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CHINA DIGITAL CULTURE (GROUP) LIMITED
中國數碼文化（集團）有限公司

(Incorporated in the Cayman Islands and continued in Bermuda with limited liability)

(Stock Code: 8175)

SUPPLEMENTAL ANNOUNCEMENT ON THE ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2019

Reference is made to the announcement of China Digital Culture (Group) Limited (the "**Company**" and together with its subsidiaries, the "**Group**") dated 22 June 2020 in relation to the audited consolidated annual results of the Group for the financial year ended 31 December 2019 (the "**FY2019 Annual Results Announcement**") and the annual report of the Group for the financial year ended 31 December 2019 (the "**FY2019 Annual Report**"). Unless otherwise defined, capitalised terms used herein shall have the same meanings as defined in the FY2019 Annual Results Announcement and the FY2019 Annual Report.

In addition to the information provided in the FY2019 Annual Results Announcement and the FY2019 Annual Report, the Board would like to provide further information to the disclaimer of opinion (the "**Audit Qualification**") issued by the auditor of the Company, namely Elite Partners CPA Limited (the "**Auditors**"), in relation to the audited consolidated financial statements of the Group for the year ended 31 December 2019 ("**FY2019**").

DETAILS OF THE AUDIT QUALIFICATION AND MANAGEMENT'S POSITION AND ASSESSMENT ON THE AUDIT MODIFICATION

On 7 May 2020, the Company received a writ of summons with statement of claim dated 21 April 2020 (the "**Claim Documents**") issued in the Court of First Instance of the High Court of Hong Kong on 7 May 2020 by the solicitors acting for Hangzhou Liaison Interactive Information Technology Co., Ltd as the plaintiff (the "**Plaintiff**" or the "**CB Holder**") against the Company as defendant. The Plaintiff is seeking various reliefs against the Company for the restitution of benefit under a subscription agreement dated 8 February 2017 relating to the convertible bonds (the "**CB**") in aggregate of HK$412,500,000 issued by the Company during the year ended 31 December 2017 (the "**Subscription Agreement**") in the sum of (i) HK$372,843,493 on the ground of misrepresentation; or alternatively (ii) HK$437,300,856 as a result of breach of the Subscription Agreement, the bond instrument (the "**Instrument**") dated 19 June 2017 and the terms and condition of the CB contained in the Instrument; or alternatively (iii) HK$105,718,493 under certain clause of a supplement deed dated 16 May 2019 and related interest (the "**Allegations**"). Details of the Allegations in the Claim Documents are as follows:

I. Misrepresentations

(a) pre-contractual misrepresentations

The Plaintiff alleged that the entering into the Subscription Agreement with the Company was induced by and acting in reliance of (i) the expected profit for the midterm of 2016 of HK$28,950,000 and (ii) the expected profit for the year ended 31 December 2016 of more than HK$60,000,000 represented by the Company (the "**1st and 2nd Representations**").

According to the audited results announcement for the financial year ended 31 December 2016 ("**FY2016**") published by the Company in March 2017, it was stated that the profit for FY2016 was approximately HK$69,021,000. Mazars CPA Limited has given an audit opinion in the annual report for FY2016, stating that the Company's financial statements give a true and fair view of the financial position of the Group as of 31 December 2016. However, as disclosed in the audited results announcement for the financial year ended 31 December 2017 published by the Company in June 2018, the profit for FY2016 has been adjusted and restated to of approximately HK$5,264,000, which represented a significant decrease in profit when comparing with the original profit.

On 14 January 2016, the Company completed the acquisition of Dream World Holdings Limited (the "**Acquisition**"). Apart from the cash consideration, subject to the fulfillment of profit guarantee requirements and progress of construction of the project, the convertible bonds in the principal amount of up to HK$360,000,000 (the "**CB Consideration**") will be issued by the Company to the vendor as contingent consideration. The CB Consideration was treated as contingent consideration payable amounting to HK$262,595,000 in the results for FY2016 published in March 2017.

In preparing the Group's consolidated financial statements for the year ended 31 December 2017, the directors of the Company have reassessed the initial accounting for the Acquisition reflected in the consolidated financial statements of the Group for FY2016 in respect of the fair value of the consideration and the purchase price allocation based on the terms of the related sale and purchase agreements and the cooperation agreements as well as the facts and circumstances available at the date of Acquisition. Also, the directors of the Company have reassessed the fair value measurement of the contingent consideration payable regarding the 2nd and 3rd tranches of CB Consideration as at 31 December 2016 based on the terms and conditions of the related agreements as well as the facts and circumstances available at that time and measured at fair value at the date of Acquisition.

As a result of the reassessment by the directors of the Company in respect of the fair value measurement of the contingent consideration payable in respect of the issuance of the 1st, 2nd and 3rd tranches of the CB Consideration and of the contingent consideration payable at the date of Acquisition and as at 31 December 2016, it was concluded that certain facts and circumstances available at the fair value measurement dates had not been considered and the valuation methodologies and certain assumptions and inputs adopted in the fair value measurement were not considered appropriate. Further, in the consolidated financial statements for FY2016, the 1st tranche of CB Consideration was not measured at its fair value on initial recognition, which was not consistent with the requirement in HKAS 39 Financial Instruments: Recognition and Measurement" that requires financial assets and financial liabilities to be measured at fair value on initial recognition. Accordingly, relevant figures have been adjusted and restated to correct the misstatements.

