

LETTER FROM THE BOARD



Forgame Holdings Limited

雲遊控股有限公司

(Incorporated in the Cayman Islands with limited liability)
(Stock Code: 00484)

Executive Directors:

Mr. HAN Jun (*Vice President*)
Mr. DIAO Guoxin (*Acting Chief Executive Officer*)
Mr. ZHU Liang (*Chief Financial Officer*)

Non-executive Director:

Mr. ZHANG Qiang (*Chairman*)

Independent Non-executive Directors:

Mr. WANG Dong
Mr. WONG Chi Kin
Mr. CUI Yuzhi
Mr. LU Xiaoma

Registered office:

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2 December 2020

To the Shareholders,

Dear Sir/Madam,

**(I) MAJOR AND CONNECTED TRANSACTION
INVOLVING OFF-MARKET SHARE BUY-BACK;
(II) SPECIAL DEAL RELATING TO LOAN ASSIGNMENT;
AND
(III) NOTICE OF EGM**

Reference is made to the announcement dated 12 November 2020 in relation to the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment in which the Loan Assignment also constituting a special deal in accordance with Rule 25 of the Takeovers Code).

The purpose of this circular is to provide you with, among other things (i) further details of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment); (ii) the letter from the Listing Rules IBC giving its recommendation to the Independent Shareholders on the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment); (iii) the letter from the Takeovers Code IBC giving its recommendation to the Independent Shareholders on the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment); (iv) the letter from the Independent Financial Adviser containing its

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advice to the Independent Board Committee and the Independent Shareholders in the same regard; (v) the notice of the EGM and (vi) other information as required under the Listing Rules, the Share Buy-back Code and the Takeovers Code.

BACKGROUND

References are made to the Announcements in relation to the Acquisition, the non-fulfilment of the Profit Guarantee, the follow up actions taken by the Company.

On 24 April 2019, among others, the Company, the Investor, Shanghai Dacheng, Beijing Xigua and the KongZhong Group entered into the Investment Agreement, pursuant to which (i) the Investor conditionally agreed to subscribe for 9.30% equity interest in Beijing Xigua in the form of new registered capital for a consideration of RMB20,000,000 in cash; and (ii) Shanghai Dacheng conditionally agreed to sell, and the Investor conditionally agreed to acquire, 60.54% equity interest in Beijing Xigua for a consideration of RMB130,152,857 (in the form of 22,268,908 Consideration Shares), by way of the equity transfer. The Consideration Shares have been deposited into an escrow account managed by the Escrow Agent as designated by KongZhong. The consideration of the equity transfer abovementioned was satisfied by the allotment and issue of the Consideration Shares at the issue price of HK\$6.876 per Consideration Share. Completion of the Investment Agreement took place on 26 June 2019.

Under the Investment Agreement, the relevant actual net profits of Beijing Xigua for the period from 1 June 2019 to 31 December 2019, the year ending 31 December 2020 and the year ending 31 December 2021 should not be less than the relevant Thresholds. Otherwise, Shanghai Dacheng, the KongZhong Group and Beijing Xigua on a joint and several basis shall compensate for the shortfall by one of the following two options to be elected by the Company.

Option A

1 June 2019 to 31 December 2019

If Beijing Xigua fails to meet the Actual Net Profits in the sum of RMB43,000,000 during the period from 1 June 2019 to 31 December 2019, Beijing Xigua, Shanghai Dacheng and the KongZhong Group shall:

- (i) compensate the Company on the shortfall to the Actual Net Profits in cash based on the following formula:

Amount of compensation in cash: (RMB43,000,000 – Actual Net Profits for the period from 1 June 2019 to 31 December 2019)/RMB157,000,000 x RMB20,000,000; and

- (ii) have the actual number of the Consideration Shares to be released to Shanghai Dacheng by the Escrow Agent downward adjusted in accordance with the following formula:

Adjusted number of Consideration Shares to be cancelled = (RMB43,000,000 – Actual Net Profits for the period from 1 June 2019 to 31 December 2019)/ RMB157,000,000 x total number of Consideration Shares issued at the completion

Financial year ending 31 December 2020

If Beijing Xigua fails to meet the Actual Net Profits in the sum of RMB52,000,000 by 31 December 2020, Beijing Xigua, Shanghai Dacheng and the KongZhong Group shall:

- (i) compensate the Company on the shortfall to the Actual Net Profits in cash based on the following formula:

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Amount of compensation in cash: (RMB52,000,000 – Actual Net Profits for the financial year ending 31 December 2020)/RMB157,000,000 x RMB20,000,000; and

- (ii) have the actual number of the Consideration Shares to be released to Shanghai Dacheng by the Escrow Agent downward adjusted in accordance with the following formula:

Adjusted number of Consideration Shares to be cancelled = (RMB52,000,000 – Actual Net Profits for the financial year ending 31 December 2020)/ RMB157,000,000 x total number of Consideration Shares issued at the completion

Financial year ending 31 December 2021

If Beijing Xigua fails to meet the Actual Net Profits in the sum of RMB62,000,000 by 31 December 2021, Beijing Xigua, Shanghai Dacheng and the KongZhong Group shall:

- (i) compensate the Company on the shortfall to the Actual Net Profits in cash based on the following formula:

Amount of compensation in cash: (RMB62,000,000 – Actual Net Profits for the financial year ending 31 December 2021)/RMB157,000,000 x RMB20,000,000; and

- (ii) have the actual number of the Consideration Shares to be released to Shanghai Dacheng by the Escrow Agent downward adjusted in accordance with the following formula:

Adjusted number of Consideration Shares to be cancelled = (RMB62,000,000 – Actual Net Profits for the financial year ending 31 December 2021)/ RMB157,000,000 x total number of Consideration Shares issued at the completion

Option B

1 June 2019 to 31 December 2019

If Beijing Xigua fails to meet the Actual Net Profits in the sum of RMB43,000,000 during the period from 1 June 2019 to 31 December 2019, Beijing Xigua, Shanghai Dacheng and the KongZhong Group shall pay to the Company, in readily available cash, the RMB equivalent of the amount determined by the following formula:

(RMB43,000,000 – Actual Net Profits for the period from 1 June 2019 to 31 December of 2019) x percentage of equity interest of the Investor in Beijing Xigua as at 31 December 2019 x 5

Financial year ending 31 December 2020

If Beijing Xigua fails to meet the Actual Net Profits in the sum of RMB52,000,000 by 31 December 2020, Beijing Xigua, Shanghai Dacheng and the KongZhong Group shall pay to the Company, in readily available cash, the RMB equivalent of the amount determined by the following formula:

(RMB52,000,000 – Actual Net Profits for the financial year ending 31 December 2020) x percentage of equity interest of the Investor in Beijing Xigua as at 31 December 2020 x 5

Financial year ending 31 December 2021

If Beijing Xigua fails to meet the Actual Net Profits in the sum of RMB62,000,000 by 31 December 2021, Beijing Xigua, Shanghai Dacheng and the KongZhong Group shall pay to the Company, in readily available cash, the RMB equivalent of the amount determined by the following formula:

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(RMB62,000,000 – Actual Net Profits for the financial year ending 31 December 2021) x percentage of equity interest of the Investor in Beijing Xigua as at 31 December 2021 x 5

In the event that the Company opts for Option B, the total amount compensated to the Company and/or the Investor during the relevant guarantee period shall not exceed RMB150,152,857, being the amount of the Full Cash Compensation.

In addition, subsequent to completion of the Investment Agreement, as Beijing Xigua needed financing to open more stores to expand its business, the Loan Agreement was entered into, among others, Beijing Xigua and Guangzhou Feidong (a wholly-owned subsidiary of the Company), pursuant to which Guangzhou Feidong agreed to grant the loan in the amount of no more than RMB53,000,000 to Beijing Xigua. Subsequently, the loan in the total amount of RMB32,300,000 was granted by Guangzhou Feidong to Beijing Xigua, being RMB14,000,000 granted on 21 November 2019, RMB10,000,000 granted on 31 December 2019 and RMB8,300,000 granted on 7 March 2020. As at the Latest Practicable Date, a sum of RMB4,222,400 has been repaid by Mr. Jiang and Mr. Sheng, the shareholders of Beijing Xigua who are jointly liable to certain extent for the repayment, and Beijing Xigua is still indebted to Guangzhou Feidong the Outstanding Sum.

As disclosed in the 2019 Annual Report, based on the management accounts of Beijing Xigua, Beijing Xigua recorded a loss for the period from 1 June 2019 to 31 December 2019, falling short of over RMB43,000,000 as compared to relevant Actual Net Profit for such period of RMB43,000,000 as originally contemplated and guaranteed pursuant to the Investment Agreement. As a result of such non-fulfilment of the Profit Guarantee, the Company has elected to request Shanghai Dacheng, the KongZhong Group and Beijing Xigua for the Full Cash Compensation. As disclosed in the Announcement dated 10 March 2020, the Company has instructed its PRC legal adviser to issue a demand letter to Shanghai Dacheng, the KongZhong Group and Beijing Xigua demanding for the Full Cash Compensation. The Company also requested repayment of the Outstanding Sum from Beijing Xigua.

