TO) SUBSIDIARIES AND A CONTROLLED SPECIAL PURPOSE ENTITY (Cont'd)

#### (b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries as at 31 December 2010 represented current account balances maintained by the Company with certain subsidiaries. All balances are unsecured and interest-free and the balances are repayable on demand. The non-current portion of the amounts due from subsidiaries as at 31 December 2009 represented an advance made to Tencent Asset Management Limited for financing its acquisition of a held-to-maturity financial instrument, which will mature in 2013. During the year ended 31 December 2010, the Group had early redeemed the instrument and the advance was fully settled by Tencent Asset Management Limited.

As at 31 December 2010, the amounts due from subsidiaries were neither past due nor impaired.

#### (c) Consolidation of a special purpose entity

In connection with the implementation of the share award scheme of the Group mentioned in Note 23(b), the Company has set up a special purpose entity, and its particulars are as follows:

Special purpose entity	Principal activities
Share Scheme Trust	Administering and holding the Company's shares acquired for a share award scheme which is set up for the benefits of eligible employees of the Group

As the Company has the power to govern the financial and operating policies of the Share Scheme Trust and can derive benefits from the contributions of the employees who are awarded with the shares by the scheme through their continued employment with the Group, the directors of the Company consider that it is appropriate to consolidate the Share Scheme Trust in accordance with the requirements of IFRS SIC 12 - Consolidation - Special Purpose Entities.

For the year ended 31 December 2010, the Company contributed approximately RMB163,395,000 (2009: RMB103,669,000) to the Share Scheme Trust for financing its acquisition of the Company's shares. RMB167,519,000 (2009: RMB103,618,000) was paid as the consideration for acquiring 1,184,883 ordinary shares (2009: 1,013,100 shares) of the Company, which have been treated as "Shares held for share award scheme" (see Note 23(b)).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 12 INVESTMENT IN ASSOCIATES

	2010 RMB'000	2009 RMB'000
Beginning of the year	477,622	302,712
Additional investments in associates	97,087	143,836
Acquisitions of associates	412,094	8,868
Transfer from available-for-sale financial assets	26,809	–
Share of profit of associates	72,359	22,206
Dividends received from associates	(15,338)	–
	<hr/>	<hr/>
End of the year	<b>1,070,633</b>	477,622
	<hr/> <hr/>	<hr/> <hr/>

During the year ended 31 December 2010, the Group acquired equity interests in seven associates ranging from 10% to 49.0%. They are principally engaged in online games development and operations and advertising business. They are based in the PRC, Southeast Asia, East Asia and the United States.

For the associate which the Group only holds 10% equity interest, the Group has representation on its board of directors in order to facilitate the Group to exercise its significant influence in the company through participation in the financial and operating policy decisions of the company. In addition, the Group also acquired additional equity interests in two then existing investee companies reported as available-for-sale investments during 2010. As a result, they became associates of the Group. These two companies are principally engaged in online games operations and mobile games operations in the United States and the PRC, respectively.

Apart from the investments described above, as at 31 December 2010, the Group's investment in associates also included 30.02% (2009: 30.02%) equity interest in a Southeast Asia online game company, 27.25% (2009: 25%) equity interest in a venture capital fund in East Asia (excluding the PRC), as well as equity interests in several mobile game developers in the PRC.

Investment in associates at 31 December 2010 included goodwill of RMB324,024,000 (2009: RMB201,603,000) arising from acquisitions.

As at 31 December 2010 and 2009, there were certain call options embedded in investments in associates. The directors consider the fair value of such call options was insignificant and accordingly, the Group did not separately recognise these call options in the financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 12 INVESTMENT IN ASSOCIATES (Cont'd)

The Group's share of the results of its associates, all of which are unlisted, and its aggregated assets (including goodwill) and liabilities, are shown in aggregate as follows:

	Assets RMB'000	Liabilities RMB'000	Revenues RMB'000	Profit RMB'000
<b>2010</b>				
A Southeast Asia based online game company, 30.02% equity interest	471,650	22,879	191,261	34,684
A United States based online game company, 22.34% equity interest	124,472	13,223	31,072	7,729
A PRC advertising media company, 10% equity interest	148,250	17,950	–	–
A PRC based online game company, 50% equity interest	98,272	3,465	20,794	7,681
Other associates (Note)	318,079	32,573	96,386	22,265
	<u>1,160,723</u>	<u>90,090</u>	<u>339,513</u>	<u>72,359</u>

Assets RMB'000	Liabilities RMB'000	Revenues RMB'000	Profit RMB'000
-------------------	------------------------	---------------------	-------------------

**2009**

An Southeast Asia based online game company, 30.02% equity interest	436,290	22,203	152,934	15,957
Other associates (Note)	65,933	2,398	18,353	6,249
	<u>502,223</u>	<u>24,601</u>	<u>171,287</u>	<u>22,206</u>

Note:

The carrying amount of each individual associate as at 31 December 2010 was below RMB80,000,000 (2009: Below RMB50,000,000).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 13 INVESTMENT IN A JOINTLY CONTROLLED ENTITY

	2010 RMB'000	2009 RMB'000
Beginning of the year	–	–
Additions	71,143	–
Share of profit of a jointly controlled entity	3,399	–
	<hr/>	<hr/>
End of the year	<u>74,542</u>	<u>–</u>

In August 2010, the Group acquired 49.92% equity interest of an Internet service company in Thailand with a total consideration of USD10,501,000 (approximately RMB71,143,000). The vendor is a wholly-owned subsidiary of Naspers Limited, the holding company of MIH China (BVI) Limited, which is the substantial shareholder of the Company. Accordingly, the transaction was regarded as related parties transaction.

The Group's share of the results of its jointly controlled entity, which is unlisted, and its assets (including goodwill) and liabilities, are shown as follows:

	Assets RMB'000	Liabilities RMB'000	Revenues RMB'000	Profit RMB'000
<b>2010</b>				
A jointly controlled entity	<u>235,827</u>	<u>161,285</u>	<u>10,329</u>	<u>3,399</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 14 FINANCIAL INSTRUMENTS BY CATEGORY

## The Group

## Assets

## At 31 December 2010

	Loans and receivables RMB'000	Available- for-sale financial assets RMB'000	Held-to- maturity investments RMB'000	Total RMB'000
Available-for-sale financial assets (Note 16)	–	4,126,878	–	4,126,878
Accounts receivable (Note 17)	1,715,412	–	–	1,715,412
Deposits and other receivables	281,126	–	–	281,126
Term deposits with initial term of over three months (Note 19)	11,725,743	–	–	11,725,743
Restricted cash (Note 28)	1,036,457	–	–	1,036,457
Cash and cash equivalents (Note 20)	10,408,257	–	–	10,408,257
Total	<u>25,166,995</u>	<u>4,126,878</u>	<u>–</u>	<u>29,293,873</u>

## At 31 December 2009

Available-for-sale financial assets (Note 16)	–	153,462	–	153,462
Accounts receivable (Note 17)	1,229,436	–	–	1,229,436
Deposits and other receivables	223,618	–	–	223,618
Held-to-maturity investments (Note 15)	–	–	341,410	341,410
Term deposits with initial term of over three months (Note 19)	5,310,168	–	–	5,310,168
Restricted cash (Note 28)	200,000	–	–	200,000
Cash and cash equivalents (Note 20)	6,043,696	–	–	6,043,696
Total	<u>13,006,918</u>	<u>153,462</u>	<u>341,410</u>	<u>13,501,790</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

**14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)****The Group (Cont'd)****Liabilities****At 31 December 2010**

	Liabilities at fair value through the profit or loss RMB'000	Other financial liabilities at amortised cost RMB'000	Total RMB'000
Accounts payable (Note 24)	–	1,380,464	1,380,464
Other payables and accruals (excluded prepayment received from customers)	–	2,923,185	2,923,185
Short-term bank borrowings (Note 28)	–	5,298,947	5,298,947
Derivative financial instruments	17,964	–	17,964
	<u>17,964</u>	<u>–</u>	<u>17,964</u>
Total	<u>17,964</u>	<u>9,602,596</u>	<u>9,620,560</u>

**At 31 December 2009**

Accounts payable (Note 24)	–	696,511	696,511
Other payables and accruals (excluded prepayment received from customers)	–	1,554,115	1,554,115
Long-term payables (Note 27)	–	274,050	274,050
Short-term bank borrowings (Note 28)	–	202,322	202,322
	<u>–</u>	<u>2,726,998</u>	<u>2,726,998</u>
Total	<u>–</u>	<u>2,726,998</u>	<u>2,726,998</u>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 14 FINANCIAL INSTRUMENTS BY CATEGORY (Cont'd)

#### The Company (Cont'd)

##### Liabilities

##### At 31 December 2010

Amounts due to subsidiaries

Other payables and accruals

Total

**Other financial  
liabilities  
at amortised cost  
RMB'000**

**1,833,802**

**56,279**

**1,890,081**

##### At 31 December 2009

Amounts due to subsidiaries

Other payables and accruals

Total

1,107,184

24,517

1,131,701

### 15 HELD-TO-MATURITY INVESTMENTS

As at 31 December 2009, the held-to-maturity investments represented a USD principal protected note with a principal amount of USD50,000,000. The note was interest bearing at a fixed annual rate and would mature in 2013. During the year ended 31 December 2010, the Group had early redeemed this investment.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 16 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2010 RMB'000	2009 RMB'000
Beginning of the year	153,462	86,180
Additions	2,179,096	67,282
Transfer to investment in associates	(26,809)	–
Net gains recognised in other comprehensive income (Note 22)	1,821,129	–
	<u>4,126,878</u>	<u>153,462</u>
End of the year	<u>4,126,878</u>	<u>153,462</u>
Non-current portion	<u>4,126,878</u>	<u>153,462</u>
Available-for-sale financial assets include the following:		
Listed equity interests:		
7.56% (2009: Nil) economic interest in Mail.ru Group Limited	<u>3,869,033</u>	–
Unlisted equity interests:		
8.30% (2009: Nil) equity interest in an online game company in Korea	68,263	–
14.56% (2009: 14.56%) equity interest in an online game company in the PRC	40,000	40,000
13.99% (2009: 13.99%) equity interest in an online game company in Korea	37,017	37,017
10% (2009: 6%) equity interest in an Internet company in India	33,198	14,758
19.71 % (2009: 10.90%) equity interest in an online game company in Korea	26,207	8,118
10.70% (2009: 10.70%) equity interest in an Internet search engine service company in the PRC	20,477	20,477
Others	<u>32,683</u>	<u>33,092</u>
	<u>4,126,878</u>	<u>153,462</u>
Market value of listed securities	<u>3,869,033</u>	–

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 16 AVAILABLE-FOR-SALE FINANCIAL ASSETS (Cont'd)

On 12 April 2010, the Group and Digital Sky Technology Limited (“DST”), a company incorporated in BVI and one of the largest Internet companies in the Russian-speaking and Eastern European markets, entered into a share subscription agreement pursuant to which the Group subscribed for an aggregate of 8,114 ordinary shares of DST for a total cash consideration at USD300,002,000 (approximately RMB2,047,904,000). After completion of the transaction, the Group held approximately 10.3% economic interest in DST and 0.5% of the total voting rights of DST.

