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Forgame Holdings Limited

雲遊控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 00484)

INSIDE INFORMATION

RESULTS OF THE INDEPENDENT INVESTIGATION IN RELATION TO VR GAMING BUSINESS

This announcement is made by Forgame Holdings Limited (the “**Company**” and together with its subsidiaries, the “**Group**”) pursuant to Rule 13.09(2)(a) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Listing Rules**”) and the Inside Information Provisions (as defined under the Listing Rules) under Part XIVA of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong).

References are made to:

- (i) the announcements of the Company dated 24 April 2019, 24 May 2019 and 26 June 2019 in relation to the Group’s acquisition (the “**Acquisition**”) of 69.84% equity interest in 北京西瓜互娛科技有限責任公司 (Beijing Xigua Huyu Technology Co., Ltd.*) (“**Beijing Xigua**”); and
- (ii) the announcement of the Company dated 21 November 2019 in relation to the expected shortfall in the actual net profits of Beijing Xigua for the period from 1 June 2019 to 31 December 2019 (i.e. below RMB43,000,000 as original contemplated and guaranteed).

BACKGROUND

Upon completion of the Acquisition, Beijing Xigua become a non-wholly owned subsidiary of the Company. Beijing Xigua is principally engaged in offering self-developed games as well as exclusively licensed games in its physical stores that are equipped with space positioning technology and virtual reality (“**VR**”) devices. Through Beijing Xigua, the Group strives to further enhance its VR gaming business.

As of 31 December 2019, Beijing Xigua operates 129 VR stores, including direct-sale stores, joint ventures and franchise stores, under the brand name “Player No. 1” across 64 cities across the PRC. Beijing Xigua also carried out brand promotion co-operation and received service fees from companies who engaged Beijing Xigua for brand promotion services through the “Player No. 1” VR stores. Ms. Li Luyi (“**Ms. Li**”), the former executive Director and chief executive officer of the Company, was responsible for the management and operation of Beijing Xigua prior to her loss of contact from late-October to early-November 2019 and her resignation on 7 November 2019.

The principal income stream of Beijing Xigua includes:

- (i) operating income recorded by the VR stores by providing equipment and venue to customers to enjoy the VR gaming experience. Typically, customers can purchase tokens and enjoy the VR gaming experience in-store upon registration as a member of the VR store (“**VR Stores Operating Income**”);
- (ii) promotion service revenue, mainly represents the promotion service cooperation agreement entered into by Beijing Xigua with customers upon which Beijing Xigua will provide promotion service to the customers’ brands in the VR stores of Beijing Xigua under the brand name “Player No. 1”;
- (iii) revenue received by providing management services to franchise stores, whereupon the establishment costs of the VR store will be borne by the franchisee and Beijing Xigua will provide store management related services to franchisee; and
- (iv) franchise income, whereupon Beijing Xigua grants the right-of-use to the franchisee to use the brand “Player No. 1” and the franchisee will bear all of the store’s operating expenses. Under the franchise arrangement, the franchisee pays franchisee fee, service fee, purchase price for VR equipment to Beijing Xigua. Further, operating income will also be shared among Beijing Xigua and the franchisee in accordance to the franchise agreement.

The Company conducted an internal review of the sales revenue of Beijing Xigua after the year ended 31 December 2019. Upon completion of such internal review and for the purpose to aid the Company to further understanding the sales revenue and identifying any potential risks and control weaknesses relating to the operation of Beijing Xigua, the Company and with the approval of the independent investigation committee of the Company (the “**Independent Investigation Committee**”), comprising Mr. Zhang Qiang, a non-executive director, and Mr. How Sze Ming, Mr. Zhao Cong Richard and Mr. Wan Joseph Jason (all independent non-executive directors who resigned on 30 April 2020), engaged an independent investigator (the “**Independent Investigator**”) to investigate on the sales revenue of Beijing Xigua during the period from 1 June 2019 to 31 December 2019 (the “**Independent Investigation**”). For clarity, Mr. Wang Dong and Mr. Wong Chi Kin, independent non-executive directors appointed on 27 April 2020 were appointed to the Independent Investigation Committee on the same day.

THE XIGUA INVESTIGATION REPORT

The Independent Investigator has completed the Independent Investigation and issued an investigation report (the “**Xigua Investigation Report**”). The scope of the Independent Investigation is limited to the work performed by the Independent Investigator with available information as of 15 April 2020. The Independent Investigator disclaims all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of the Investigation Report.