As disclosed in the Announcement dated 23 October 2020, the Company was given to understand that Shanghai Dacheng and the KongZhong Group have difficulties in arranging for the Full Cash Compensation. The Company was also given to understand that Beijing Xigua has difficulties in repaying the Outstanding Sum. Since the non-fulfilment of the Profit Guarantee, the parties to the Investment Agreement have held various rounds of negotiations and discussions to come to an amicable resolution of the matter. In particular, in light of the circumstances, together with the fact that (a) all the Consideration Shares are currently being held under an escrow account managed by the Escrow Agent; and (b) the financial difficulties that Beijing Xigua and the KongZhong Group are facing in repaying the Outstanding Sum, the parties to the Investment Agreement have been contemplating a mutually agreeable and viable settlement plan which has eventuated into the Transfer Agreement involving (a) the unwinding of the Acquisition (by way of the Equity Disposal and the Share Buy-back); and (b) the Loan Assignment.

The Transfer Agreement was considered and regarded by the parties to the Investment Agreement as the optimal solution to resolve the long-standing issues associated with (a) the non-fulfilment of the Profit Guarantee; (b) the deteriorating operational performance of Beijing Xigua; and (c) the protection of the interests of the Company and the Shareholders as a whole.

TRANSFER AGREEMENT

On 12 November 2020 (after trading hours), among others, the Company, the Investor, Beijing Xigua, Shanghai Dacheng, the KongZhong Group and Guangzhou Feidong entered into the Transfer Agreement, pursuant to which: (i) the Company shall dispose of the 69.84% equity interest in Beijing Xigua to KongZhong China (or its designated third party) (i.e. the Equity Disposal) and the Consideration Shares shall be transferred from Shanghai Dacheng through the Escrow Agent to the Company (i.e. the Share Buy-back); and (ii) the Company shall assign the Outstanding Sum to KongZhong China (or its designated third party) (i.e. the Loan Assignment).

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Set out below is the principal terms of the Transfer Agreement.

Date

12 November 2020 (after trading hours)

Parties

- (i) the Company;
- (ii) the Investor;
- (iii) the KongZhong Group;
- (iv) Shanghai Dacheng;
- (v) Beijing Xigua;
- (vi) Mr. Wang Leilei;
- (vii) Mr. Jiang;
- (viii) Mr. Sheng; and
- (ix) Guangzhou Feidong.

Shanghai Dacheng is a company incorporated in the PRC with limited liability and is owned as to 98.54% by KongZhong China by certain contractual arrangements, which is in turn wholly-owned by KongZhong.

As at the Latest Practicable Date, (a) Shanghai Dacheng is interested in 22,268,908 Consideration Shares being held in an account managed by the Escrow Agent; and (b) KongZhong is interested in 10,202,168 Shares, representing approximately 13.97% and 6.40% of the issued share capital of the Company, respectively. Further, as Shanghai Dacheng is owned as to 98.54% by KongZhong China by way of certain contractual arrangements and KongZhong China is owned as to 100% by KongZhong, the KongZhong Group is interested in 32,471,076 Shares, representing approximately 20.37% of the issued share capital of the Company as at the Latest Practicable Date. Accordingly, each of KongZhong and Shanghai Dacheng is a connected person of the Company.

Subject Matter

- (i) the disposal of the 69.84% equity interest in Beijing Xigua by the Company to KongZhong China (or its designated third party) (i.e. the Equity Disposal) and the buy-back of the 22,268,908 Consideration Shares by the Company from Shanghai Dacheng (through the Escrow Agent) for share cancellation (i.e. the Share Buy-back); and
- (ii) the assignment of the Outstanding Sum in the amount of RMB30,599,878 to KongZhong China (or its designated third party) originally due to Guangzhou Feidong (i.e. the Loan Assignment).

Implied Transfer Consideration

As disclosed in the paragraph headed "Background" in this circular, Beijing Xigua was and is unable to fulfil the Profit Guarantee, and Beijing Xigua, Shanghai Dacheng and KongZhong Group are

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experiencing financial difficulties in payment of the Full Cash Compensation and the Outstanding Sum.

After rounds of negotiations and discussions between the relevant parties for the purpose of resolving all outstanding issues amicably which have eventuated to the Transfer Agreement:

- (a) KongZhong China has agreed to pay the Company in cash in the amount of RMB20,000,000, equivalent to the amount of consideration that the Company paid to subscribe for 9.30% equity interest in Beijing Xigua in the form of new registered capital under the Investment Agreement;
- (b) KongZhong China has agreed to pay the Company in cash in the amount of RMB5,519,280 for the Loan Assignment; and
- (c) Shanghai Dacheng shall through the Escrow Agent deliver 22,268,908 Consideration Shares to the Company for cancellation.

((a) and (b) collectively, the Cash Consideration)

As the Transfer Agreement aims to unwind the Acquisition, the implied Buy-back Price for transfer of the Consideration Shares is HK\$6.876, which is equivalent to the issue price per Consideration Share under the Investment Agreement.

The Implied Transfer Consideration is RMB155,672,137, which is equivalent to the sum of consideration for the Acquisition (i.e. RMB150,152,857) and consideration for the Loan Assignment (i.e. RMB5,519,280).

With respect to the consideration for the Loan Assignment, the Board has considered the following:

- (a) 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 devices;
- (b) as explained by Beijing Xigua that due to the Epidemic, the operations of the physical stores abovementioned have been suspended since early 2020 upon request of the relevant government departments in the PRC as part of the prevention and control measures to protect the public from the risk of viral infection;
- (c) as such, the Company was given to understand that Beijing Xigua has been facing financial difficulties and was unable to repay the Outstanding Sum despite repeated requests from the Company through different approaches. The Company was also provided with the recent financial statements and other relevant documents of Beijing Xigua which confirmed the financial difficulties of the latter;
- (d) it is possible that the Company could commence legal proceedings against Beijing Xigua to recover the Outstanding Sum. However, the Board, after careful deliberations, analysis and calculations, is of the view that such legal proceedings may not be in the interests of the Company and the Shareholders as a whole due to the following reasons:
 - (i) the legal proceedings would likely last for a substantial period of time which would add additional burden in terms of legal costs and expenses on the Company. In addition, the management of the Company would likely need to spend a considerable amount of time and resources for such legal proceedings including but not limited to preparing and reviewing the legal documents and complying with the necessary legal

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procedures;

- (ii) the outcome of the legal proceedings would be uncertain and unpredictable;
 - (iii) even if the Company obtained a favourable judgment out of the Outstanding Sum legal proceedings against Beijing Xigua, the Company would likely need to face the problem of and difficulties in judgment enforcement;
 - (iv) considering the financial difficulties that Beijing Xigua is facing, if Beijing Xigua is unable to repay the Outstanding Sum, the Company considers that Beijing Xigua would be unable to pay the judgment sum either. As such, it is likely that a winding up legal proceedings against Beijing Xigua would be instituted in order for the Company to obtain as much as it could out of the remaining assets of Beijing Xigua, which would be another additional burden in terms of time, costs and expenses as well as resources on the Company;
 - (v) in the event that the Company could obtain the judgment to wind up Beijing Xigua, it is possible that there would be other creditors of Beijing Xigua coming forward to claim and realise the remaining assets of Beijing Xigua;
 - (vi) considering that the date of the Loan Agreement, being 21 November 2019, is comparatively recent, it is further possible that those other creditors may have priority over the Company when claiming the assets of the Beijing Xigua;
 - (vii) to conclude, it is likely that the Company would need to bear a substantial amount of legal costs and expenses as well as spend a lot of time and resources for different kind of legal proceedings, but may lose the priority to other creditors when claiming and realising the remaining assets of Beijing Xigua, not to mention that it is unlikely that there will be much assets left in Beijing Xigua;
- (e) in light of the above and given the circumstances, the Board is of the view that a better approach to recover the Outstanding Sum as much as it could is to negotiate and discuss with Beijing Xigua and the relevant parties and to come up with an arrangement (i.e. the Loan Assignment) to resolve the issues smoothly and amicably;
- (f) after further discussions and negotiations with Beijing Xigua and the relevant parties, during which the Company had the opportunity to request and review the financial statements and other relevant documents of the KongZhong Group, it was revealed that the current consideration for the Loan Assignment is already the highest amount that can be offered by the KongZhong Group in order for the KongZhong Group at the same time to maintain their usual business operation, solvency and sufficient operating cashflow;
- (g) the consideration for the Loan Assignment, the amount of which despite being comparatively low to the Outstanding Sum, could allow the Company to obtain general working capital early which is beneficial to the operation of the Group;
- (h) the Loan Assignment can serve to lower the asset losses of the Company which will lead to a healthier financial position of the Company;
- (i) despite repeated attempts to recover the Outstanding Sum, Beijing Xigua has failed to fulfil its repayment obligation. The Loan Assignment, which involves a party not originally involved in the Loan Agreement, provides for an one-off solution to the Group to recover the Outstanding Sum to the largest extent possible given the financial position of the Beijing Xigua and the KongZhong Group; and

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- (j) in view of the uncertainty in recovering the Outstanding Sum from Beijing Xigua, the Board opines that the Loan Assignment represents an opportunity for the Group to recover the Outstanding Sum as much as the Company could possibly recover, which will make a positive contribution to the cashflow of the Group.