DST then changed its name to Mail.ru Group Limited (“Mail.ru”) and completed its Initial Public Offering (“IPO”) in November 2010. The global depositary receipts (“GDRs”) of Mail.ru (each GDR representing one ordinary share) commenced their unconditional trading in the London Stock Exchange on 11 November 2010. After the IPO, the Group held 16,228,000 ordinary shares in Mail.ru, representing approximately 7.56% economic interest in the company on a fully diluted basis. The Group’s interest in Mail.ru is subject to a 180-day lock-up period.

At 31 December 2010, the carrying amount of the interest in Mail.ru held by the Company exceeded 10% of total assets of the Company and the Group.

As at 31 December 2010 and 2009, there were certain call options embedded in available-for-sale financial assets. The directors considered that the fair value of such call options was insignificant and accordingly, the Group did not separately recognise these call options in the financial statements.

### 17 ACCOUNTS RECEIVABLE

	2010 RMB'000	2009 RMB'000
0 - 30 days	931,438	690,858
31 - 60 days	331,922	173,331
61 - 90 days	143,785	112,752
Over 90 days but less than a year	308,267	252,495
	<u>1,715,412</u>	<u>1,229,436</u>

All accounts receivable are denominated in RMB.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 17 ACCOUNTS RECEIVABLE (Cont'd)

The carrying amounts of accounts receivable of the Group's major agents/customers are as follows:

	<b>2010</b>	2009
	<b>RMB'000</b>	RMB'000
Telecommunications operators	<b>1,030,549</b>	796,802
Online advertising customers	<b>613,427</b>	421,328
Others	<b>71,436</b>	11,306
	<b><u>1,715,412</u></b>	<u>1,229,436</u>

While there are no contractual requirements for telecommunication operators to pay amounts owed to the Group within a specified period of time, these customers usually settle the amounts due by them within a period of 30 to 120 days. Online advertising customers, which are mainly advertising agencies, are usually granted a credit period of 90 days after full execution of the contracted advertisement orders.

As at 31 December 2010, insignificant amounts of accounts receivable were past due. No impairment provision was considered necessary after management had performed assessment on their credit quality with reference to historical counterparty default rates.

The directors considered that the carrying value of the receivable balance approximated its fair value as at 31 December 2010.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 18 PREPAYMENTS, DEPOSITS AND OTHER ASSETS

	2010 RMB'000	2009 RMB'000
Included in non-current assets:		
Prepayment for land use rights (Note (a))	<b>258,237</b>	–
Prepayment for online game licences	<b>187,193</b>	–
Loan to a related party (Note (b))	–	54,700
Non-current portion of running royalty fees for online games	–	25,606
	<b>445,430</b>	80,306
Included in current assets:		
Current portion of running royalty fees for online games	<b>85,755</b>	35,460
Prepaid expenses	<b>120,991</b>	95,404
Advances to suppliers	–	73,860
Rental deposits and other deposits	<b>46,466</b>	14,448
Interests receivable	<b>89,435</b>	53,450
Refundable value added tax (“VAT”)	<b>45,764</b>	57,052
Others	<b>99,461</b>	43,968
	<b>487,872</b>	373,642
	<b>933,302</b>	453,948

Notes:

- (a) During the year ended 31 December 2010, the Group entered into an agreement to purchase land use rights associated with pieces of land located in Beijing, the PRC for construction of office buildings. The total cash consideration was approximately RMB430,395,000, of which RMB258,237,000 was paid before 31 December 2010 in accordance with the payment terms of the agreement.
- (b) The amount represented the outstanding balance of a loan due by Shenzhen Shijiaqi Investment Company Limited (“Shijiaqi”), a limited liability company incorporated in the PRC and wholly owned by Mr Zhang Yan, a director of Shenzhen Domain, a non-wholly owned subsidiary of the Company as at 31 December 2009. Such loan had been fully settled as at 31 December 2010.

As at 31 December 2010, the carrying amounts of the prepayments, deposits and other assets approximated their fair values.

Deposits and other receivables (excluding prepayment for land use rights, prepaid expenses, prepayment for online game licences and running royalty fees for online games) were neither past due nor impaired. Their recoverability was assessed with reference made to the credit status of the recipients.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 19 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

The effective interest rate for the term deposits of the Group with initial term of over three months for the year ended 31 December 2010 was 2.15% (2009: 2.17%).

An analysis of the Group and the Company's term deposits denominated in USD and HKD with initial term of over three months as at 31 December 2010 was presented in Note 3.1(a).

The directors considered that the carrying value of the term deposits with initial term of over three months approximated their fair value as at 31 December 2010. Term deposits with initial term of over three months were neither past due nor impaired.

As at 31 December 2010, approximately 94% (2009: 91%) of these term deposits were placed in the Bank of China, Agricultural Bank of China, China Construction Bank, China Merchants Bank, Industrial and Commercial Bank of China and Morgan Stanley Bank International (China) Limited.

### 20 CASH AND CASH EQUIVALENTS

	Group		Company	
	2010	2009	2010	2009
	RMB'000	RMB'000	RMB'000	RMB'000
Cash in bank and on hand	<b>5,688,087</b>	1,898,166	<b>237,525</b>	101,426
Term deposits with initial term within three months	<b>4,720,170</b>	4,145,530	–	655
	<b>10,408,257</b>	6,043,696	<b>237,525</b>	102,081
Maximum exposure to credit risk	<b>10,407,767</b>	6,043,069	<b>237,525</b>	101,842

The effective interest rates of the term deposits of the Group with initial term within three months for the year ended 31 December 2010 and 2009 were 1.62% and 1.48%, respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 20 CASH AND CASH EQUIVALENTS (Cont'd)

Details of the balances denominated in USD and HKD maintained by the Group and the Company as at 31 December 2010 are presented in Note 3.1(a). Approximately RMB7,648,272,000 (2009: RMB5,482,886,000) of the total balance of the Group was denominated in RMB and it was deposited with banks in the PRC. The Company had no material cash balance denominated in RMB.

As at 31 December 2010, cash at bank and term deposits with initial term within three months were neither past due nor impaired. In addition, approximately 88% (2009: approximately 92%) of cash and cash equivalents of the Group were placed in Standard Chartered Bank, The Hongkong and Shanghai Banking Corporation, Bank of China, Agricultural Bank of China, China Construction Bank, China Merchants Bank and Industrial and Commercial Bank of China.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 21 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE

The total authorised share capital of the Company comprises 10,000,000,000 ordinary shares (2009: same) with par value of HKD0.0001 per share (2009: HKD0.0001 per share).

As at 31 December 2010, 1,835,730,235 ordinary shares (2009: 1,818,890,059 ordinary shares) were issued and allotted. They were all fully paid up.

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Total RMB'000
<b>At 1 January 2009</b>	1,796,513,053	195	1,155,209	(21,809)	381,439	1,515,034
Employee share option schemes:						
- value of employee services	-	-	-	-	167,178	167,178
- number of shares issued and proceeds received	16,249,906	2	165,446	-	-	165,448
Employee share award scheme:						
- value of employee services	-	-	-	-	154,946	154,946
- shares purchased for share award scheme	-	-	-	(103,618)	-	(103,618)
- shares allotted for share award scheme	8,181,180	-	-	-	-	-
- cancellation of shares pursuant to share award scheme	(132,080)	-	-	-	-	-
- shares vested from share award scheme and transferred to grantee	-	-	(1,660)	1,660	-	-
Repurchase and cancellation of shares	(1,922,000)	-	(74,570)	-	-	(74,570)
<b>At 31 December 2009</b>	<u>1,818,890,059</u>	<u>197</u>	<u>1,244,425</u>	<u>(123,767)</u>	<u>703,563</u>	<u>1,824,418</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 21 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Shares held for share award scheme RMB'000	Share-based compensation reserve RMB'000	Total RMB'000
<b>At 1 January 2010</b>	<b>1,818,890,059</b>	<b>197</b>	<b>1,244,425</b>	<b>(123,767)</b>	<b>703,563</b>	<b>1,824,418</b>
Employee share option schemes:						
- value of employee services	-	-	-	-	139,621	139,621
- number of shares issued and proceeds received (Note (i))	15,801,201	1	199,248	-	-	199,249
Employee share award scheme:						
- value of employee services	-	-	-	-	356,479	356,479
- shares purchased for share award scheme (Note (ii))	-	-	-	(167,519)	-	(167,519)
- shares allotted for share award scheme (Note (iv))	3,662,975	-	-	-	-	-
- shares vested from share award scheme and transferred to the grantees	-	-	(33,149)	33,149	-	-
Repurchase and cancellation of shares	(2,624,000)	-	(310,222)	-	-	(310,222)
<b>At 31 December 2010</b>	<b>1,835,730,235</b>	<b>198</b>	<b>1,100,302</b>	<b>(258,137)</b>	<b>1,199,663</b>	<b>2,042,026</b>

As at 31 December 2010, the total number of issued ordinary shares of the Company was 1,835,730,235 shares (2009: 1,818,890,059 shares) which included 13,562,814 shares (2009: 10,411,434 shares) held under the share award scheme (Note 23(b)).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 21 SHARE CAPITAL, SHARE PREMIUM, SHARES HELD FOR SHARE AWARD SCHEME AND SHARE-BASED COMPENSATION RESERVE (Cont'd)

Notes:

- (i) During the year ended 31 December 2010, 14,499,326 Post-IPO options with exercise prices ranging from HKD3.6650 to HKD90.3000; and 1,301,875 Pre-IPO options with exercise prices ranging from USD0.0497 to USD0.4396 were exercised.
- (ii) During the year ended 31 December 2010, the Share Scheme Trust (as described in Note 23(b)) acquired 1,184,883 ordinary shares of the Company in the open market for the purpose of the share award scheme. The total amount paid was HKD191,447,000 (equivalent to approximately RMB167,519,000) and had been deducted from shareholders' equity.
- (iii) During the year ended 31 December 2010, the Share Scheme Trust transferred 1,696,478 ordinary shares of the Company (2009: 132,376 shares) to the share awardees upon vesting of the awarded shares.
- (iv) During the year ended 31 December 2010, the Company allotted 3,662,975 ordinary shares (2009: 8,181,180 shares) to the Share Scheme Trust for the purpose of granting awarded shares under the share award scheme.
- (v) As at 31 December 2010, included in "Shares held for share award scheme", 80 shares (2009: 10 shares) held by the Share Scheme Trust had not yet been granted to employees (Note 23(b)). They represented "treasury shares" of the Group as at that date.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 22 OTHER RESERVES