Details of the principal findings as set forth in the Xigua Investigation Report are as follow:

The Independent Investigator noted that the game recording system of Beijing Xigua only recorded the actual playing time of certain large VR games and there is no function to match the actual playing time of the VR game to the sales record on the system. Prior to the gaming record and sales system being linked in December 2019, staffs at the VR stores may activate VR games at its autonomy regardless of whether customers have actually paid or purchased token for the game.

(i) Operating income — certain suspicious large-sum corporate group transactions

The Independent Investigator discovered certain suspicious large-sum corporate group transactions as follows:

- (a) In June 2019, 16 large-sum corporate group transactions in an aggregate sum of RMB1.12 million were recorded. Among which, one particular store in Beijing recorded 10 corporate group transactions in an aggregate sum of RMB720,000, and another one store in Beijing recorded 6 corporate group transactions in an aggregate sum of RMB400,000. Specifically,
 - the 16 large-sum corporate group transactions were paid by non-registered members of the VR stores and the VR stores do not record the contact information and other information of the relevant customers, nor can the relevant store identify when the gaming services were provided to those customers under the 16 large-sum corporate group transactions;
 - there was no specific approval requirement and/or customers record requirement for large-sum token re-charge; and
 - the payees of the corporate group transactions have some sorts of relationship with Ms. Li, including assistants to Ms. Li as well as other business acquaintance of Ms. Li.
- (b) In July 2019, 23 large-sum corporate group transactions in an aggregate sum of RMB1.15 million were recorded in the operating system. Among which, one particular store in Beijing recorded 10 corporate group transactions in an aggregate sum of RMB500,000, and another one store in Beijing recorded 13 corporate group transactions in an aggregate sum of RMB650,000. Specifically,
 - the time shown for certain of those token recharge transactions were during non-business hours of the relevant VR stores and the payment method as record was shown as “company transfer”; and

- based on discussion with certain staffs of the relevant VR stores made by the Independent Investigator, the payment method “company transfer” as recorded in the system is one of the bookkeeping method, which does not involve the actual payment of the amount and may be recorded as such to identify write-off of corporate group transactions.

(ii) Operating income — certain large-sum refund transactions

3 large-sum refund transactions in an aggregate of RMB7.83 million were recorded in the operating system. Upon communication being made by the Independent Investigator with certain employees of the VR stores, the Independent Investigator were given to understand that refunds within VR gaming business are not typical and staffs at the VR stores have no authority to process refund with no such refund setting in the store sales system. If any customer needs to process a refund, the relevant VR store needs to notify the regional manager together with the reason for the refund, and the regional manager will be the one to record such refund on the system.

Upon enquiry being made by the Independent Investigator with the manager and staff of the relevant VR store, a large sum of re-charge and refund of RMB7.72 million was recorded due to system error. Upon verification of the relevant sales and bank statements as provided by Beijing Xigua, no record of such re-charge and refund could be identified.

(iii) Operating income — certain token recharge transactions were recorded as being recharged by the employees of Beijing Xigua

During the period from June to December 2019, it was discovered that a total of 208 employees of Beijing Xigua recharged and consumed at the store with an aggregate amount of about RMB3 million. Among them, the cumulative recharge and consumption of 21 employees exceeded RMB30,000 per person, in aggregate RMB1.12 million. Beijing Xigua recorded a revenue of RMB2.72 million in these transactions.

Upon communication being made by the Independent Investigator with certain store managers and store assistants of the VR stores, the Independent Investigator was given to understand that, the large-sum recharge and consumption by the employees were mainly due to irregularity of payment collection. For example, (a) shop assistants may perform token recharge for customers who do not want to register as members of the VR stores and subsequently settle the sum in cash or electronic transfer method with the relevant customer; (b) in order to realise immediate increase in the consumable amount and store performance, the store staffs may recharge through their own membership card first and later offer discounted price to customers upon actual consumption; and (c) store employees recharge their membership cards in order to obtain performance rewards.

Upon review of the personal electronic payment record of certain employees with significant recharge amounts, it is noted that the amount received by the employees from customers, the amount recharged by the employees and the sales record of Beijing Xigua are identical.

(iv) Promotion service income

Based on the Xigua Investigation Report, the provision of promotional services by Beijing Xigua experienced certain operating difficulties in the past, including:

- early termination of the promotion service cooperation contract by customers;
- promotion effect was found to be less effective and positive as originally expected resulting in termination of cooperation;
- non-performance of promotional services by Beijing Xigua due to the customers did not provide promotional material; and
- mis-match between the products of the customer and the needs of the players of the VR stores, and no evidence of rendering the promotion services.

(v) Franchise management income

During the period from June to December 2019, franchise management income amounted to approximately RMB940,000.