Considering the above, the Board is of the view that the Loan Assignment, the amount of which despite being relatively lower than the Outstanding Sum, is the optimal solution that the Company could achieve out of various rounds of negotiations and discussions with Beijing Xigua and the relevant parties after considering (i) the adverse impact of the Epidemic on almost every industry in the PRC; (ii) the nature of the business that Beijing Xigua operates which suffers hard during the Epidemic; (iii) the difficult environment and market conditions for Beijing Xigua to operate in the PRC; and (iv) the operation and financial difficulties that Beijing Xigua and the KongZhong Group are facing, and is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

The implied Buy-back Price represents:

- (i) a premium of approximately 207% over the closing price of HK\$2.24 per Share as quoted on the Stock Exchange on the Latest Practicable Date;
- (ii) a premium of approximately 202% over the closing price of HK\$2.28 per Share as quoted on the Stock Exchange on the Last Trading Day;
- (iii) a premium of approximately 198% over the closing price of HK\$2.31 per Share as quoted on the Stock Exchange on 12 November 2020, being the date of the Transfer Agreement and the relevant announcement;
- (iv) a premium of approximately 179% over the average closing price of approximately HK\$2.47 per Share for the last five trading days up to and including the Last Trading Day;
- (v) a premium of approximately 177% over the average closing price of approximately HK\$2.48 per Share for the last ten trading days up to and including the Last Trading Day;
- (vi) a premium of approximately 165% over the average closing price of approximately HK\$2.59 per Share for the last 30 trading days up to and including the Last Trading Day;
- (vii) a premium of approximately 134% over the average closing price of approximately HK\$2.94 per Share for the last 90 trading days up to and including the Last Trading Day;
- (viii) a premium of approximately 119% over the average closing price of approximately HK\$3.14 per Share for the last 180 trading days up to and including the Last Trading Day; and
- (ix) a premium of approximately 52.8% over the unaudited consolidated net asset value attributable to the Shareholders of approximately HK\$4.5 per Share (based on the unaudited consolidated net assets attributable to the Shareholders as at 30 June 2020 of approximately RMB632,916,000 (equivalent to approximately HK\$719,223,000 based on an exchange rate of RMB0.88: HK\$1) and 159,379,238 Shares in issue as at the Latest Practicable Date.

The Cash Consideration of RMB25,519,280 shall be paid by KongZhong China (or its designated third party) in the following manner:

- (i) a sum of RMB1,000,000 in cash shall be paid within 10 days of the date where all the

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conditions precedent under the Transfer Agreement have been satisfied or waived (if applicable), or by the end of 31 December 2020, whichever is earlier;

- (ii) a sum of RMB2,519,280 in cash shall be paid by the end of 31 March 2021; and
- (iii) thereafter, a sum of RMB2,000,000 in cash shall be paid at least quarterly by the end of June, September, December and March per year starting from 2021 until the balance of RMB22,000,000 has been paid in full.

Among the 10,202,168 Shares that KongZhong is interested in as at the Latest Practicable Date, 1,851,568 Shares (equivalent to approximately HK\$4,221,575 and HK\$4,147,512 calculated by using the closing prices of HK\$2.28 and HK\$2.24 per Share as quoted on the Stock Exchange on the Last Trading Day and on the Latest Practicable Date, respectively) have been agreed by the KongZhong Group to be delivered to a third party escrow agent jointly appointed by the KongZhong Group and the Company for security purpose that in the event of default in the payment of the Cash Consideration, such third party escrow agent is allowed to dispose of such 1,851,568 Shares and apply the sale proceeds to pay the relevant amount due.

With respect to the 1,851,568 Shares that have been agreed by the KongZhong Group to deliver to a third party escrow agent, the Board has considered the following:

- (a) as disclosed in the paragraph headed “Background” in this circular and in the Announcements, the Company was given to understand that Shanghai Dacheng and the KongZhong Group have been facing financial difficulties to make the Full Cash Compensation with respect to the non-fulfilment of the Profit Guarantee and the repayment of the Outstanding Sum;
- (b) further, as disclosed in the Announcement dated 10 March 2020, the Company has instructed its PRC legal adviser to issue a demand letter to Shanghai Dacheng, the KongZhong Group and Beijing Xigua demanding for the Full Cash Compensation;
- (c) given the reason of the financial difficulties, the Company was given to understand that the KongZhong Group are only able to pay the Cash Compensation by instalments. In order to protect the interests of the Company and the Shareholders as a whole, the Company requested securities with respect to the payment of the Cash Compensation by instalments, and the KongZhong Group agreed to deliver the 1,851,568 Shares to a third party escrow agent for security purpose;
- (d) apart from the 1,851,568 Shares, the Company also requested other additional securities with an attempt to secure the total amount of the Cash Consideration as much as it could. However, after further discussions and negotiations with the KongZhong Group, during which the Company had the opportunity to conduct a comprehensive review on the KongZhong Group and by obtaining its financial statements and other relevant documents, it was revealed that KongZhong Group did not have sufficient assets to provide the other additional securities per the Company’s request;
- (e) the KongZhong Group also explained that except the 1,851,568 Shares, other securities that the KongZhong Group are interested in have already been pledged to other third parties;
- (f) despite that no additional securities could be provided, during the comprehensive review on the KongZhong Group abovementioned, the Board has also assessed KongZhong China’s payment capability and is of the view that KongZong China would not have concerns on its solvency in respect of the payment of the Cash Consideration by instalments;

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- (g) the Company further requested certain documents in relation to the cashflow and business operations and proposals of the KongZhong Group for the coming future, and based on these documents, the Company believes that the KongZhong Group will have sufficient cash resources to satisfy its future working capital and other financing requirements in order to allow them to operate their business as planned and pay the Cash Consideration by installment as disclosed above;
- (h) the Company is not aware of any recent history of default in payment by the KongZhong Group with respect to any amount payable by the KongZhong Group to other parties, and therefore the Company considers that the KongZhong Group, despite having financial difficulties, are operating their business feasibly and are capable of making repayment to the Company;
- (i) as at the Latest Practicable Date, the Company believes that there has not been a significant change in credit quality of the KongZhong Group and the Cash Consideration is considered fully recoverable; and
- (j) the 1,851,568 Shares (equivalent to approximately HK\$4,221,575 and HK\$4,110,481 calculated by using the closing prices of HK\$2.28 and HK\$2.22 per Share as quoted on the Stock Exchange on the Last Trading Day and on the Latest Practicable Date, respectively), the value of which albeit being comparatively lower than the Cash Consideration, could still serve as security to a certain degree with respect to the payment by instalment of the Cash Compensation offered by the KongZhong with an attempt to resolve the issues amicably.

In light of the above, after considering that (i) the KongZhong Group will have sufficient working capital to operate their business; (ii) the risk of default in payment of the Cash Consideration by KongZhong Group is low given no significant change in credit quality of the KongZhong Group; (iii) the KongZhong Group's attempt to resolve the matter amicably by revealing the underlying financial statements to the Company and offering the only available securities to the Company to secure the payment of the Cash Consideration; (iv) the relationship between the Group, Beijing Xigua and the KongZhong Group have been amicable; and (v) the KongZhong Group's lack of additional assets for security purpose for the Cash Consideration, the Board is of the view that the 1,851,568 Shares to be delivered to an escrow agent by the KongZhong Group is the most favourable solution that the Company could obtain with respect to the security for the payment of the Cash Consideration by instalment out of numerous rounds of negotiations and discussions with the KongZhong Group in order to protect the interests of the Shareholders as a whole, and is fair and reasonable given the difficult circumstances.