	PRC statutory reserves					Total RMB'000
	Capital reserve (Note i) RMB'000	Revaluation reserve RMB'000	Other reserves RMB'000	Statutory	Reserve	
				surplus reserve fund (Note ii) RMB'000	fund (Note ii) RMB'000	
<b>Balance at 1 January 2009</b>	20,000	(6,174)	(515,000)	55,731	12,405	(433,038)
Exercise of put options granted to non-controlling interest owners	-	-	281	-	-	281
Reversal of the liabilities in respect of put options granted to non-controlling interest owners	-	-	264,200	-	-	264,200
Profit appropriations to statutory reserves	-	-	-	2,193	-	2,193
<b>Balance at 31 December 2009</b>	<u>20,000</u>	<u>(6,174)</u>	<u>(250,519)</u>	<u>57,924</u>	<u>12,405</u>	<u>(166,364)</u>
<b>Balance at 1 January 2010</b>	<b>20,000</b>	<b>(6,174)</b>	<b>(250,519)</b>	<b>57,924</b>	<b>12,405</b>	<b>(166,364)</b>
Reversal of the liabilities in respect of the put options granted to non-controlling interest owners (Note 27)	-	-	94,246	-	-	94,246
Acquisition of additional interests in a subsidiary (Note 44)	-	-	154,198	-	-	154,198
Profit appropriations to statutory reserves	-	-	-	8,237	-	8,237
Appreciation of available-for-sale financial assets (Note 16)	-	-	1,821,129	-	-	1,821,129
Transfer to retained earnings	-	6,174	2,075	-	-	8,249
<b>Balance at 31 December 2010</b>	<u>20,000</u>	<u>-</u>	<u>1,821,129</u>	<u>66,161</u>	<u>12,405</u>	<u>1,919,695</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 22 OTHER RESERVES (Cont'd)

Notes:

- (i) The capital reserve arises upon elimination of the registered capital balance of Tencent Computer upon formation of the Group.
- (ii) In accordance with the Companies Laws of the PRC and the stipulated provisions of the articles of association of subsidiaries with limited liabilities in the PRC, appropriation of net profits (after offsetting accumulated losses from prior years) should be made by these companies to their respective Statutory Surplus Reserve Funds and the Discretionary Reserve Funds before distributions are made to the owners. The percentage of appropriation to Statutory Surplus Reserve Fund is 10%. The amount to be transferred to the Discretionary Reserve Fund is determined by the equity owners of these companies. When the balance of the Statutory Surplus Reserve Fund reaches 50% of the registered capital, such transfer needs not to be made. Both the Statutory Surplus Reserve Fund and Discretionary Reserves Fund can be capitalised as capital of an enterprise, provided that the remaining Statutory Surplus Reserve Fund shall not be less than 25% of the registered capital.

In addition, in accordance with the Law of the PRC on Enterprises with Foreign Investments and the stipulated provisions of the articles of association of wholly owned foreign subsidiaries in the PRC, appropriation from net profits (after offsetting accumulated losses brought forward from prior years) should be made by these companies to their respective Reserve Funds. The percentage of net profit to be appropriated to the Reserve Fund is not less than 10% of the net profit. When the balance of the Reserve Fund reaches 50% of the registered capital, such transfer needs not be made.

With approvals obtained from their respective boards of directors of these companies, the Reserve Fund can be used to offset accumulated deficit or to increase capital.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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### 23 SHARE OPTION AND SHARE AWARD SCHEMES

#### (a) Share option schemes

The Company has adopted several share option schemes for the purpose of providing incentives and rewards to its directors, executives or officers, employees, consultants and other eligible persons:

(i) Pre-IPO Share Option Scheme (the “Pre-IPO Option Scheme”)

On 27 July 2001, the Company adopted the Pre-IPO Option Scheme. As at the listing date of the Company on 16 June 2004, all options under the Pre-IPO Option Scheme had been granted.

(ii) Post-IPO Share Option Scheme I (the “Post-IPO Option Scheme I”)

On 24 March 2004, the Company adopted the Post-IPO Option Scheme I in which the Board may, at its discretion, invite any employee, consultant or director of any company in the Group to take up options to subscribe for shares in the Company at a price determined by it pursuant to the terms of the scheme. The Post-IPO Option Scheme I will remain in force for a period of ten years, commencing on the adoption date.

The Post-IPO Option Scheme I was terminated upon the adoption of the Post-IPO Share Option Scheme II (the “Post-IPO Option Scheme II”) as mentioned below.

(iii) Post-IPO Option Scheme II

On 16 May 2007, the Company adopted the Post-IPO Option Scheme II. Pursuant to the Post-IPO Option Scheme II, the Board may, at its discretion, grant options to any eligible person to subscribe for shares in the Company. The Post-IPO Option Scheme II shall be valid and effective for a period of ten years commencing on its date of adoption.

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme II shall not exceed 88,903,654 shares, 5% of the issued shares as at the date of shareholders’ approval of the Post-IPO Option Scheme II (the “Scheme Mandate Limit A”). Options lapsed in accordance with the terms of the Post-IPO Option Scheme II shall not be counted for the purpose of calculating the 5% limit. The Company may refresh the Scheme Mandate Limit A by an ordinary resolution of the shareholders passed in a general meeting, provided that the Scheme Mandate Limit A so refreshed shall not exceed 5% of the issued shares as at the date the shareholders approve the refreshing of such Scheme Mandate Limit A. Options previously granted under any existing schemes (including options outstanding, cancelled, or lapsed in accordance with the relevant scheme rules or exercised options) shall not be counted for the purpose of calculating the limit as refreshed. Options granted under the Post-IPO Option Scheme II will expire no later than the last day of the seven-year period after the date of grant of options (subject to early termination as set out in the terms of the Post-IPO Option Scheme II).

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### 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

#### (a) Share option schemes (Cont'd)

- (iv) Post-IPO Share Option Scheme III (the "Post-IPO Option Scheme III")

On 13 May 2009, the Company adopted the Post-IPO Option Scheme III. Pursuant to the Post-IPO Option Scheme III, the Board may, at its discretion, grant options to any eligible person (any senior executive or senior officer, director of any member of the Group or any invested entity and any consultant, advisor or agent of any member of the Board) to subscribe for shares in the Company. The Post-IPO Option Scheme III shall be valid and effective for a period of ten years commencing on its date of adoption.

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme III shall not exceed 36,018,666 shares, 2% of the issued shares as at the date of shareholders' approval of this scheme (the "Scheme Mandate Limit B"). Options lapsed in accordance with the terms of the Post-IPO Option Scheme III shall not be counted for the purpose of calculating the 2% limit. The Company may refresh the Scheme Mandate Limit B by an ordinary resolution of the shareholders passed in a general meeting, provided that the Scheme Mandate Limit B so refreshed shall not exceed 2% of the issued shares as at the date the shareholders approve the refreshing of such Scheme Mandate Limit B. Options previously granted under any existing schemes (including options outstanding, cancelled, or lapsed in accordance with the relevant scheme rules or exercised options) shall not be counted for the purpose of calculating the limit as refreshed. Options granted under the Post-IPO Option Scheme III will expire after the last day of the ten-year period after the date of grant of options (subject to early termination as set out in the terms of the Post-IPO Option Scheme III).

The maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Post-IPO Option Scheme II, the Post-IPO Option Scheme III and any other share option schemes of the Company must not in aggregate exceed 30% of issued shares from time to time.

The maximum number of shares (issued and to be issued) in respect of which options may be granted under the Post-IPO Option Scheme II, the Post-IPO Option Scheme III and any other share option schemes of the Company (whether exercised, cancelled or outstanding) to any eligible person in any 12-month period shall not exceed 1% of the issued shares from time to time unless such grant has been duly approved by an ordinary resolution of the shareholders in a general meeting at which the relevant eligible person and his associates are abstained from voting. In calculating the aforesaid limit of 1%, options that have lapsed shall not be counted.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

## (a) Share option schemes (Cont'd)

## (1) Movements in share options

Movements in the number of options outstanding and their related weighted average exercise prices are as follows:

	Pre-IPO Option Scheme		Post-IPO Option Scheme I		Post-IPO Option Scheme II		Post-IPO Option Scheme III		Total
	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	Average exercise price	No. of options	No. of options
<b>At 1 January 2009</b>	USD0.0964	4,124,083	HKD10.4762	37,615,536	HKD41.2330	28,715,506	-	-	70,455,125
Granted	-	-	-	-	HKD89.8122	2,952,150	-	-	2,952,150
Exercised	USD0.1164	(2,004,895)	HKD8.4108	(12,249,167)	HKD54.2627	(1,995,844)	-	-	(16,249,906)
Lapsed	USD0.0498	(254,120)	HKD9.6262	(424,451)	HKD45.7985	(680,393)	-	-	(1,358,964)
<b>At 31 December 2009</b>	USD0.0812	1,865,068	HKD11.5050	24,941,918	HKD45.1756	28,991,419	-	-	55,798,405
Currently exercisable as at 31 December 2009	USD0.0812	1,865,068	HKD9.6579	18,037,478	HKD41.5573	3,057,144	-	-	22,959,690
<b>At 1 January 2010</b>	USD0.0812	1,865,068	HKD11.5050	24,941,918	HKD45.1756	28,991,419	-	-	55,798,405
Granted	-	-	-	-	HKD138.3689	2,708,350	HKD158.5000	1,000,000	3,708,350
Exercised	USD0.0759	(1,301,875)	HKD9.9387	(11,925,949)	HKD32.3254	(2,573,377)	-	-	(15,801,201)
Lapsed	-	-	HKD17.9512	(210,206)	HKD58.2388	(331,224)	-	-	(541,430)
<b>At 31 December 2010</b>	USD0.0935	563,193	HKD12.8579	12,805,763	HKD54.9391	28,795,168	HKD158.5000	1,000,000	43,164,124
Currently exercisable as at 31 December 2010	USD0.0935	563,193	HKD11.2750	11,069,343	HKD41.4494	6,210,804	-	-	17,843,340

During the year ended 31 December 2010, 1,000,000 share options (2009: Nil) were granted to an executive director of the Company.

As a result of options exercised during the year ended 31 December 2010, 15,801,201 (2009: 16,249,906) ordinary shares were issued by the Company (Note 21). The weighted average price of the shares at the time these options were exercised was HKD161.12 (equivalent to approximately RMB140.40) per share (2009: HKD90.56 per share).

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## 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

## (a) Share option schemes (Cont'd)

## (2) Outstanding share options

Details of the expiry dates, exercise prices and the respective numbers of share options which remained outstanding as at 31 December 2010 and 2009 are as follows:

Expiry Date	Range of exercise price	Number of options	
		2010	2009
31 December 2011 (Pre-IPO Option Scheme)	USD0.0497	<b>482,700</b>	1,660,300
	USD0.1967-USD0.4396	<b>80,493</b>	204,768
		<b>563,193</b>	1,865,068
10 years commencing from the adoption date of 24 March 2004 (Post-IPO Option Scheme I)	HKD3.6650-HKD8.3500	<b>5,553,585</b>	13,237,120
	HKD11.5500-HKD25.2600	<b>7,252,178</b>	11,704,798
		<b>12,805,763</b>	24,941,918
7 years commencing from date of grant of options (Post-IPO Option Scheme II)	HKD31.7500-HKD43.5000	<b>14,186,579</b>	15,589,627
	HKD45.5000-HKD90.3000	<b>11,660,539</b>	13,137,092
	HKD128.4000-HKD158.5000	<b>2,948,050</b>	264,700
		<b>28,795,168</b>	28,991,419
10 years commencing from date of grant of options (Post-IPO Option Scheme III)	HKD158.5000	<b>1,000,000</b>	–
		<b>43,164,124</b>	55,798,405

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For the year ended 31 December 2010  
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### 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

#### (a) Share option schemes (Cont'd)

##### (3) Fair value of options

The directors have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement on parameters, such as risk free rate, dividend yield and expected volatility, is required to be made by the directors in applying the BS Model.