As noted by the Independent Investigator in its Xigua Investigation Report, only one of the signed franchisees had actually paid and made payment of joining fee to Beijing Xigua. Based on the discussion between the Independent Investigator and Mr. Han Jun, an executive director and chief executive officer of the Company, Mr. Han informed that certain responsible persons (who are employees of Haitouhui) of the franchise stores had become unreachable since November 2019. Accordingly, a few of the VR stores that had been renovated or had just opened for operation were not able to continue to operate. In order to minimize any further damage to the brand name of “Player No. 1” in the PRC and jeopardize the rights of those who have purchased token at the relevant stores, the Company decided to take over those stores. Any expenses incurred prior to the relevant stores being taken over by the Company will be borne by the party who actually made the payment.

In particular, as of the date of the Xigua Investigation Report, Beijing Xigua failed to provide the relevant franchise agreements relating to one of the named franchisee in Hangzhou.

In addition, certain such franchisees were found to have some sort of relationship with the employees of Beijing Xigua or Haitouhui or Kong Zhong Group or Ms. Li, including relative and acquaintance of Ms. Li, and it remains unclear as to whether that early termination of the franchise custodian business may be related to the loss of contact of Ms. Li and her team. Certain franchisees may have received money from KongZhong Group and/or Haitouhui.

(vi) Franchise income

Pursuant to the Xigua Investigation Report, certain franchisees who remained unreachable were found to have some sort of relationship with Ms. Li Luyi, including relative and business acquaintance of Ms. Li.

(vii) Transactions with a Decoration Service Supplier and an Equipment Supplier

Based on the Xigua Investigation Report, it was discovered that suppliers which provided decoration service and provided equipment to Beijing Xigua were found to have some sort of relationship with the employees of Beijing Xigua or Haitouhui or Ms. Li, including relative of Ms. Li.

RECOMMENDATIONS BY THE INDEPENDENT INVESTIGATOR

Based on the results of the Independent Investigation, certain areas of improvements were suggested by the Independent Investigator, including, among others, as follows:

- (a) Beijing Xigua should improve the business cooperation review and management system to improve the quality, efficiency and transparency of cooperation. This includes the establishment of due diligence procedures to introduce business partners, and strengthening background checks and financial risk assessment of existing and potential business partners. The enhanced review and management system should be able to assist the Company to assess any potential conflicts of interest with business partners;
- (b) improve the operation management system and sales system functions of VR stores;
- (c) improve personnel management system of Beijing Xigua; and
- (d) formulate codes of integrity for employees and business partners, and strengthen the awareness and implementation of compliance and integrity by employees and business partners through training and promotion.

The above recommendations were reviewed by the Independent Investigation Committee, and reported to the Board.

IMPACT OF THE GROUP'S BUSINESS OPERATION AND FINANCIAL POSITION

The Board (including the Independent Investigation Committee) is assessing the impact brought by matters and issues identified in the Xigua Investigation Report to its business operation and the possible financial impact to the Group, which may relate to its revenue, expenses, assets and liabilities of the VR gaming business for the year ended 31 December 2019.

The Company will disclose such impacts, if any, in the annual results announcement and/or annual report of the Company in due course.

FURTHER ACTIONS TO BE TAKEN

The Board is of the view that the Xigua Investigation Report was carried out comprehensively by professionals and, as advised by the Independent Investigator, such investigation has been completed to the extent that is presently possible. Full cooperation was given and no limitations were imposed by the Company to the Independent Investigator in their conduct of the Xigua Investigation Report.

Pursuant to the Xigua Investigation Report, there has been no evidence implicating any of the existing directors of the Company involved in the issues identified in the Xigua Investigation Report. The Board together with the Group's management will continue to improve the internal control of the Group.

The Board (including the independent non-executive Directors), after considering, among other matters, the results of the Xigua Investigation Report, noted and accepted the recommendations made by the Independent Investigator. The Company will strive to improve its internal control over Beijing Xigua.

The Company will also consider to engage an internal control consultant to conduct a complete review, and provide recommendations, on certain scopes of the internal control system in respect of its VR gaming business.

The Company will make further announcement in relation to the progress of the implementation of such recommendations and the engagement of the internal control consultant as and when appropriate.

Shareholders of the Company and potential investors should exercise caution when dealing in the shares of the Company.

By order of the Board
Forgame Holdings Limited
ZHANG Qiang
Chairman

Hong Kong, 8 May 2020

As at the date of this announcement, the executive Directors are Mr. HAN Jun and Ms. LIANG Na; the non-executive Director is Mr. ZHANG Qiang; the independent non-executive Directors are Mr. WANG Dong and Mr. WONG Chi Kin.

** For identification purpose only*