Conditions precedent

The Transfer is conditional upon the satisfaction of each of the following conditions precedent:

- (i) the parties to the Transfer Agreement having completed all necessary internal procedures to agree to the terms and conditions and approve the signing and execution of the Transfer Agreement;
- (ii) the Executive having approved the Share Buy-back pursuant to Rule 2 of the Share Buy-back Code (and such approval not having been withdrawn) and the condition(s) of such approval, if any, having been satisfied;
- (iii) the Executive having approved the Loan Assignment, which constitutes a special deal in accordance with Rule 25 of the Takeovers Code (and such approval not having been withdrawn) and the condition(s) of such approval, if any, having been satisfied;

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- (iv) the parties to the Transfer Agreement having obtained all necessary consent, approval or waivers from any government or regulatory authority, including the Stock Exchange and the SFC, or third parties in connection with the execution and performance of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment), where required;
- (v) the approval of (a) each of the Equity Disposal and the Loan Assignment by a simple majority of the Independent Shareholders present at the EGM by poll in accordance with the Listing Rules; (b) the Loan Assignment by a simple majority of the Independent Shareholders present at the EGM by poll in accordance with the Takeovers Code; and (c) the Share Buy-back by at least three-fourths of the Independent Shareholders present at the EGM by poll, in accordance with the applicable requirements of the Listing Rules, Share Buy-back Code, Takeovers Code and other applicable laws and regulations;
- (vi) the Company having sufficient reserves in the form of capital and/or share premium in its accounts to effect the Share Buy-back;
- (vii) each of the warranties provided in the Transfer Agreement remaining true and accurate in all respects up to the Completion;
- (viii) the due performance and observance by Shanghai Dacheng, Beijing Xigua, the KongZhong Group, Mr. Wang Leilei, Mr. Jiang and Mr. Sheng of all their undertakings and obligations under the Transfer Agreement; and
- (ix) no challenge or threat to challenge with respect to nor litigation or investigation instituted in respect of the transactions contemplated under the Transfer Agreement.

Shanghai Dacheng, Beijing Xigua, the KongZhong Group, Mr. Wang Leilei, Mr. Jiang, and Mr. Sheng shall use their best endeavours to satisfy the above conditions precedent as soon as possible. Save and except for conditions (vii) and (viii) which can be waived unilaterally by the Company, none of the conditions precedent set out above is capable of being waived by the parties to the Transfer Agreement.

If any of the above conditions precedent cannot be fulfilled or waived by the Long Stop Date, and without affecting the liabilities of any party to another party to the Transfer Agreement for any antecedent breach of any terms thereof, the Transfer Agreement and any matters contained therein and the rights and obligations of the parties thereto shall be of no effect from the date following the Long Stop Date.

With reference to condition (iv), as at the Latest Practicable Date and to the best knowledge of the Company, save for the requirements under conditions (ii), (iii) and (v), the Company is not aware of any necessary consents, authorisations, licences and/or approvals required to be obtained from any relevant government authorities or other relevant regulatory bodies for entering into and the implementation of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Share Buy-back).

In relation to condition (vi), as at the Latest Practicable Date, the Company confirms that it has sufficient reserves in the form of capital and/or share premium in its accounts to effect the Share Buy-back and expects to continue to be so satisfied until Completion.

As at the Latest Practicable Date, save as conditions (i) and (vi), none of the above conditions precedent has been fulfilled.

Completion

LETTER FROM THE BOARD

Upon the satisfaction (or waiver, if applicable) of all of the conditions precedents as set out in the paragraph headed “Conditions precedent” above in this circular:

- (a) the Loan Assignment shall take place immediately;
- (b) within two (2) days, Shanghai Dacheng shall deliver through the Escrow Agent the Consideration Shares to the Company for cancellation;
- (c) within five (5) days, the parties to the Transfer Agreement shall complete the relevant registration procedures for change (工商變更登記) with respect to the Equity Disposal (i.e. the Completion); and
- (d) within ten (10) business days (or a later day to be agreed between the Company and the KongZhong Group), the escrow arrangement with respect to the 1,851,568 Shares shall be completed.

Upon Completion, the parties to the Investment Agreement (including Shanghai Wangyu) and the Loan Agreement shall not be entitled to the rights given and be discharged from their respective obligations under the Investment Agreement and the Loan Agreement. KongZhong China (or its designated third party) shall continue to make payment for the Cash Consideration in accordance with the manner disclosed in the paragraph headed “Implied Transfer Consideration” above in this circular until full payment.

EFFECTS ON THE SHAREHOLDING STRUCTURE OF THE COMPANY

The following table illustrates the Company’s shareholding structure (i) as at the Latest Practicable Date; and (ii) immediately after completion of the Share Buy-back, assuming there will be no other change in the issued share capital and the shareholding structure of the Company between the Latest Practicable Date and the date on which the Share Buy-back is completed.

Name of Shareholder	As at the Latest Practicable Date		Immediately after the completion of the Share Buy-back	
	Number of Shares held	Approximate %	Number of Shares held	Approximate %
Foga Group Ltd. ⁽¹⁾⁽⁷⁾	21,673,338	13.60%	21,673,338	15.81%
WANG Dongfeng ⁽²⁾	1,650,800	1.04%	1,650,800	1.20%
Foga Holdings Ltd. ⁽¹⁾	7,763,997	4.87%	7,763,997	5.66%
Subtotal — Foga Group Ltd. and its concert parties	31,088,135	19.51%	31,088,135	22.67%
Foga Internet Development Ltd. ⁽⁴⁾	7,785,700	4.89%	7,785,700	5.68%
YANG Tao ⁽⁵⁾⁽⁷⁾	1,340,000	0.84%	1,340,000	0.98%
Subtotal — Foga Internet Development Ltd. and its concert party	9,125,700	5.73%	9,125,700	6.66%

LETTER FROM THE BOARD

Name of Shareholder	As at the Latest Practicable Date		Immediately after the completion of the Share Buy-back	
	Number of Shares held	Approximate %	Number of Shares held	Approximate %
KongZhong ⁽³⁾	10,202,168	6.40%	10,202,168	7.44%
Shanghai Dacheng ⁽³⁾	22,268,908	13.97%	0	0%
Subtotal — KongZhong and its concert party	32,471,076	20.37%	10,202,168	7.44%
China Create Capital Limited ⁽⁶⁾	9,584,000	6.01%	9,584,000	6.99%
ZHANG Qiang ⁽⁸⁾	93,333	0.06%	93,333	0.07%
Other Shareholders	77,016,994	48.32%	77,016,994	56.17%
Total	159,379,238	100%	137,110,330	100%

Notes:

- (1) Foga Group Ltd. is wholly-owned by Managecorp Limited as the trustee of Wang Trust. Wang Trust is a discretionary trust set up by Mr. WANG Dongfeng, who is its settlor and protector, with Managecorp Limited as trustee on 15 March 2013. The beneficiary objects of Wang Trust include Mr. WANG Dongfeng and certain of his family members. Mr. WANG Dongfeng and Managecorp Limited are taken to be interested in 21,673,338 Shares held by Foga Group Ltd.. In addition, Foga Holdings Ltd. is wholly-owned by Managecorp Limited as the trustee of Hao Dong Trust. Hao Dong Trust is a discretionary trust set up by Mr. LIAO Dong, who is its settlor and protector, with Managecorp Limited as trustee on 15 March 2013. The beneficiary object of Hao Dong Trust is Mr. LIAO Dong himself. Mr. LIAO Dong and Managecorp Limited are taken to be interested in 7,763,997 Shares held by Foga Holdings Ltd.
- (2) Mr. WANG Dongfeng was granted 500,000 RSUs under the RSU Scheme in 2016, all of which vested during the period from 1 December 2016 to 1 June 2018. Mr. WANG Dongfeng bought an aggregate of 850,800 Shares during the period from 26 June to 13 July 2017. He was further granted 300,000 RSUs under the RSU Scheme in 2018, 50,000 of which vested on 1 December 2018 and 250,000 of which were cancelled on 30 June 2019. The Company further granted 250,000 RSUs to Mr. WANG Dongfeng under the RSU Scheme in 2019, 50,000 of which vested on 1 July 2019 and 50,000 vested on 1 January 2020. Mr. WANG Dongfeng resigned from executive Director with effect from 30 September 2019. Given that 1 RSU represents 1 Share upon vesting, the figure of 1,650,800 comprising 1,500,800 Shares and 150,000 uncancelled RSUs as well is considered as a prudent and complete disclosure by the Company of Mr. WANG Dongfeng's interests in the Company.
- (3) Shanghai Dacheng is owned as to 98.54% by KongZhong China by way of certain contractual arrangements, which is in turn 100% owned by KongZhong. By virtue of the SFO, the KongZhong Group are taken to be interested in the 22,268,908 Shares held by Shanghai Dacheng.
- (4) Foga Internet Development Ltd. is wholly-owned by Mr. YANG Tao. Mr. YANG Tao is taken to be interested in the 7,785,700 Shares held by Foga Internet Development Ltd.
- (5) Mr. YANG Tao was granted 1,340,000 RSUs under the RSU Scheme in 2016, all of which vested during the period from 1 December 2016 to 1 June 2018.
- (6) China Create Capital Limited is a company incorporated in the BVI and interested in 9,584,000 Shares in the capacity of a beneficial owner. To the best of the knowledge of the Company, none of the Directors is holding any shares in China Create Capital Limited and China Create Capital Limited is not related to other Shareholders.