The fair value of the options granted to employees, together with the parameters used, during the period from 1 January 2009 to 31 December 2010 are as follows:

Date of grant	Fair value of options	No. of options granted	Exercise price	Closing	Risk free rate	Dividend yield	Expected volatility	Exercisable date
				share price at date of grant				
17/2/2009	HKD6,613,000	380,000	HKD48.01	HKD45.75	1.45%	0.71%	54.0%	Based on grant date (Note (iv))
10/7/2009	HKD92,727,000	2,307,450	HKD90.30	HKD90.30	2.14%	0.71%	53.4%	Based on grant date: 393,950 options (Note (iv)), 1,162,250 options (Note (v)) and 751,250 options (Note (vi))
24/9/2009	HKD748,000	14,700	HKD128.40	HKD128.40	2.21%	0.71%	53.0%	Based on grant date (Note (iv))
24/11/2009	HKD16,827,000	250,000	HKD146.58	HKD145.10	1.92%	0.71%	52.7%	Based on grant date (Note (vi))
24/3/2010	HKD55,365,000	750,000	HKD158.50	HKD158.30	2.35%	0.63%	52.1%	Based on grant date: 25,000 options (Note (v)), 500,000 options (Note (vii)) and 225,000 options (Note (viii))
24/3/2010	HKD83,898,000	1,000,000	HKD158.50	HKD158.30	2.73%	0.63%	52.1%	Based on grant date (Note (ix))
5/7/2010	HKD110,630,000	1,933,350	HKD130.40	HKD130.40	2.06%	0.63%	51.5%	Based on grant date : 163,300 options (Note (iv)), 1,067,550 options (Note (v)) and 702,500 options (Note (x))
13/8/2010	HKD1,414,000	25,000	HKD 150.70	HKD144.80	1.72%	0.63%	51.1%	Based on grant date: 12,500 options (Note (iv)) and 12,500 options (Note (v))

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### 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

#### (a) Share option schemes (Cont'd)

##### (3) Fair value of options (Cont'd)

Notes:

- (i) The risk free rate was determined based on the yield to maturity of Hong Kong Government Bonds with maturity in December 2015, June 2016 or December 2016, June 2017, December 2017, or December 2019 as at the date of valuation.
- (ii) Dividend yield was estimated based on the Company's historical dividend yield.
- (iii) Volatility, measured as the standard deviation of expected share price returns, was determined based on the average daily trading price volatility of the shares of the Company.
- (iv) The first 20% of the option can be exercised one year after the grant date, and then each 20% of the total options will become exercisable in each subsequent year.
- (v) The first 20% of the option can be exercised two years after the grant date, and then each 20% of the total options will become exercisable in each subsequent year.
- (vi) The first 20% of the option can be exercised three years after the grant date, and then each 20% of the total options will become exercisable in each subsequent year, except the last 20% of the total options which will become exercisable in the eleventh month after the fourth 20% of the total options become exercisable.
- (vii) The first 50% of the option can be exercised four years after the grant date, and then the remaining 50% of the total options will become exercisable in the subsequent year.
- (viii) The first one-third of the option can be exercised four years after the grant date, and then each one-third of the total options will become exercisable in each subsequent year.
- (ix) The first 25% of the option can be exercised five years after the grant date, and then each 25% of the total options will become exercisable in each subsequent year.
- (x) The first 20% of the option can be exercised three years after the grant date, and then each 20% of the total options will become exercisable in each subsequent year. The last 20% of the total option will become exercisable in the eleventh month of the seventh year.

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### 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

#### (b) Share award scheme

On 13 December 2007, the Company adopted a share award scheme (the “Share Scheme”), which was subsequently amended on 31 January 2008 and 13 May 2009, respectively. The Board may, at its absolute discretion, select any eligible persons (the “Awarded Persons”) to participate in the Share Scheme.

Pursuant to the Share Scheme, ordinary shares of the Company are acquired by an independent trustee (the “Trustee”) at the cost of the Company or shares are allotted to the Trustee under general mandates granted or to be granted by shareholders of the Company at general meetings from time to time. These shares are/will be held in trust for the Awarded Persons by the Trustee until the end of each vesting period. Vested shares are/will be transferred at no cost to the Awarded Persons. The Awarded Persons are not entitled to the dividends on the awarded shares not yet transferred to them.

Unless it is early terminated by the Board, the Share Scheme shall be valid and effective for a term of fifteen years commencing on the adoption date according to the amendment on 13 May 2009.

The number of shares to be awarded under the Share Scheme throughout its duration shall not exceed 2% of the issued share capital of the Company as at the adoption date. The maximum number of shares which may be awarded to an Awarded Person under the Share Scheme shall not exceed 1% of the issued share capital of the Company as at the adoption date.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

## (b) Share award scheme (Cont'd)

- (1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares

Movements in the number of shares held for the Share Scheme and awarded shares for the years ended 31 December 2010 and 2009 are as follows:

	Shares held for the Share Scheme	Awarded shares
<b>At 1 January 2009</b>	132,160	1,349,450
Purchased	1,013,100	–
Allotted to Share Scheme	8,181,180	–
Granted to the employee	(9,194,350)	9,194,350
Cancelled	(132,080)	–
Vested	–	(132,376)
	<u>10</u>	<u>10,411,424</u>
<b>At 31 December 2009</b>	<u>10</u>	<u>10,411,424</u>
Currently exercisable as at 31 December 2009		<u>339,056</u>
<b>At 1 January 2010</b>	<b>10</b>	<b>10,411,424</b>
Purchased (Note 21(ii))	<b>1,184,883</b>	–
Allotted to Share Scheme	<b>3,662,975</b>	–
Granted to the employee	<b>(4,847,788)</b>	<b>4,847,788</b>
Vested	–	<b>(1,696,478)</b>
	<u>80</u>	<u>13,562,734</u>
<b>At 31 December 2010</b>	<u>80</u>	<u>13,562,734</u>
Currently exercisable as at 31 December 2010		<u>101,337</u>

During the year ended 31 December 2010, no awarded shares (2009: Nil) had been granted to any director of the Company.

The fair value of the awarded shares was calculated based on market prices of the Company's shares as at the respective grant dates. The expected dividends during the vesting periods have been taken into account when assessing the fair value of these awarded shares.

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### 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

#### (b) Share award scheme (Cont'd)

- (1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

The fair value of the awarded shares and their vesting dates during the period from 1 January 2009 to 31 December 2010 are as follows:

<b>Date of grant</b>	<b>Total value of shares at grant date</b>	<b>No. of shares granted</b>	<b>market price at grant date</b>	<b>Vesting date (Note(i))</b>
23/1/2009	HKD5,341,000	120,700	HKD44.25	Based on grant date: 60,700 shares (Note (ii)), 35,000 shares (Note (iv)) and 25,000 shares (Note (v))
17/2/2009	HKD1,144,000	25,000	HKD45.75	Based on grant date (Note (ii))
10/7/2009	HKD772,599,000	8,555,910	HKD90.30	Based on grant date: 4,746,045 shares (Note (ii)), 3,456,575 shares (Note (iii)), 41,600 shares (Note (iv)), 196,690 shares (Note (vii)), 15,000 shares (Note (viii)), 35,000 shares (Note (ix)), 35,000 shares (Note (x)) and 30,000 shares (Note (xi))
22/9/2009	HKD23,916,000	186,840	HKD128.00	Based on grant date: 144,420 shares (Note (ii)), 40,820 shares (Note (iii)) and 1,600 shares (Note(iv))
24/11/2009	HKD24,725,000	170,400	HKD145.10	Based on grant date: 38,650 shares (Note (ii)), 23,750 shares (Note (iii)), 8,000 shares (Note (v)) and 100,000 shares (Note (vii))

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

## (b) Share award scheme (Cont'd)

- (1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
15/12/2009	HKD21,870,000	135,500	HKD161.40	Based on grant date: 116,500 shares (Note (ii)), 16,500 shares (Note (iii)) and 2,500 shares (Note (vii))
8/1/2010	HKD7,656,000	45,600	HKD167.90	Based on grant date: 36,850 shares (Note (ii)) and 8,750 shares (Note (iii))
24/3/2010	HKD29,618,000	187,100	HKD158.30	Based on grant date: 15,100 shares (Note (v)), 70,500 shares (Note (ii)), 11,500 shares (Note (iii)) and 90,000 shares (Note (vi))
9/4/2010	HKD56,668,000	351,100	HKD161.40	Based on grant date: 115,500 shares (Note (xii)), 229,800 shares (Note (ii)) and 5,800 shares (Note (iii))
13/5/2010	HKD27,965,000	175,993	HKD158.90	Based on grant date: 25,000 shares (Note (xiii)), 10,500 shares (Note (iv)), 100,000 (Note (viii)), 37,993 (Note (ii)) and 2,500 shares (Note (iii))

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## 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

## (b) Share award scheme (Cont'd)

- (1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
2/6/2010	HKD6,452,000	42,500	HKD151.80	Based on grant date: 10,000 shares (Note (iv)), 29,000 shares (Note (ii)) and 3,500 shares (Note (iii))
5/7/2010	HKD486,691,000	3,732,295	HKD130.40	Based on grant date: 52,725 shares (Note (v)), 1,814,715 shares (Note (ii)), 1,417,330 shares (Note (iii)), 397,525 shares (Note (vii)) and 50,000 shares (Note (xiv))
7/7/2010	HKD1,088,000	8,000	HKD136.00	Based on grant date: 4,000 shares (Note (ii)) and 4,000 shares (Note (iii))
13/8/2010	HKD4,185,000	28,900	HKD144.80	Based on grant date: 23,900 shares (Note (ii)) and 5,000 shares (Note (iii))
3/9/2010	HKD5,518,000	38,000	HKD145.20	Based on grant date: 29,000 shares (Note (ii)) and 9,000 shares (Note (iii))
27/9/2010	HKD4,369,000	25,900	HKD168.70	Based on grant date: 21,700 shares (Note (ii)) and 4,200 shares (Note (iii))

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## 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

## (b) Share award scheme (Cont'd)

- (1) Movements in shares held for the Share Scheme and awarded shares, and the fair value of awarded shares (Cont'd)

Date of grant	Total value of shares at grant date	No. of shares granted	market price at grant date	Vesting date (Note(i))
17/11/2010	HKD19,254,000	115,500	HKD166.70	Based on grant date: 85,000 shares (Note (ii)) and 30,500 shares (Note (iii))
15/12/2010	HKD17,268,000	96,900	HKD178.20	Based on grant date: 91,900 shares (Note (ii)) and 5,000 shares (Note (iii))

Notes:

- (i) The awarded shares will generally be transferred to the Awarded Person on or about the relevant vesting dates.
- (ii) The first 20% of these awarded shares will be vested one year after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.
- (iii) The first 20% of these awarded shares will be vested two years after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.
- (iv) The first one-third of these awarded shares will be vested one year after the grant date, and then each one-third of the total awarded shares will be vested in each subsequent year.
- (v) The first 50% of these awarded shares will be vested one year after the grant date, and the remaining 50% of the total awarded shares will be vested in the subsequent year.
- (vi) The first one-third of these awarded shares will be vested four years after the grant date, and then each one-third of the total awarded shares will be vested in each subsequent year.
- (vii) The first 20% of these awarded shares will be vested three years after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.
- (viii) The first 25% of these awarded shares will be vested one year after the grant date, and then each 25% of the total awarded shares will be vested in each subsequent year.
- (ix) The first 50% of these awarded shares will be vested from 31 December 2009, and the remaining 50% of the total awarded shares will be vested in the subsequent year.
- (x) The first 50% of these awarded shares will be vested from 31 December 2010, and the remaining 50% of the total awarded shares will be vested in the subsequent year.