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- (7) Mr. WANG Dongfeng, Mr. LIAO Dong and Mr. YANG Tao are co-founders of the Group. For further details of their relationship, please refer to the sections headed “Our History, Reorganization and Corporate Structure” and “Directors and Senior Management” of the prospectus of the Company dated 19 September 2013.
- (8) As at the Latest Practicable Date, Mr. ZHANG Qiang, a non-executive Director, is holding 93,333 Shares in the capacity as a beneficial owner, representing approximately 0.06% of the issued share capital of the Company. Mr. ZHANG Qiang was granted 100,000 RSUs, all of which vested during the period from 1 December 2016 to 1 June 2018. He was further granted 50,000 RSUs, 8,333 of which vested on 1 December 2018 and 41,667 of which were cancelled on 30 June 2019. Mr. ZHANG Qiang sold 75,000 Shares on 17 January 2019. The Company further granted 60,000 RSUs to Mr. ZHANG Qiang, of which 12,000 vested on 1 July 2019, 12,000 vested on 1 January 2020 and 12,000 vested on 1 July 2020. Given that 1 RSU represents 1 Share upon vesting, the figure of 93,333 comprising 69,333 Shares and 24,000 uncancelled RSUs as well is considered as a prudent and complete disclosure by the Company of Mr. ZHANG Qiang’s interests in the Company.

The Company has adopted the Pre-IPO Share Option Scheme by a resolution of the Shareholders on 31 October 2012, which was amended on 1 September 2013. The Pre-IPO Share Option Scheme is not subject to the provision of Chapter 17 of the Listing Rules as the Pre-IPO Share Option Scheme does not involve the grant of options by the Company to subscribe for Shares once the Company is a listed issuer. No further options will be granted under the Pre-IPO Share Option Scheme.

Pursuant to the Pre-IPO Share Option Scheme, the Company had granted options to subscribe for 6,440,911 Shares to the Directors and employees/former employees of the Group. The following persons are holders of the outstanding share options:

Name of share option holders	Outstanding as at the Latest Practicable Date
Four former Directors and 361 employees/former employees	452,370
Total	452,370

The 452,370 share options outstanding as at 30 June 2020 represent 452,370 Shares in the event that the former are exercised in full.

In addition, the Company has approved and adopted the RSU Scheme. The RSU Scheme is not subject to the provisions of Chapter 17 of the Listing Rules as the RSU Scheme does not involve the grant of options by the Company to subscribe for new Shares. The following persons are holders of the outstanding RSUs:

Name of RSU holders	Unvested as at the Latest Practicable Date
ZHANG Qiang	24,000 <i>(Note)</i>
Five former Director and 16 employees	602,000 <i>(Note)</i>
Total	602,000 <i>(Note)</i>

Note: The RSUs which have vested shall be satisfied at the Company’s absolute discretion within a reasonable period from the vesting date of such RSUs by directing and procuring the professional trustee of the RSU Scheme to transfer the Shares underlying the award to the relevant grantees which such trustee has acquired by making on-market purchases of the Shares in accordance with the relevant terms and conditions of the RSU Scheme.

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Save as disclosed above, the Group has no outstanding warrants, options, convertible securities or other derivatives convertible into Shares, and no share or loan capital of the Group has been put under option or agreed conditionally or unconditionally to be put under option and no other conversion right affecting the Shares or other derivatives in respect of securities which are being offered for or which carry voting rights have been issued or granted or agreed conditionally or unconditionally to be issued or granted.

Upon Completion, pursuant to the Share Buy-back, the Consideration Shares will be cancelled and the number of Shares in issue following the Share Buy-back will be reduced from 159,379,238 (being the number of issued Shares as at the Latest Practicable Date) to 137,110,330 and the shareholding interest of the Shareholders will be increased proportionally. The percentage interest in the issued Shares of all other Shareholders, including KongZhong (whose percentage interest in the issued Shares will increase from approximately 6.40% to 7.44%), will be proportionally increased following the cancellation of the Consideration Shares and as a result of the reduction in the number of issued Shares. Shanghai Dacheng will no longer hold any Shares upon the Completion.

INFORMATION ABOUT THE GROUP

The Company is an investment holding company. The Group is principally engaged in developing and publishing domestic and overseas webgames and mobile games as well as providing internet micro-credit service and financial information service in the PRC.

The Investor is a direct wholly-owned subsidiary of the Company and a company established under the laws of the PRC with limited liability. It is principally engaged in the development of software and design of game software.

Guangzhou Feidong is an indirectly wholly-owned subsidiary of the Company. It is principally engaged in the business of webgames development.

INFORMATION ABOUT THE KONGZHONG GROUP AND SHANGHAI DACHENG

KongZhong is a company incorporated under the laws of the Cayman Islands with limited liability and is an investment holding company. To the best of the knowledge, information and belief of the Company after making reasonable enquiries:

- (1) KongZhong is 100% owned by Linkedsee Limited, which in turn is 73.13% owned by Linkedsee Group Limited and 26.87% owned by Mr. WANG Leilei;
- (2) Shanghai Changhui Internet Technology Co., Limited* (上海常匯互聯網科技有限公司) and Mr. WANG Leilei hold 57.32% and 42.68% of equity interest of Linkedsee Group Limited, respectively;
- (3) Beijing Wuxing Rongcheng Technology Co., Limited* (北京五星融誠科技有限責任公司) holds 100% equity interest of Shanghai Changhui Internet Technology Co., Limited* (上海常匯互聯網科技有限公司);
- (4) Beijing Wuxing Rongcheng Technology Co., Limited* (北京五星融誠科技有限責任公司) is 51.11% owned by Mr. WANG Leilei, 40.89% owned by Hexie Chengzhang Phase II (YIWU) Investment Center (Limited Partnership)* (和諧成長二期(義烏)投資中心(有限合夥)) and 8.0% owned by Gongqingcheng Wujiang Xingyao Investment Management Partnership Enterprise (Limited Partnership)* (共青城五疆星耀投資管理合夥企業(有限合夥)); and
- (5) Hexie Chengzhang Phase II (YIWU) Investment Center (Limited Partnership)* (和諧成長二期

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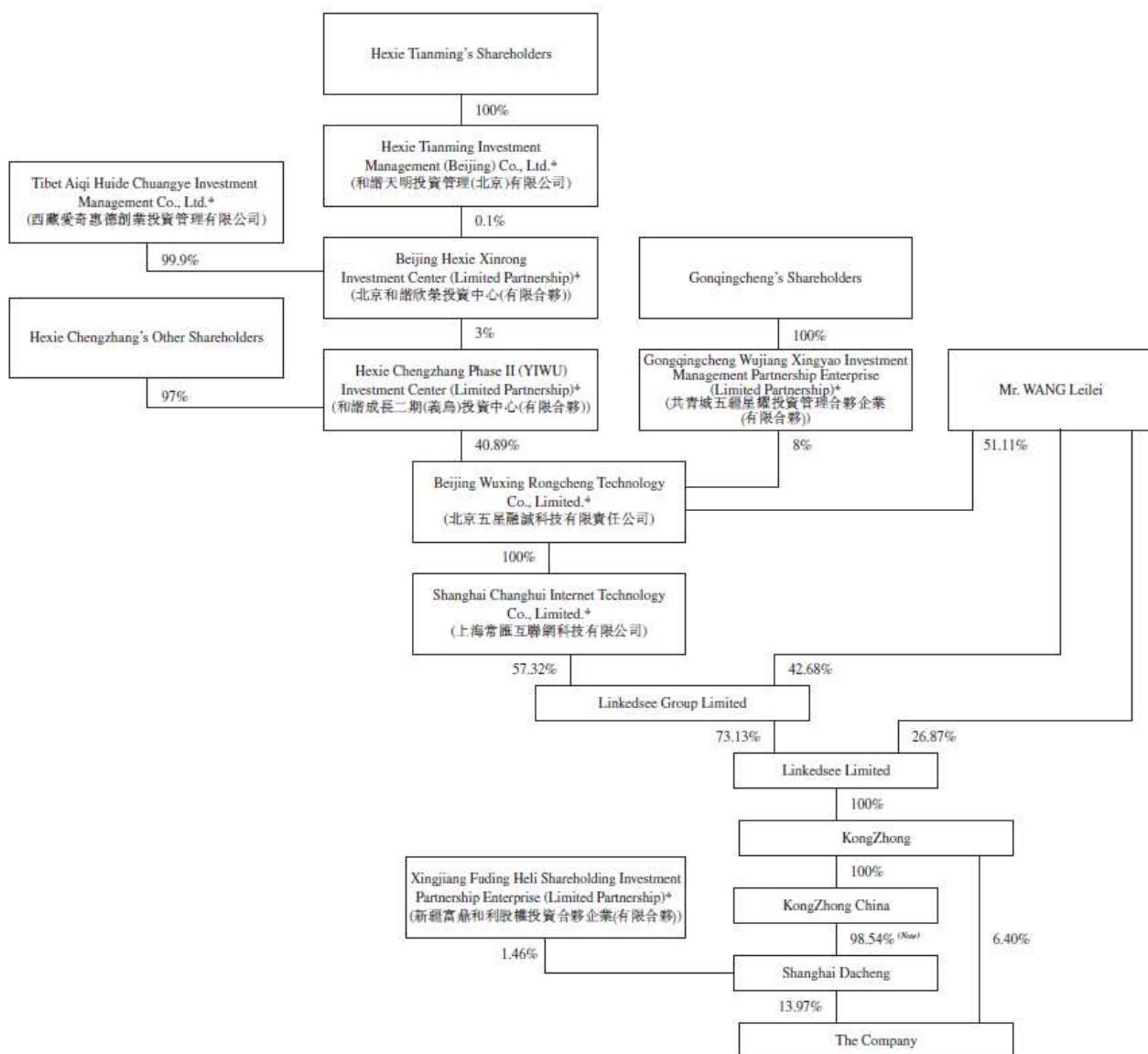
(義烏)投資中心(有限合夥) is 3% held by Beijing Hexie Xinrong Investment Center (Limited Partnership)* (北京和諧欣榮投資中心(有限合夥)). Beijing Hexie Xinrong Investment Center (Limited Partnership)* (北京和諧欣榮投資中心(有限合夥)) is 0.1% owned by Hexie Tianming Investment Management (Beijing) Co., Ltd.* (和諧天明投資管理(北京)有限公司).

KongZhong China is a company established under the laws of the PRC with limited liability and is wholly-owned by KongZhong. It is principally engaged in developing computer software and providing integrated technical advisory services of computer systems.

Shanghai Dacheng is a company established under the laws of the PRC with limited liability. It is principally engaged in publication of internet games and owned as to 98.54% by KongZhong by way of certain contractual arrangements.

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To the best of the knowledge, information and belief of the Company after making reasonable enquiries, set out below is a chart in respect of the shareholding structure of Shanghai Dacheng as at the Latest Practicable Date:



Note: Shanghai Dacheng is owned as to 98.54% by KongZhong by way of certain contractual arrangements.

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INFORMATION ABOUT BEIJING XIGUA

Beijing Xigua is a company established under the laws of the PRC with limited liability. 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 devices. As at the Latest Practicable Date, Beijing Xigua is owned as to 69.84% by the Investor, 4.54% by Shanghai Wangyu, 18.14% by Mr. Jiang, 6.12% by Mr. Sheng and 1.36% by Shanghai Dacheng.

Set out below is a summary of the unaudited consolidated financial information of Beijing Xigua as prepared in accordance with IFRS for the years ended 31 December 2018 and 2019:

	For the year ended 31 December 2018 (RMB) (unaudited)	For the year ended 31 December 2019 (RMB) (unaudited)
Loss before tax	5,402,953	87,238,980
Loss after tax	5,402,953	87,238,980

As at 31 December 2019, Beijing Xigua has audited consolidated net liabilities of approximately RMB73,702,000¹. As at 30 June 2020, Beijing Xigua has unaudited consolidated net liabilities of approximately RMB89,522,000.

Pursuant to Rule 14.58 of the Listing Rules, the Company is required to disclose the net profits and book value of Beijing Xigua set out above (the “**Unaudited Beijing Xigua Financial Information**”). **However, in light of the qualified opinion issued by the Auditor in the 2019 Annual Report set out below, the Directors are of the view that the Unaudited Beijing Xigua Financial Information may not be true and accurate.**

Meanwhile, pursuant to Rule 10 of the Takeovers Code, the Unaudited Beijing Xigua Financial Information constitutes a profit forecast and must be reported on by the Auditor and the Company’s financial adviser(s) in accordance with the Takeovers Code and such report must be lodged with the Executive in accordance with Rule 10.4 of the Takeovers Code. However, as discussed above, **the Auditor has issued a qualified opinion in relation to the financial information of Beijing Xigua for the period from 26 June 2019, being the date of the completion of the Acquisition, to 31 December 2019, in the 2019 Annual Report, and hence the Auditor would not be able to provide an assurance on the compilation of the Unaudited Beijing Xigua Financial Information. Accordingly, the Unaudited Beijing Xigua Financial Information would not be reported on by the Auditor and financial adviser of the Company in accordance with Rule 10.4 of the Takeovers Code.**

Shareholders and potential investors of the Company should note that the Unaudited Beijing Xigua Financial Information does not meet the standard required by Rule 10 of the Takeovers Code and has not been reported on in accordance with the Takeovers Code. In addition, Shareholders and potential investors of the Company should not rely on the Unaudited Beijing Xigua Financial Information when they deal or contemplate dealing in the Shares or other securities (if any) of the Company. Shareholders and potential investors of the Company should also exercise caution in placing

¹ As the consolidated statement of financial position of Beijing Xigua only concerns a given point in time (i.e. 31 December 2019), it was audited by the Auditor together the consolidated statement of financial position of the Group. On the other hand, the consolidated statement of profit or loss and other comprehensive income of Beijing Xigua for the year ended 31 December 2019 is unaudited as Beijing Xigua only entered the Group in June 2019 and its accounts prior to that are not audited by the Auditor.

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reliance on the Unaudited Beijing Xigua Financial Information in assessing the merits and demerits of the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment).

As disclosed in the 2019 Annual Report, the Auditor issued a qualified opinion in relation to Beijing Xigua, which is as set out below:

“As disclosed in note 38(a) to the consolidated financial statements, the Group acquired a 69.84% equity interest in Beijing Xigua Huyu Technology Co., Ltd. (“Beijing Xigua”) on 26 June 2019. 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. Due to the insufficient supporting documents and relevant explanations on the accounting books and records in respect of Beijing Xigua and its operations, we were unable to obtain sufficient appropriate audit evidence to satisfy ourselves as to whether the acquisition of Beijing Xigua and the following income and expenses for the year ended 31 December 2019 and the assets and liabilities as at 31 December 2019, and the segment information and other related disclosure notes in relation to the Group, as included in the consolidated financial statements of the Group, have been accurately recorded and properly accounted for in the consolidated financial statements ...”

For further details of the above qualified opinion, please refer to the 2019 Annual Report and the supplemental Announcement dated 22 October 2020.

Beijing Xigua has been held by the Company for less than 12 months prior to date of the Transfer Agreement. The original acquisition cost of Beijing Xigua to the Group was RMB150,152,857 (composed of a cash consideration RMB20,000,000 and a consideration of RMB130,152,857 in the form of 22,268,908 Consideration Shares), which was determined taking into account a number of factors including but not limited to: (i) the previous assessment on the prospects of the virtual reality game industry by the Company’s management; (ii) the Thresholds as guaranteed profits pursuant to the terms and conditions of the Investment Agreement; (iii) a valuation of the 100% equity value of Beijing Xigua and its subsidiaries, namely 北京玩氩科技有限責任公司 (Beijing Wan Ke Technology Co., Ltd.*), 蕪湖空見信息科技有限公司 (Wuhu Kongjian Information Technology Co., Ltd.*) and 天津玩氩科技有限公司 (Tianjin Wan Ke Technology Co., Ltd.*) prepared by an independent valuer adopting market approach; (iv) the expected future development of Beijing Xigua, in particular its potential of being one of the largest VR game brands in the PRC; and (v) the expected benefits to be derived by the Group from the transaction as described under the paragraph headed “Reasons for and benefits of the Transaction” in the Announcement dated 24 April 2019.

PUBLIC FLOAT

The Company intends to maintain its listing on the Stock Exchange and to continue to meet the public float requirements under Rule 8.08 of the Listing Rules. It is expected that the Company will meet the said public float requirement after completion of the Share Buy-back.

FINANCIAL EFFECTS OF THE TRANSFER

Upon completion of the Equity Disposal, Beijing Xigua will cease to be a subsidiary of the Company and the Company will not be holding any issued shares of Beijing Xigua.

Set out below are the impact of the Transfer Agreement and the transactions contemplated thereunder on the financial performance and financial position of the Group. It should be noted that they are for illustrative purpose only.

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Earnings

Upon completion of the Equity Disposal, the Group expects to record a gain or loss on the Equity Disposal which will be reflected in the consolidated statement of profit or loss after taking into account the fair value of the Consideration Shares as at the date of the Completion less the net assets value of Beijing Xigua attributable to the Company as at the date of the Completion and the transaction costs to be incurred for the Equity Disposal.

Based on the net liabilities of Beijing Xigua attributable to the Company of approximately RMB89,522,000 as at 30 June 2020, the Company currently expects to recognise a gain of approximately RMB74,707,000 (by using the then closing price as the deemed fair value of the Consideration Shares of approximately HK\$69,702,000 (calculated by using the closing price of the Shares on 30 June 2020 of HK\$3.13 per Share times the number of Consideration Shares of 22,268,908) less the net liabilities of Beijing Xigua attributable to the Company of approximately RMB89,522,000 as at 30 June 2020). It is contemplated that the reserves of the Remaining Group will be increased upon the recognition of the disposal gain and the transaction costs in the consolidated statement of profit or loss.