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### 23 SHARE OPTION AND SHARE AWARD SCHEMES (Cont'd)

#### (b) Share award scheme (Cont'd)

Notes: (Cont'd)

- (xi) The first 50% of these awarded shares will be vested from 31 December 2011, and the remaining 50% of the total awarded shares will be vested in the subsequent year.
- (xii) 66,000 shares of these awarded shares will be vested 3 months after the grant date, and then the remaining of the total awarded shares will be vested 15 months after the grant date.
- (xiii) The first 50% of these awarded shares will be vested 3 months after the grant date, and then the remaining 50% of the total awarded shares will be vested 15 months after the grant date.
- (xiv) The first 20% of these awarded shares will be vested four years after the grant date, and then each 20% of the total awarded shares will be vested in each subsequent year.

#### (2) Outstanding awarded shares

Details of fair value and the respective numbers of awarded shares which remained outstanding as at 31 December 2010 and 2009 are as follows:

Market price at grant date	Number of shares	
	2010	2009
HKD44.25 – HKD90.30	<b>8,361,903</b>	9,918,684
HKD128.00 – HKD178.20	<b>5,200,831</b>	492,740
	<b><u>13,562,734</u></b>	<b><u>10,411,424</u></b>

#### (c) Expected retention rate of grantees

The Group has to estimate the Expected Retention Rate of Grantees in order to determine the amount of share-based compensation expenses charged to the income statement. As at 31 December 2010, the Expected Retention Rate of Grantees was assessed to be 91% (31 December 2009: 91%).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 24 ACCOUNTS PAYABLE

Accounts payable and their ageing analysis are as follows:

	2010 RMB'000	2009 RMB'000
0 - 30 days	975,869	493,013
31 - 60 days	242,547	72,554
61 - 90 days	68,632	82,525
Over 90 days but less than a year	93,416	48,419
	<u>1,380,464</u>	<u>696,511</u>

## 25 OTHER PAYABLES AND ACCRUALS

	2010 RMB'000	2009 RMB'000
Staff costs and welfare accruals	1,337,627	846,349
Marketing and administrative expense accruals	533,631	267,417
Prepayments received from customers	74,623	71,936
Deposits from customer-to-customer business	766,472	265,136
Others	285,455	175,213
	<u>2,997,808</u>	<u>1,626,051</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 26 DERIVATIVE FINANCIAL INSTRUMENTS

	2010 RMB'000	2009 RMB'000
Foreign exchange forward contracts - held for trading	<u>17,964</u>	<u>–</u>

During the year ended 31 December 2010, the Group entered into foreign exchange forward contracts with several banks to purchase USD600,000,000 with RMB. The contracted amount of USD to be purchased was equal to the aggregate principal amounts of USD-denominated bank borrowings (details disclosed in Note 28) expected to be repaid by the Group. These forward contracts will mature within one year, and they will be settled at the difference between the forward rates stated in the contracts and the spot rates as at the respective maturity dates, multiplied by the notional amounts of the face value of the contracts.

### 27 LONG-TERM PAYABLES

	2010 RMB'000	2009 RMB'000
Non-current portion of the present value of running royalty fee	–	25,606
Present value of liabilities for the put options granted to non-controlling interest owners	<u>–</u>	<u>248,444</u>
	<u>–</u>	<u>274,050</u>

As at 31 December 2009, the long-term payables mainly represented a financial liability arising from certain put options granted to non-controlling interest owners of a 40% equity interest of Shenzhen Domain (“SZ Domain Holders”). In 2008, the Group granted put options to the SZ Domain Holders for selling their 40% equity interest (out of which 29% equity interest are held by Shijiaqi) in Shenzhen Domain to the Group, upon certain conditions were met (the “Option Equity Interest”).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 27 LONG-TERM PAYABLES (Cont'd)

As the Group did not have the unconditional right to avoid delivering cash under the put option agreement, the Group had previously recognised the relevant financial liability at an amount equal to the present value of the estimated future cash outflow when it would be required to acquire the Option Equity Interest. The directors of the Company also considered that the risk and reward for these equity interests would only be transferred to the Group upon the option was exercised. Accordingly, the initial recognition of the liabilities had been reflected as a debit made to equity attributable to the Company's equity holders.

At 31 December 2009, the put option liabilities recognised by the Group on the Option Equity Interest were approximately RMB248,444,000.

In April 2010, the Group entered into certain agreements to acquire the exercisable Option Equity Interest (representing approximately 32% of equity interest in Shenzhen Domain) from the holders at a total consideration of RMB154,198,000 (Note 44). As a result, the original put option agreement was terminated and the directors of the Company revised the relevant put option liabilities to RMB154,198,000. The difference was charged as a credit to equity. Such liabilities had been fully discharged as at 31 December 2010.

### 28 SHORT-TERM BANK BORROWINGS

	2010 RMB'000	2009 RMB'000
Bank borrowings accounted for as RMB borrowings (Note (a))		
– secured (Note (b))	990,887	202,322
– unsecured	334,440	–
	<u>1,325,327</u>	<u>202,322</u>
USD borrowings		
– unsecured (Note (c))	3,973,620	–
	<u>5,298,947</u>	<u>202,322</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 28 SHORT-TERM BANK BORROWINGS (Cont'd)

(a) These bank borrowings were denominated in USD according to the loan agreements executed with the lending banks. The aggregate principal amount was USD198,637,000 and the interest rates were fixed at 1.71% to 3.36% per annum. These borrowings will be repaid in full in USD and the term for each of these borrowings is one year. Concurrently, foreign exchange forward contracts were arranged with the same banks as at the respective initial borrowing dates in order to enable the Group to purchase the required amount of USD with RMB for settling the principal amounts of the borrowings plus related interests upon the loan due dates. The bank borrowings and the foreign exchange forward contracts are deemed as linked transactions and accordingly, the bank borrowings have effectively been accounted for as borrowings denominated in RMB.

These bank borrowings and the forward contracts were transacted on the belief that, despite the associated interest expenses to be incurred, the Group would benefit from the interest income from the restricted cash (Note (b)) and the cash increased as a result of the unsecured bank borrowings, as well as the fixed exchange gains arising from the bank borrowings (which are calculated as the difference between the forward rates stated in the contracts and the respective spot rates at the borrowing dates).

(b) These bank borrowings were secured by a pledge of bank deposits of RMB1,014,493,000 of the Group with the banks.

(c) These unsecured bank borrowings were also denominated in USD. The aggregate principal amount was USD600,000,000 and the interest rates were fixed at 1.20% to 2.32% per annum. In addition, the Group entered into foreign forward contracts to purchase the required amount of USD with RMB for settling the principal amount of the borrowings upon the due dates (Note 26). However, the Group arranged the bank loans and the forward contracts with different banks, and the Group did not adopt hedge accounting. As a result, these bank borrowings and the relevant foreign forward contracts were accounted for separately. These bank borrowings were accounted for as USD denominated bank borrowings and stated at amortised cost, while the forward contracts were accounted for as derivative financial instruments stated at fair value with their gains or losses recorded in "Other gains/(losses), net" in the consolidated income statement.

The fair value of the short-term bank borrowings approximated to their carrying amounts as at 31 December 2010.

### 29 DEFERRED REVENUE

Deferred revenue mainly represents service fees prepaid by customers for certain Internet value-added services in the form of pre-paid tokens or cards, of which the related services had not been rendered as at 31 December 2010. It also included customer loyalty incentives offered by the Group to its customers which were valued at their respective fair values.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 30 DEFERRED INCOME TAXES

Deferred income taxes are calculated in full on temporary differences under the liability method using the tax rates which are expected to apply at the time of reversal of the temporary differences.

There was no offsetting of deferred income tax assets and liabilities in 2010 and 2009.

	<b>2010</b>	2009
	<b>RMB'000</b>	RMB'000
Deferred income tax assets:		
– to be recovered after more than 12 months	<b>164,442</b>	244,829
– to be recovered within 12 months	<b>54,577</b>	56,187
	<u><b>219,019</b></u>	<u>301,016</u>
Deferred income tax liabilities:		
– to be recovered after more than 12 months	<b>(14,633)</b>	(13,245)
– to be recovered within 12 months	<b>(952,578)</b>	(356,738)
	<u><b>(967,211)</b></u>	<u>(369,983)</u>

The gross movements of the deferred income tax account were as follows:

	<b>2010</b>	2009
	<b>RMB'000</b>	RMB'000
At beginning of year	<b>(68,967)</b>	255,796
Business combinations	<b>(8,691)</b>	–
Debit to income statement relating to origination and reversal of temporary differences (Note 39)	<b>(615,639)</b>	(324,763)
Effect of change in tax rates recognised in income statement (Note 39)	<b>(54,895)</b>	–
At end of year	<u><b>(748,192)</b></u>	<u>(68,967)</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 30 DEFERRED INCOME TAXES (Cont'd)

The movements of deferred tax assets, which are arising from intra-group software and technology sales, were as follows:

	2010 RMB'000	2009 RMB'000
At beginning of year	301,016	334,164
Credit to income statement relating to origination of temporary differences	29,709	27,020
Effect of change in tax rates recognised in income statement	(54,895)	–
Charge to income statement relating to reversal of temporary differences	(56,811)	(60,168)
At end of year	<u>219,019</u>	<u>301,016</u>

The deferred tax assets recognised are mainly related to the temporary differences arising from certain intra-group software and technology transfer transactions (Note 4.2(a)). The credit to income statement represents tax impacts of originating temporary differences arising from these software and technology transfer, while the charge to income statement represents tax impacts of the reversal of the temporary differences as a result of the amortisation of the costs of these software and technology.