It should be noted that the disposal gain calculated above is only for illustrative purpose which assumes the completion of the Equity Disposal had taken place on 30 June 2020. The actual profit or loss on the Equity Disposal will depend on the fair value of the Consideration Shares and the net assets value of Beijing Xigua as at the completion date of the Equity Disposal.

Working Capital

According to the estimations of the Company, the working capital of the Remaining Group is expected to increase slightly by approximately RMB22,302,000 from approximately RMB512,478,000 to approximately RMB534,780,000, mainly due to the receipt of the Cash Consideration of RMB25,519,280 and the exclusion of the fair value of Profit Guarantee of RMB74,000,000 and the negative working capital of Beijing Xigua of approximately RMB70,783,000.

Since there is no cash outflow required by the Company in order to effect the Share Buy-back, the Directors consider that the Share Buy-back will not have a material adverse effect on the working capital sufficiency of the Company upon completion of the Share Buy-back.

Asset and liabilities

As at 30 June 2020, the assets and liabilities of the Group amounted to approximately RMB756,598,000 and RMB123,682,000 respectively. Upon completion of the Transfer, the assets and liabilities of the Remaining Group will decrease by 7.66% and 56.03% to approximately RMB698,640,000 and RMB54,382,000 respectively after exclusion of the assets and liabilities of Beijing Xigua.

Net assets

Assuming that the Loan Assignment had taken place on 30 June 2020, the Group would have incurred loss in the amount of approximately RMB24,180,000 for the Loan Assignment due to the net effect of (a) approximately RMB28,078,000 being the outstanding principal under the Loan Agreement; (b) approximately RMB1,621,000 being the accumulated interest as at 30 June 2020; and (c) RMB5,519,000 being the consideration of the Loan Assignment received under the Transfer Agreement.

It is expected that the net asset value of the Remaining Group attributable to the owners of the Company will increase by approximately RMB11,342,000 from approximately RMB632,916,000 to RMB644,258,000, due to the net effect of (a) the exclusion of (i) the net liabilities of Beijing Xigua attributable to the Company of approximately RMB89,522,000 as at 30 June 2020; (ii) the outstanding principal of approximately RMB28,078,000 and the accumulated interest of approximately RMB1,621,000 under the Loan Agreement as

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at 30 June 2020; and (iii) the fair value of Profit Guarantee of RMB74,000,000; and (b) the receipt of the Cash Consideration of RMB25,519,280. Accordingly, the Group's net assets attributable to the owners of the Company per Share as at 30 June 2020 would increase from approximately RMB4.06 to approximately RMB4.82.

Loss per Share

For the period ended 31 December 2019, the loss per share was RMB1.48. Based on the estimated gain of approximately RMB74,707,000 to be recognised, a loss per Share of RMB0.97 will be recorded.

In view of the above, the Company is of the view that the Share Buy-back will not have material adverse effect on the Group's earnings per Share, liabilities, net assets per Share and working capital.

REASONS FOR AND BENEFITS OF THE TRANSFER

Given that starting from September 2019, the results of Beijing Xigua have fallen short of expectation, the Company has been considering different solutions and taking up certain actions to deal with the deteriorating business and operations of Beijing Xigua in order to protect the interests of the Company and the Shareholders as a whole. Such actions include but not limited to actively communicating with Beijing Xigua with the hope to improve its performance, instructing the Company's PRC legal advisers to issue a demand letter to each of the KongZhong Group and Shanghai Dacheng stating the Company's decision to opt for the Full Cash Compensation and demanding a compensation payment from the KongZhong Group and Shanghai Dacheng, as disclosed in the Announcements.

However, the Company is given to understand that the KongZhong Group, Beijing Xigua and Shanghai Dacheng had serious difficulties in arranging the Full Cash Compensation. In light of the circumstances, the Company considers that the Transfer involving the Equity Disposal and the Share Buy-back would be an optimal solution for the KongZhong Group and Shanghai Dacheng to compensate the loss that the Company suffers as it does not extensively call on the funding resources of the KongZhong Group and Shanghai Dacheng.

The terms of the Transfer Agreement are also generally in line with the original terms under the Investment Agreement to the extent that:

- (i) under the Investment Agreement, should Beijing Xigua be unable to meet the Profit Guarantee, the Company is entitled to elect the Full Cash Compensation;
- (ii) the number of Consideration Shares issued under the Investment Agreement and to be cancelled under the Transfer Agreement is the same without any adjustment;
- (iii) the Investment Agreement allows the Company to take actions to seek compensation and according to the dispute resolution clause of the Investment Agreement, to resolve any disputes between the parties, the parties have to first resolve through discussions and negotiations. During discussions and negotiations, the parties have explored various settlement proposals and finally agreed on the Transfer arrangement under the Transfer Agreement; and
- (iv) except Guangzhou Feidong which is a party to the Loan Agreement and Shanghai Wangyu, the existing parties involved in the Investment Agreement continue to be the parties to the Transfer Agreement. Despite not being a party to the Transfer Agreement, Shanghai Wangyu has confirmed that it has no objection to the terms and conditions of the Transfer Agreement and the transactions contemplated thereunder, and waives the pre-emptive right (if any) that it may be entitled to being an existing shareholder of Beijing Xigua.

In addition, considering that the net asset value of the Company shall be increased from approximately

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RMB632,916,000 to RMB644,258,000, representing an increase in total net asset value of RMB11,342,000, the Transfer Agreement and the transactions contemplated thereunder (including the Share Buy-back) are expected to bring about positive effects on the net asset value per Share which is in the interests of the Company and the Shareholders as a whole. The Company also believes that it is in the interest of the Shareholders to be compensated by way of the Transfer instead of protracted arbitration and legal proceedings which, although could have been taken on or around 9 April 2020, being the cut-off date on which the KongZhong Group and Shanghai Dacheng should have repaid the Full Cash Compensation, as the latter potentially last for an uncertain period of time with unforeseeable cost implications and enforcement outcome.

In considering proceeding with the Share Buy-back, the Company has taken into consideration that:

- (i) the Share Buy-back is part and parcel of the Transfer, which is considered an optimal solution for the KongZhong Group and Shanghai Dacheng to compensate the loss that the Company suffers which does not extensively call on the funding resources of Shanghai Dacheng and create excessive funding burden;
- (ii) the Transfer Agreement and the transactions contemplated thereunder (including the Share Buy-back) are expected to enhance consolidated net asset value attributable to the Shareholders per Share and bring about other positive financial effects as discussed in the paragraph headed “Financial effects of the Transfer” above in this circular; and
- (iii) it is a good opportunity for the Company to buy-back and cancel a significant block of Shares in a single transaction without significantly affecting the normal trading of the Shares in terms of price and volume as opposed to conducting a large number of daily on-market buy-back transactions under a general buy-back mandate over a period of time.

Further, in addition to the fact that the KongZhong Group and Shanghai Dacheng had serious difficulties arranging the Full Cash Compensation as disclosed above, based on the existing financial conditions and operational performance of Beijing Xigua, it is anticipated that the latter may not be able to repay the Outstanding Sum to Guangzhou Feidong, at least not within a short period of time. If Beijing Xigua fails to repay the Outstanding Sum, Guangzhou Feidong is entitled to commence legal proceedings to recover the same. The Company is of the view that it is not in the interests of the Company and the Shareholders as a whole to commence such legal proceedings given that:

- (i) the Company intends to discontinue its investment in the VR game business;
- (ii) it is anticipated that Beijing Xigua will continue to be loss making in the near future;
- (iii) legal proceedings could potentially last for long time with unforeseeable and unpredictable cost implications and enforcement outcome; and
- (iv) the Company intends to focus its resources on its other existing businesses.

Considering the above, the Company is of the view that the Loan Assignment is able to lower the asset losses of the Company, reduce unhealthy assets of the Company, improve the quality of the Company’s assets and recoup its investment in Beijing Xigua, which will improve the overall financial position of the Company.

REGULATORY IMPLICATIONS

Share Buy-back Code

The Share Buy-back constitutes an off-market share buy-back by the Company. The Company has made an application to the Executive for approval of the Share Buy-back pursuant to Rule 2 of the Share Buy-back Code. The Executive’s approval, if granted, will normally be conditional upon, among other things, the

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approval of the Share Buy-back by at least three-fourths of the votes cast on a poll by the Independent Shareholders present in person or by proxy at the EGM.

As disclosed in the paragraph headed “Conditions Precedents” above in this circular, the Completion is subject to the condition precedent that the Share Buy-back having been approved by the Executive. Therefore, the Company will not proceed with the Share Buy-back unless the Executive approves the Share Buy-back pursuant to Rule 2 of the Share Buy-back Code. However, there is no assurance that such approval will be granted or that all other conditions precedent to the Transfer Agreement will be fulfilled.