As at 31 December 2010, the Group did not recognise deferred income tax assets of RMB66,459,000 (2009: RMB33,902,000) in respect of cumulative tax losses amounting to RMB265,836,000 (2009: RMB135,607,000). These tax losses will expire from 2011 to 2015.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 30 DEFERRED INCOME TAXES (Cont'd)

The movements of deferred tax liabilities were as follows:

Deferred tax liabilities:	Intangible assets acquired in business combination at fair value	Withholding tax on the earnings anticipated to be remitted by subsidiaries	Total
	RMB'000	RMB'000 (Note)	RMB'000
<b>At 1 January 2009</b>	(28,368)	(50,000)	(78,368)
Credit/(charge) to income statement relating to origination of temporary differences	8,385	(300,000)	(291,615)
<b>At 31 December 2009</b>	(19,983)	(350,000)	(369,983)
<b>At 1 January 2010</b>	(19,983)	(350,000)	(369,983)
Business combination	(8,691)	–	(8,691)
Credit/(charge) to income statement relating to origination of temporary differences	6,625	(595,162)	(588,537)
<b>At 31 December 2010</b>	(22,049)	(945,162)	(967,211)

Note:

According to applicable PRC tax regulations, withholding tax will be levied on the dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 (Note 39 (a)(iv)).

As at 31 December 2010, the Group recognised the relevant deferred tax liabilities of RMB945,162,000 (2009: RMB350,000,000) on the earnings anticipated to be remitted by certain PRC subsidiaries in the foreseeable future. No withholding tax had been provided for the earnings of approximately RMB3,610,269,000 (2009: RMB4,300,000,000) expected to be retained by the PRC subsidiaries and not to be remitted out of the PRC in the foreseeable future based on management's estimation of the funding requirements outside of the PRC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 31 COST OF REVENUES

Cost of revenues mainly comprises the Mobile and Telecom Charges (Note 2.24(a)), bandwidth and server custody fees, staff costs, sharing and content subscription costs incurred in deriving the revenues.

### 32 INTEREST INCOME

Interest income mainly represented interest income from bank deposits, including current deposit, term deposits with initial term of three months or less, term deposits with initial term of over three months and investment income from held-to-maturity investments.

### 33 OTHER GAINS/(LOSSES), NET

	2010 RMB'000	2009 RMB'000
Government subsidies	96,537	28,339
Fair value gains on financial assets held for trading	–	11,929
Losses from derivative financial instruments (Note 26)	(17,964)	–
Donation to a charity fund established by the Group	(70,000)	(85,000)
Gain/(loss) on disposals of fixed assets	883	(3,043)
Loss on disposals of intangible assets	–	(1,654)
Others	28,600	(8,784)
	<u>38,056</u>	<u>(58,213)</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 34 EXPENSES BY NATURE

	2010 RMB'000	2009 RMB'000
Employee benefits expenses (Note) (Note 35)	3,143,967	2,133,135
Mobile and telecommunications charges and bandwidth and server custody fees	2,089,273	1,584,025
Content costs and agency fees	2,797,872	1,430,526
Promotion and advertising expenses	557,601	306,309
Depreciation of fixed assets (Note) (Note 6)	668,580	405,301
Amortisation of intangible assets (Note 10)	109,411	131,897
Amortisation of land use rights (Note 9)	3,724	466
Travelling and entertainment expenses	124,320	108,404
Operating lease rentals in respect of office buildings	116,378	89,381
Auditor's remuneration	8,000	5,950
Other expenses	482,670	301,889
	<hr/>	<hr/>
Total cost of revenues, selling and marketing expenses and general and administrative expenses	<b>10,101,796</b>	<b>6,497,283</b>
	<hr/> <hr/>	<hr/> <hr/>

Note:

Research and development expenses for the year ended 31 December 2010 were RMB1,685,525,000 (2009: RMB1,191,637,000) which included employee benefit expenses of RMB1,407,948,000 (2009: RMB948,309,000) and depreciation of fixed assets of RMB194,090,000 (2009: RMB215,674,000).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 35 EMPLOYEE BENEFITS EXPENSES (INCLUDING DIRECTORS' EMOLUMENTS)

	2010 RMB'000	2009 RMB'000
Wages, salaries and bonuses	2,223,725	1,548,049
Welfare, medical and other expenses	207,495	129,603
Share-based compensation expenses	495,772	321,422
Contributions to pension plans (Note)	197,238	117,774
Training expenses	19,737	16,287
	<u>3,143,967</u>	<u>2,133,135</u>

Note:

All local employees of the subsidiaries in the PRC participate in employee social security plans established in the PRC, which cover pension, medical and other welfare benefits. The plans are organised and administered by the governmental authorities. Except for the contribution to these social security plans, the Group has no other material commitments owing to the employees. According to the relevant regulations, the portion of premium and welfare benefit contributions that should be borne by the companies within the Group as required by the above social security plans are principally determined based on percentages of the basic salaries of employees, subject to a certain ceiling, and are paid to the respective labour and social welfare authorities. Contributions to the plans are expensed as incurred. The applicable percentages used to provide for insurance premium and welfare benefit funds are listed below.

	Percentage
Pension insurance	8 – 22%
Medical insurance	0.5 – 12%
Unemployment insurance	0 – 2.5%
Housing fund	0 – 12%

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 36 DIRECTORS' EMOLUMENTS

The aggregate amounts of emoluments paid/payable to directors of the Company for the year ended 31 December 2010 and 2009 are as follows:

	2010 RMB'000	2009 RMB'000
Fees - independent non-executive directors	2,157	1,854
Salaries, bonuses, allowances and benefits in kind	39,919	33,851
Contributions to pension plans	48	40
Share-based compensation expenses charged to income statement	21,796	18,710
	<u>63,920</u>	<u>54,455</u>
Number of directors		
– with emoluments	6	6
– without emoluments	2	2
Number of directors	<u>8</u>	<u>8</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**36 DIRECTORS' EMOLUMENTS (Cont'd)**

The remuneration of every director for the year ended 31 December 2010 is set out below.

Name of director	Salaries, bonuses, allowances and benefits				Total RMB'000
	Fees RMB'000	in kind RMB'000	Contributions to pension plans RMB'000	Share-based compensation expenses RMB'000	
Ma Huateng	–	18,419	24	–	18,443
Zhang Zhidong	–	13,282	24	–	13,306
Lau Chi Ping Martin (Note)	795	8,218	–	21,523	30,536
Iain Ferguson Bruce	596	–	–	91	687
Ian Charles Stone	383	–	–	91	474
Li Dong Sheng	383	–	–	91	474
Antonie Andries Roux	–	–	–	–	–
Charles St Leger Searle	–	–	–	–	–
	<u>2,157</u>	<u>39,919</u>	<u>48</u>	<u>21,796</u>	<u>63,920</u>

Note:

During the year ended 31 December 2010, 1,000,000 share options (2009: Nil) were granted to Mr Lau Chi Ping, Martin. Other than that, no options/awarded shares were granted to other executive, non-executive or independent non-executive directors of the Company (2009: Nil).

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For the year ended 31 December 2010  
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## 36 DIRECTORS' EMOLUMENTS (Cont'd)

The remuneration of every director for the year ended 31 December 2009 is set out below.

Name of director	Fees RMB'000	Salaries, bonuses, allowances and benefits	Contributions to pension plans	Share-based compensation expenses	Total RMB'000
		in kind RMB'000	RMB'000	RMB'000	
Ma Huateng	–	15,616	20	–	15,636
Zhang Zhidong	–	11,375	20	–	11,395
Lau Chi Ping Martin	820	6,860	–	18,245	25,925
Iain Ferguson Bruce	418	–	–	155	573
Ian Charles Stone	308	–	–	155	463
Li Dong Sheng	308	–	–	155	463
Antonie Andries Roux	–	–	–	–	–
Charles St Leger Searle	–	–	–	–	–
	<u>1,854</u>	<u>33,851</u>	<u>40</u>	<u>18,710</u>	<u>54,455</u>

No director received any emolument from the Group as an inducement to join or leave the Group or compensation for loss of office. No director waived or has agreed to waive any emoluments during the year ended 31 December 2010 (2009: Nil).

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### 37 FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Group during the year included two (2009: three) directors whose details have been reflected in the analysis presented above (Note 36). The emoluments paid/payable to the remaining three (2009: two) individuals during the year were as follows:

	2010 RMB'000	2009 RMB'000
Salaries, bonuses, allowances and benefits in kind	28,832	18,252
Share-based compensation expenses charged to income statement	22,042	6,338
Contributions to pension plans	70	39
	<u>50,944</u>	<u>24,629</u>

The emoluments of the above three individuals (2009: two) fell within the following bands:

	Number of individuals	
	2010	2009
Emolument bands		
HKD13,000,001 – HKD13,500,000 (equivalent to RMB11,320,401 – RMB11,755,800)	–	1
HKD15,000,001 – HKD15,500,000 (equivalent to RMB13,062,001 – RMB13,497,400)	–	1
HKD16,000,001 – HKD16,500,000 (equivalent to RMB13,932,801 – RMB14,368,200)	1	–
HKD21,000,001 – HKD21,500,000 (equivalent to RMB18,286,801 – RMB18,722,200)	2	–

### 38 FINANCE COSTS, NET

	2010 RMB'000	2009 RMB'000
Interest expenses	35,027	–
Exchange (gains)/losses	(34,189)	1,953
	<u>838</u>	<u>1,953</u>

Interest expenses mainly arose from the USD bank borrowings mentioned in Note 28.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 39 TAX EXPENSE

#### (a) Income tax

(i) Cayman Islands and British Virgin Islands profits tax

The Group has not been subject to any taxation in these jurisdictions for the year ended 31 December 2010 (2009: Nil).

(ii) Hong Kong profits tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising in Hong Kong for the year ended 31 December 2010 (2009: Nil).

(iii) PRC Corporate Income Tax ("CIT")

CIT is provided on the assessable income of entities within the Group incorporated in the PRC, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

Pursuant to the PRC Corporate Income Tax Law passed by the Tenth National People's Congress on 16 March 2007 ("CIT Law"), the CIT for domestic and foreign enterprises has been unified at 25%, effective 1 January 2008.

The CIT Law also provides a five-year transitional period starting from its effective date for those enterprises which were established before the promulgation of the CIT law and which were entitled to preferential income tax rates under the then effective tax laws or regulations.

On 26 December 2007, the State Council issued the "Circular to Implementation the Transitional Preferential Policies for the Corporate Income Tax". Pursuant to this circular, the transitional income tax rates for the Group's subsidiaries established in the Shenzhen Special Economic Zone or the Beijing High Technology Zone before 16 March 2007 are 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011 and 2012, respectively. Other tax preferential treatments such as reduction of 50% in income tax rate shall be based on the above transitional income tax rates for the respective years.

In 2008, six subsidiaries namely Tencent Computer, Tencent Technology, Shenzhen Domain, Cyber Shenzhen, Tencent Beijing and Cyber Tianjin, applied for and were subsequently approved as High/New Technology Enterprises, and accordingly, they were subject to a reduced preferential CIT rate of 15% according to the CIT Law. With such status, the above mentioned transitional income tax rates for the period from 2008 to 2010 were no longer applicable to them.

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### 39 TAX EXPENSE (Cont'd)

#### (a) Income tax (Cont'd)

##### (iii) PRC Corporate Income Tax ("CIT") (Cont'd)

In April 2010, the PRC tax authorities issued a new tax circular Guoshui 2010 No. 157 to clarify that an entity is only allowed to enjoy either the preferential CIT rate of 15% as a High/New Technology Enterprise or CIT exemption for two or three years and followed by a 50% reduction for the next 3 years based on the unified CIT rate in the PRC.

According to the special tax incentives granted by the local tax authority in Beijing, Tencent Beijing is exempt from CIT for three years starting from the first year of its commercial operation, followed by a 50% reduction for the next three years. 2005 was its first year of operation and accordingly, the provision for CIT was provided at a rate of 11% for 2010 (2009: 7.5%).

As approved by the relevant tax authority, Cyber Tianjin is exempt from CIT for two years commencing from the first year of profitable operation after offsetting tax loss brought forward from prior years, followed by a 50% reduction for the next three years. 2008 was its first profit-making year and accordingly provision for CIT was made at a rate of 12.5% for 2010 (2009: Nil).

In addition, Beijing Yonghang was recognised as a newly set-up software production enterprise in 2009, and according to the tax incentives granted by the tax authority, it was exempt from CIT in 2009, followed by a 50% reduction from 2010 to 2012. As a result, the provision for CIT was made at a rate of 12.5% for 2010 (2009: Nil).

Furthermore, Tencent Chengdu was recognised as a newly set-up software production enterprise by the relevant tax authority, Tencent Chengdu is exempt from CIT for two years commencing from the first year of profitable operation after offsetting tax loss brought forward from prior years, followed by a 50% reduction for the next three years. 2010 was its first profit-making year and accordingly it was exempt from CIT in 2010 (2009: Nil).

For Tencent Technology, it was further approved as a national key software enterprise for 2010, and accordingly, its CIT rate in 2010 was further reduced to 10%.

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**39 TAX EXPENSE (Cont'd)****(a) Income tax (Cont'd)**

## (iv) PRC withholding tax

According to applicable PRC tax regulations, dividends distributed by a company established in the PRC to a foreign investor with respect to profits derived after 1 January 2008 are subject to a 10% withholding tax. If a foreign investor is incorporated in Hong Kong and meets the conditions or requirements under the double taxation arrangement entered into between the PRC and Hong Kong, the relevant withholding tax rate will be reduced to 5% from 10%.

The income tax charge of the Group for the year ended 31 December 2010 and 2009 are analysed as follows:

	<b>2010</b>	2009
	<b>RMB'000</b>	RMB'000
Current tax	<b>1,127,390</b>	494,357
Deferred income tax (Note 30)	<b>670,534</b>	324,763
	<b>1,797,924</b>	819,120

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
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## 39 TAX EXPENSE (Cont'd)

### (a) Income tax (Cont'd)

The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the tax rate of 22% for the year ended 31 December 2010 (2009: 20%), the tax rate of the major subsidiaries of the Company before preferential tax treatments. The difference is analysed as follows:

	2010 RMB'000	2009 RMB'000
Profit before income tax	9,913,133	6,040,731
Less: Share of profit of associates and a jointly controlled entity	<u>(75,758)</u>	<u>(22,206)</u>
	<b>9,837,375</b>	<b>6,018,525</b>
Tax calculated at a tax rate of 22% (2009: 20%)	2,164,223	1,203,705
Effects of different tax rates available to different companies of the Group	(575,213)	(363,940)
Effect of tax holiday on assessable profits of subsidiaries	(556,561)	(429,638)
Effect of changes in tax rates	54,895	–
Income not subject to tax	(29,217)	–
Expenses not deductible for tax purposes	110,391	75,691
Adjustments in respect of prior year	5,869	(13,528)
Withholding tax on earnings expected to be remitted by PRC subsidiaries (Note 30)	595,162	300,000
Unrecognised deferred income tax assets	<u>28,375</u>	<u>46,830</u>
Income tax expense	<b><u>1,797,924</u></b>	<b><u>819,120</u></b>

### (b) Value-added tax, business tax and related taxes

The operations of the Group are also subject to the following taxes in the PRC:

Category	Tax rate	Basis of levy
Value-added tax ("VAT")	(i) 17%	Sales value of goods sold, offsetting by VAT on purchases
	(ii) 3%	Sales value of goods sold
Business tax ("BT")	3-5%	Services fee income
City construction tax	1-7%	Net VAT and BT payable amount
Educational surcharge	3%	Net VAT and BT payable amount

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 40 LOSS ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE COMPANY

The loss attributable to the equity holders of the Company for the year ended 31 December 2010 is dealt with in the financial statements of the Company to the extent of RMB59,255,000 (2009: profit of RMB728,237,000).

### 41 EARNINGS PER SHARE

#### (a) Basic

Basic earnings per share ("EPS") are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2010	2009
Profit attributable to equity holders of the Company for the year (RMB'000)	<u>8,053,625</u>	<u>5,155,646</u>
Weighted average number of ordinary shares in issue (thousand shares)	<u>1,816,954</u>	<u>1,801,646</u>
Basic EPS (RMB per share)	<u><u>4.432</u></u>	<u><u>2.862</u></u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 41 EARNINGS PER SHARE (Cont'd)

#### (b) Diluted

Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options and awarded shares granted by the Company (collectively forming the denominator for computing the diluted EPS). No adjustment is made to earnings (numerator).

	2010	2009
Profit attributable to equity holders of the Company for the year (RMB'000)	<u>8,053,625</u>	<u>5,155,646</u>
Weighted average number of ordinary shares in issue (thousand shares)	1,816,954	1,801,646
Adjustments for share options (thousand shares)	35,252	43,566
Adjustments for awarded shares (thousand shares)	<u>8,777</u>	<u>2,073</u>
Weighted average number of ordinary shares for the calculation of diluted earnings per share (thousand shares)	<u>1,860,983</u>	<u>1,847,285</u>
Diluted EPS (RMB per share)	<u><u>4.328</u></u>	<u><u>2.791</u></u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 42 DIVIDEND

The dividend paid in 2010 was RMB639,264,000 (2009: RMB554,604,000), which excluded the dividend related to the shares held by the Share Scheme Trust of RMB3,717,000 (2009: RMB462,000).

A final dividend in respect of the year ended 31 December 2010 of HKD0.55 per share (2009: HKD0.40 per share) was proposed pursuant to a resolution passed by the Board on 16 March 2011 and subject to the approval of the shareholders in the annual general meeting to be held on 11 May 2011. These consolidated financial statements do not reflect this dividend payable.

### 43 BUSINESS COMBINATION

On 20 September 2010, the Group entered into an agreement (“Acquisition Agreement”) to acquire 100% equity interest in Comsenz Inc. (“Comsenz”), a company incorporated in the Cayman Islands, at a consideration of approximately USD43,000,000 (equivalent to RMB292,844,000). Through its wholly-owned foreign enterprise in the PRC, Comsenz controls an operating company established in the PRC through various contractual arrangements (collectively referred to as the “Comsenz Group”). The Comsenz Group is an Internet community software and service provider in the PRC.

In addition, pursuant to the Acquisition Agreement, the Group undertakes to grant awarded shares of the Company equivalent to USD2,000,000 to the key employees of the Comsenz Group one year after the acquisition.

As a result of the acquisition, the Group is expected to increase its presence in the market where the Comsenz Group has been operating in. The goodwill of RMB240,467,000 arising from the acquisition is attributable to anticipated operating synergies, assembled workforce and economies of scale expected from combining the operations of the Group and Comsenz Group. None of the goodwill recognised is expected to be deductible for income tax purposes.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 43 BUSINESS COMBINATION (Cont'd)

The following table summarises the consideration paid for the acquisition and the amounts of assets acquired and liabilities assumed recognised at the acquisition date.

	RMB'000
<b>Considerations:</b>	
Cash paid	270,848
Cash to be paid (included in other payables)	21,996
	<hr/>
Total considerations	292,844
	<hr/> <hr/>
<b>Acquisition-related costs</b> (Note)	1,246
	<hr/>
<b>Recognised amounts of identifiable assets acquired and liabilities assumed:</b>	
Cash and cash equivalents	1,996
Accounts receivable	2,264
Prepayments, deposits and other receivables	702
Fixed assets	2,490
Computer software and technology (included in intangible assets)	634
Technology platform (included in intangible assets)	31,500
Customer relationship (included in intangible assets)	6,626
Trademark (included in intangible assets)	19,490
Licences (included in intangible assets)	324
Other payables and accruals	(2,294)
Current income tax liabilities	(932)
Other tax liabilities	(1,732)
Deferred income tax liabilities (Note 30)	(8,691)
	<hr/>
<b>Total identifiable net assets</b>	52,377
	<hr/>
Goodwill	240,467
	<hr/>
	292,844
	<hr/> <hr/>

Note:

The acquisition-related costs were included in general and administrative expenses in the consolidated income statement for the year ended 31 December 2010

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 43 BUSINESS COMBINATION (Cont'd)

The business conducted by the Comsenz Group contributed to the Group revenues of RMB4,757,000 and a net loss of RMB11,122,000 for the period from the acquisition date to 31 December 2010. If the above acquisition had occurred on 1 January 2010, the Group's revenues would have been increased by RMB32,549,000 and net profit would have been decreased by RMB35,418,000. These amounts have been arrived at based on the Group's accounting policies by adjusting the results of the Comsenz Group to reflect the additional amortisation that would have been charged against the identifiable intangible assets upon acquisition from 1 January 2010, together with the consequential tax effects.

### 44 TRANSACTIONS WITH NON-CONTROLLING INTEREST OWNERS OF A SUBSIDIARY

As mentioned in Note 27, the Group entered into agreements to acquire the exercisable Option Equity Interest in Shenzhen Domain from the SZ Domain Holders (the "Transaction") in April 2010. After the Transaction, Shenzhen Domain became a wholly owned subsidiary of the Company.