Takeovers Code

As at the Latest Practicable Date, other than (a) approximately 6.40% interest in the existing total issued share capital of the Company owned by KongZhong; and (b) the Consideration Shares representing approximately 13.97% interest in the existing total issued share capital of the Company which were originally to be released to Shanghai Dacheng pursuant to the Investment Agreement but would be subject to the Share Buy-back contemplated under the Transfer Agreement as disclosed in this circular, none of Shanghai Dacheng or parties acting in concert with it and the Company and parties acting in concert with it:

- (i) holds, owns, controls or directs any Shares, convertible securities, warrants, options or derivatives in respect of the Shares;
- (ii) has secured an irrevocable commitment to vote in favour of or against the Transfer Agreement and the transactions contemplated thereunder;
- (iii) holds outstanding warrants, options or securities convertible into Shares or derivatives in respect of the Shares;
- (iv) save for the Investment Agreement, has any arrangement (whether by way of option, indemnity or otherwise) or contracts under Note 8 to Rule 22 of the Takeovers Code in relation to the Shares which might be material to the Transfer Agreement and/or the Share Buy-back;
- (v) save for the Transfer Agreement, has any agreement or arrangement to which Shanghai Dacheng and parties acting in concert with it is a party which relates to the circumstances in which it may or may not invoke or seek to invoke a pre-condition or a condition to the Transfer Agreement and/or the Share Buy-back; or
- (vi) has borrowed or lent any relevant securities (as defined in Note 4 to Rule 22 of the Takeovers Code) in the Company.

In addition, the Company and KongZhong China confirm that as at the Latest Practicable Date:

- (i) apart from the consideration as provided in the paragraph headed “Implied Transfer Consideration” in this circular, there is no other consideration, compensation or benefit in whatever form paid or to be paid by the KongZhong China or any parties acting in concert with it to the Company or any party acting in concert with it in connection with the Transfer;
- (ii) apart from the Investment Agreement, the Loan Agreement and the Transfer Agreement, there is no understanding, arrangement or agreement or special deal (as defined under Rule 25 of the Takeovers Code) between the KongZhong China or any party acting in concert with it on the one hand, and Company and any party acting in concert with it on the other hand; and
- (iii) there is no understanding, arrangement or agreement or special deal (as defined under Rule 25 of the Takeovers Code) between (I) any Shareholders; and (II)(a) KongZhong China and any party acting in concert with it; or (b) the Company, its subsidiaries or associated companies.

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Special Deal

As the amount of the Outstanding Sum is higher than the consideration for the Loan Assignment, and the relevant proposed settlement is not extended to all other Shareholders, the Loan Assignment constitutes a special deal under Rule 25 of the Takeovers Code, and will be conditional upon obtaining the prior consent of the Executive under Rule 25 of the Takeovers Code. An application has been made to the Executive for consent under Rule 25 of the Takeovers Code for the Loan Assignment. Such consent, if granted, will be subject to (i) the Independent Financial Adviser publicly states that in its opinion the terms of the Loan Assignment are fair and reasonable; and (ii) the Loan Assignment is approved by the Independent Shareholders by way of poll at the EGM, in which the KongZhong Group, Shanghai Dacheng and parties acting in concert with any of them who are Shareholders, will be required to abstain from voting in the EGM.

Listing Rules

As one or more of the applicable percentage ratios in respect of the Transfer exceed 25% but is less than 75%, the Transfer constitutes a major transaction of the Company under Chapter 14 of the Listing Rules. As at the Latest Practicable Date, (i) Beijing Xigua is a non- wholly owned subsidiary of the Company; (ii) Shanghai Dacheng is interested in 22,268,908 Consideration Shares being held in an account managed by the Escrow Agent, representing approximately 13.97% of the issued share capital of the Company; and (iii) the KongZhong Group is interested in 10,202,168 Shares, representing approximately 6.40% of the issued share capital of the Company. Accordingly, each of Beijing Xigua, Shanghai Dacheng and the KongZhong Group is a connected person of the Company, and the Transfer therefore constitutes a connected transaction for the Company and is subject to the reporting, announcement, circular and Independent Shareholders' approval requirements under Chapters 14 and 14A of the Listing Rules.

Closure of Register of Members

The register of members of the Company will be closed from Monday, 21 December 2020 to Thursday, 24 December 2020 (both dates inclusive) during which period no transfer of Shares will be registered. In order to be entitled to attend and vote at the EGM, all completed transfer documents accompanied by the relevant share certificates must be lodged with the Company's branch share registrar and transfer office in Hong Kong, Tricor Investor Services Limited at Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong no later than 4:30p.m. on Friday, 18 December 2020 for registration.

Voting

The voting in respect of the Transfer Agreement and the transactions contemplated thereunder at the EGM will be conducted by way of poll. As at the Latest Practicable Date, the KongZhong Group is interested in 32,471,076 Shares, representing approximately 20.37% of the issued share capital of the Company, of which KongZhong is interested in 10,202,168 Shares and Shanghai Dacheng is interested in 22,268,908 Consideration Shares, representing approximately 6.40% and 13.97% of the issued share capital of the Company, respectively. Save for these holdings, none of the members of the KongZhong Group or Shanghai Dacheng or parties acting in concert with any of them held any Shares as at the Latest Practicable Date. By reason of the requirements of the Share Buy-back Code, the Takeovers Code and the Listing Rules, the KongZhong Group and Shanghai Dacheng will abstain from voting in the EGM. Save for these parties, to the best of the knowledge, information and belief of the Directors after making all reasonable enquiries, no other Shareholder is required to abstain from voting on the resolutions approving the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment).

GENERAL

The Independent Financial Adviser has been appointed to advise the Independent Board Committee and the Independent Shareholders on the Transfer Agreement and the transactions contemplated thereunder.

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The Independent Board Committee (comprising the Listing Rules IBC and the Takeovers Code IBC) has been established to consider the Transfer Agreement and the transactions contemplated thereunder and to give recommendation to the Independent Shareholders as to how to vote on the resolutions to be proposed at the EGM in relation thereof.

EGM

A notice convening the EGM to be held at Room 1106 Block A Phase I, Innovation Technology Plaza, Tianan Digital City, Chegongmiao, Futian District, Shenzhen, China on Thursday, 24 December 2020 at 14:00 is set out on pages EGM-1 to EGM-4 of this circular.

The purpose of the EGM is to consider and, if thought fit, approve the resolution approving the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment).

A form of proxy for use at the EGM is enclosed with this circular. Such form is also available at the website of the Stock Exchange at www.hkexnews.hk. Whether or not you are able to attend the EGM, you are requested to complete the accompanying form of proxy in accordance with the instructions printed thereon and return it to the Company's branch share registrar and transfer office in Hong Kong, Tricor Investor Services Limited at Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong as soon as possible but in any event not less than 48 hours before the time appointed for the holding of the EGM or any adjournment thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjournment thereof should you so wish.

All votes at the EGM will be taken by poll pursuant to Rule 2 of the Share Buy-back Code.

RECOMMENDATIONS

The Directors (including members of the Independent Board Committee whose views are set out in their respective letters after having considered the advice and recommendation of the Independent Financial Adviser) are of the opinion that the terms of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment) are fair and reasonable, on normal commercial terms and in the interests of the Company and the Shareholders as a whole. The Directors recommend the Shareholders to vote in favour of the relevant resolutions to be proposed at the EGM.

Having taken into account the advice of the Independent Financial Adviser, the Listing Rules IBC recommends the Independent Shareholders to vote in favour of the relevant resolution to be proposed at the EGM to approve the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment). Your attention is drawn to the letter from the Listing Rules IBC as set out on pages 44 to 45 of this circular and the letter from the Independent Financial Adviser as set out on pages 48 to 71 of this circular which contain their recommendations to the Independent Shareholders regarding the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment). The Independent Shareholders are advised to read the aforesaid letters before deciding as to how to vote on the relevant resolution to be proposed at the EGM.

Having taken into account the advice of the Independent Financial Adviser, the Takeovers Code IBC recommends the Independent Shareholders to vote in favour of the relevant resolution to be proposed at the EGM to approve the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment). Your attention is drawn to the letter from the Takeovers Code IBC as set out on pages 46 to 47 of this circular and the letter from the Independent Financial Adviser as set out on pages 48 to 71 of this circular which contain their recommendations to the Independent Shareholders regarding the Transfer Agreement and the transactions contemplated thereunder (including the Share Buyback and the Loan Assignment). The Independent Shareholders are advised to read the aforesaid letters before deciding as to how to vote on the relevant resolution to be proposed at the EGM.

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FURTHER INFORMATION

Your attention is also drawn to the additional information set out in the appendices to this circular.

MISCELLANEOUS

The English text of this circular shall prevail over the Chinese text for the purpose of its interpretation.

Yours faithfully,
By order of the Board
Forgame Holdings Limited



ZHANG Qiang
Chairman