Carrying amount of the non-controlling interests acquired and the excess of the consideration paid recognised within equity as a result of the Transaction are as follows:

	2010 RMB'000
Carrying amount of non-controlling interest acquired	31,095
Consideration paid/payable to non-controlling interest owners	<u>(154,198)</u>
Excess of consideration paid recognised within equity	<u><u>(123,103)</u></u>

The effect of the Transaction on equity attributable to the Company's equity holders during the year ended 31 December 2010 is summarised as follows:

	2010 RMB'000
Total comprehensive income for the year attributable to the equity holders of the Company	9,874,754
Effect of the Transaction on equity	<u>(123,103)</u>
Total comprehensive income for the year attributable to the equity holders of the Company after taking consideration of the Transaction	<u><u>9,751,651</u></u>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 45 CONSOLIDATED CASH FLOW STATEMENT

### (a) Reconciliation of net profit to net cash inflow from operating activities:

	2010 RMB'000	2009 RMB'000
Profit for the year	8,115,209	5,221,611
Adjustments for:		
Income tax expense	1,797,924	819,120
Depreciation of fixed assets and investment properties	669,860	405,876
Amortisation of intangible assets	109,411	131,897
Amortisation of leasehold land and land use rights	3,724	466
(Gain)/loss on disposals of fixed assets	(883)	3,043
Loss on disposals of intangible assets	–	1,654
Fair value losses on derivative financial assets	17,964	–
Interest income	(255,922)	(136,014)
Share-based compensation expenses	495,772	321,422
Share of profit of associates	(72,359)	(22,206)
Share of profit of a jointly controlled entity	(3,399)	–
Exchange (gains)/losses	(34,189)	1,953
Changes in working capital:		
Inventories	–	5,483
Accounts receivable	(483,712)	(245,977)
Prepayments, deposits and other receivables	(51,936)	36,892
Financial assets held for trading	–	329,804
Long-term payables	(179,804)	(43,331)
Accounts payable	478,330	247,454
Other payables and accruals	1,551,226	608,788
Other tax liabilities	9,942	113,045
Deferred revenue	1,024,570	1,053,833
Cash generated from operations	<u>13,191,728</u>	<u>8,854,813</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 45 CONSOLIDATED CASH FLOW STATEMENT (Cont'd)

## (a) Reconciliation of net profit to net cash inflow from operating activities: (Cont'd)

In the consolidated cash flow statement, proceeds from disposals of fixed assets comprise:

	2010 RMB'000	2009 RMB'000
Net book amount	691	3,638
Gain/(loss) on disposals of fixed assets	883	(3,043)
	<hr/>	<hr/>
Proceeds from disposals of fixed assets	<u>1,574</u>	<u>595</u>

## (b) Analysis of changes in financing during the years are as follows:

	Dividend payable RMB'000	Share capital including premium RMB'000	Shares held for share award scheme RMB'000	Short-term bank borrowings RMB'000	Total RMB'000
<b>At 1 January 2009</b>	–	1,155,404	(21,809)	–	1,133,595
Proceeds from issue of shares and share options	–	165,448	–	–	165,448
Payments for repurchase of issued shares/purchase of shares for share award scheme	–	(74,570)	(103,618)	–	(178,188)
Vesting of awarded shares	–	(1,660)	1,660	–	–
Proposed dividend	554,604	–	–	–	554,604
Payment of dividend	(554,604)	–	–	–	(554,604)
Proceeds from short-term bank borrowings	–	–	–	202,322	202,322
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>At 31 December 2009</b>	<u>–</u>	<u>1,244,622</u>	<u>(123,767)</u>	<u>202,322</u>	<u>1,323,177</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 45 CONSOLIDATED CASH FLOW STATEMENT (Cont'd)

#### (b) Analysis of changes in financing during the years are as follows: (Cont'd)

	Dividend payable	Share capital including premium	Shares held for share award scheme	Short-term bank borrowings	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
<b>At 1 January 2010</b>	–	1,244,622	(123,767)	202,322	1,323,177
Proceeds from issue of shares and share options	–	199,249	–	–	199,249
Payments for repurchase of issued shares/purchase of shares for share award scheme	–	(310,222)	(167,519)	–	(477,741)
Vesting of awarded shares	–	(33,149)	33,149	–	–
Proposed dividend	639,264	–	–	–	639,264
Payment of dividend	(639,264)	–	–	–	(639,264)
Repayment of short-term bank borrowings	–	–	–	(202,322)	(202,322)
Proceeds from short-term bank borrowings	–	–	–	5,298,947	5,298,947
<b>At 31 December 2010</b>	–	1,100,500	(258,137)	5,298,947	6,141,310

#### (c) Major non-cash transactions

There were no other material non-cash transactions for the year ended 31 December 2010.

### 46 CONTINGENCIES

The Group has no material contingent liabilities outstanding as at 31 December 2010.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

## 47 COMMITMENTS

## (a) Capital commitments

Capital commitments as at 31 December 2010 and 2009 are analysed as follows:

	2010 RMB'000	2009 RMB'000
Contracted:		
Construction of buildings	211,558	36,215
Purchase of other fixed assets	135,165	55,606
Capital investment in an investee	100,996	14,335
	<u>447,719</u>	<u>106,156</u>
Authorised but not contracted:		
Construction of buildings	373,277	247,001
Capital investment in an investee	385,000	19,802
	<u>758,277</u>	<u>266,803</u>
	<u><u>1,205,996</u></u>	<u><u>372,959</u></u>

## (b) Operating lease commitments

The future aggregate minimum lease payments under non-cancellable operating leases in respect of buildings are as follows:

	2010 RMB'000	2009 RMB'000
Contracted:		
Not later than one year	236,343	67,893
Later than one year and not later than five years	572,818	86,730
Later than five years	18,845	3,242
	<u>828,006</u>	<u>157,865</u>
	<u><u>828,006</u></u>	<u><u>157,865</u></u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010  
(All amounts in RMB unless otherwise stated)

### 47 COMMITMENTS (Cont'd)

#### (c) Other commitments

The future aggregate minimum payments under non-cancellable bandwidth and server custody leases and online game licensing agreements are as follows:

	2010 RMB'000	2009 RMB'000
Contracted:		
Not later than one year	1,064,792	357,632
Later than one year and not later than five years	1,981,543	171,230
	<u>3,046,335</u>	<u>528,862</u>

### 48 RELATED PARTIES TRANSACTIONS

Except as disclosed in Note 13 (Investment in a jointly controlled entity), Note 23 (Share options and share award scheme) and Note 36 (Directors' emoluments) to the consolidated financial statements, the Group had no other material transactions with related parties for the year ended 31 December 2010, and no other related parties' balances as at 31 December 2010. The key management compensation has already been disclosed in Note 36 (Directors' emoluments).

### 49 SUBSEQUENT EVENT

Subsequent to 31 December 2010, the Group acquired a majority interest in Riot Games, Inc. ("Riot Games"), a US-based independent developer and publisher of premium online games, from the existing shareholders including the founders of Riot Games (the "Founders"), for a cash consideration of USD231,500,000 (the "Acquisition"). Immediately before the Acquisition, Riot Games was approximately 22.34% held by the Company and accounted for as an associate of the Company. Subsequent to the closing of the Acquisition, the interest of the Group and the Founders in Riot Games was approximately 92.78% and 7.22% respectively. Riot Games became a subsidiary of the Company as a result of the Acquisition.

In connection with the Acquisition, the Group will offer, among others, cash bonus, employee options and special restricted stock units of Riot Games to the Founders and certain key employees. As of the date of this report, the Group is in the process of assessing and quantifying the total consideration payable for the Acquisition arising from the above arrangements, as well as the fair value of the net identifiable assets acquired. As such, it is not in a position to complete its initial accounting because of the time constraint and the multiple components of the total consideration payable for the Acquisition.

# Definitions

In this annual report, unless the context otherwise requires, the following expressions shall have the following meanings:

<b>Term</b>	<b>Definition</b>
“Adoption Date”	13 December 2007
“AGM”	the annual general meeting of the Company to be held on Wednesday, 11 May 2011 or any adjournment thereof
“API”	application programming interface
“Articles of Association”	the articles of association of the Company
“Audit Committee”	the audit committee of the Company
“Auditor”	PricewaterhouseCoopers, the auditor of the Company
“Awarded Person”	a person who is eligible to participate in the Scheme
“Awarded Shares”	the shares of the Company awarded under the Scheme
“Beijing BIZCOM”	Beijing BIZCOM Technology Company Limited
“Beijing Emark”	Beijing Emark Information and Technology Company Limited
“Beijing Starsinhand”	Beijing Starsinhand Technology Company Limited
“Board”	the board of directors of the Company
“CEO”	chief executive officer
“CG Code”	the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules
“CNNIC”	China Internet Network Information Center
“Company”	Tencent Holdings Limited, a limited liability company organised and existing under the laws of the Cayman Islands and the shares of which are listed on the Stock Exchange
“Company Website”	the website of the Company at <a href="http://www.tencent.com">www.tencent.com</a>
“COSO Framework”	the Internal Control Integrated Framework issued by the Committee of Sponsoring Organisations
“Cyber Tianjin”	Tencent Cyber (Tianjin) Company Limited
“Cyber Shenzhen”	Tencent Cyber (Shenzhen) Company Limited
“DNF”	Dungeon and Fighter
“Fund”	the Tencent Collaboration Fund

<b>Term</b>	<b>Definition</b>
“Group”	the Company and its subsidiaries
“Guangzhou Yunxun”	Guangzhou Yunxun Technology Company Limited
“HKD”	the lawful currency of Hong Kong Special Administrative Region
“IA”	internal audit department of the Company
“IC”	internal control department of the Company
“IM”	Instant Messaging
“Investment Committee”	the investment committee of the Company
“IPO”	initial public offering
“IVAS”	Internet value-added services
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Mail.ru”	Mail.ru Group Limited
“MIH China”	MIH China (BVI) Limited
“MMOG(s)”	Massively Multiplayer Online Game(s)
“Model Code”	the Model Code for Securities Transactions by Directors of Listed Companies set out in Appendix 10 to the Listing Rules
“MVAS”	mobile and telecommunications value-added services
“New OPCOs”	Beijing Emark, Wang Dian, Beijing BIZCOM, Beijing Starsinhand, Shenzhen Shijitianyou Technology Company Limited, Tianjin Shouzhongwanwei Network Technology Company Limited and Guangzhou Yunxun
“PCU”	peak concurrent user accounts
“Pre-IPO Option Scheme”	the Pre-IPO Share Option Scheme
“Post-IPO Option Scheme I”	the Post-IPO Share Option Scheme I
“Post-IPO Option Scheme II”	the Post-IPO Share Option Scheme adopted by the Company on 16 May 2007
“Post-IPO Option Scheme III”	the Post-IPO Share Option Scheme adopted by the Company on 13 May 2009
“PRC” or “China”	the People’s Republic of China

<b>Term</b>	<b>Definition</b>
“Remuneration Committee”	the remuneration committee of the Company
“Riot Games”	Riot Games, Inc.
“RMB”	the lawful currency of the PRC
“Scheme”	the share award scheme of the Company adopted by the Board on the Adoption Date
“SFO”	the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong) as amended, supplemented or otherwise modified from time to time
“Shiji Kaixuan”	Shenzhen Shiji Kaixuan Technology Company Limited
“SKT CFC”	the co-operation framework contract dated 28 February 2004 entered into between Cyber Tianjin and Shiji Kaixuan
“SKT Co-operation Committee”	the co-operation committee established under the SKT CFC
“SMS”	Short Message Service
“SNS”	Social Networking Service
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“TCS CFC”	the co-operation framework contract dated 28 February 2004 entered into between Tencent Technology and Tencent Computer
“TCS Co-operation Committee”	the co-operation committee established under the TCS CFC
“Tencent Beijing”	Tencent Technology (Beijing) Company Limited
“Tencent Chengdu”	Tencent Technology (Chengdu) Company Limited
“Tencent Computer”	Shenzhen Tencent Computer Systems Company Limited
“Tencent Shanghai”	Tencent Technology (Shanghai) Company Limited
“Tencent Technology”	Tencent Technology (Shenzhen) Company Limited
“USD”	the lawful currency of the United States of America
“WAP”	Wireless Application Protocol
“Wang Dian”	Nanjing Wang Dian Technology Company Limited
“WFOEs”	Tencent Technology, Cyber Tianjin, Tencent Beijing, Cyber Shenzhen, Tencent Chengdu and Tencent Shanghai