Due to the effect of the prior year adjustments performed in the Group's consolidated financial statements for the year ended 31 December 2017, the results for FY2016 had been adjusted and the profit was restated to of approximately HK$5,264,000. Therefore, The plaintiff alleges that the 1st and 2nd Representations were false.

(b) pre-completion misrepresentations

Before the completion of Subscription Agreement, the Plaintiff conducted financial due diligence review on the Company and alleges that the Company has made the further representations, by way of positive profit alert announcement, on 27 March 2017 to inform potential investors that the Company expected "to record an increase of approximately 139% in net profit for the year ended 31 December 2016 as compared to that of the same period in 2015" ("**Further Representations**").

The Plaintiff alleges that induced by and acting in reliance of the 1st and 2nd Representations and the Further Representations (but not otherwise), the Plaintiff proceeded to completion of the Subscription Agreement.

At the time of making the 1st and 2nd Representations and Further Representations, the Company honestly believed the same to be true and it was well after the Plaintiff had entered into the Subscription Agreement and the Instrument that the Company was made aware of the certain matters giving rise to the restatement of the results for FY2016. Also, the Company's former auditors, Mazars CPA Limited has given an audit opinion in the FY2016 Annual Report, stating that the Company's financial statements give a true and fair view of the financial position of the Group as of 31 December 2016 which supports the 1st and 2nd Representations and Further Representations.

II. Breach of the agreements

(a) breach of the Subscription Agreement and Instrument

The Plaintiff alleged that the Company has breached certain clauses in the Subscription Agreement and/or the Instrument, details of which are set out as follows:

(i) the CB Holder shall be entitled to convert all or part of the principal amount of the of the CB into the Company's shares at any time from 31 October 2017 to 20 June 2022 (the "**Conversion Rights**"). Upon the Plaintiff's exercise of its Conversion Rights, the Company shall allot the relevant conversion shares within 14 days (the "**Conversion Obligation**").

(ii) the Company shall pay the CB Holder interest on the principal amount of the CB at 5.5% per annum (the "**Interest**") payable on an annual basis (the "**Interest Obligation**").

(iii) the Company shall allow the CB Holder access to the audited accounts of the Company and its subsidiaries (the "**Provision of Accounts Obligation**").

(iv) time shall be the essence of the Subscription Agreement.

(v) the CB Holder shall be entitled to immediate payment of the principal amount of the CB and accrued interest upon the occurrence of an event of default.

The Plaintiff alleged that the Company has breached the Interest Obligation by failing to pay amount in arrears of HK$5,718,493.16 in respect of Interest for the second year ("**2nd Year Interest Arrears**"); further or alternatively, the Company has breached the Conversion Obligation by ignoring the conversion notice sent by the Plaintiff; further or alternatively, the Company has breached the Provision of Accounts Obligation. The Plaintiff further alleged the events of defaults occurred under the Instrument, such that the principal amount together with all accrued interest has become immediate due.

Due to the occurrence of legal dispute, the settlement of 2nd Year Interest Arrears is still pending. Regarding the alleged breach of the Conversion Obligation, the Company did not breach the Conversion Obligation as the alleged conversion notice sent by the Plaintiff is not valid. And the Company has complied with the Provision of Accounts Obligation as the audited accounts of the Company are available to public. The Company has also sent its annual reports to the Plaintiff upon its request.

(b) *breach of Supplemental Deeds*

On 1 April 2019 and 16 May 2019, the Company entered into the first supplemental deed and the second supplement deed (the "**Supplemental Deeds**") respectively with the CB Holder in relation to the proposed amendments to the terms and conditions of the CB (the "**Proposed Amendments**"). Pursuant to the terms of the Supplemental Deeds, the Company (i) shall pay the interest on a quarterly basis; and (ii) shall be entitled to redeem the CB in whole or in part at 100% of the principal amount of the CB prior to the maturity date.

The Plaintiff alleged that the Company has breached certain conditions precedent regarding the Supplemental Deeds and details of which are set out as follows:

(i) interest shall be payable on a quarterly basis rather annual basis; and

(ii) the Company shall partially redeem the CB in the principal sum of HK$50,000,000 plus any accrued but unpaid Interest on or before 31 May 2019 and partially redeem the CB in the principal sum of HK$50,000,000 plus any accrued but unpaid Interest on or before 30 June 2019.

As disclosed in the circular of the Company dated 28 May 2019, the Proposed Amendments shall be subject to shareholder's approval on the special general meeting (the "**SGM**"). Based on the poll results announcement of the SGM dated 14 June 2019, relevant resolutions have been voted down by the shareholders, and hence the Proposed Amendments have not been effective. Under such circumstance, the Company is not obligated to redeem the CB and does not breach the Supplemental Deeds.

The Company has filed the defence on 2 July 2020 and denied the claims made by the Plaintiff. Based on the above and with reference to the opinion of the legal advisors, the directors of the Company are of the view that the Company has valid ground to defense the Allegations.

Details of the action plan of the Group to address the Audit Qualification

Notwithstanding the preparation for the defence documents, the directors of the Company had assessed the Group's current liquidity, performance and available sources of financing in considering the Group's ability to continue as a going concern. The management will also take actions including (i) negotiations with potential strategic investors in respect of a possible equity contribution to the Company; (ii) negotiations with Plaintiff to settle the legal case; (iii) speeding up the collection of receivables process; and (iv) tightening the operating cash outflows through cutting costs and capital expenditures to mitigate the Group's liquidity pressure and improve the conditions of cash flow (the "**Action Plan**").

The current progress of the Action Plan are as follows:

i. The Company has entered into the subscription agreements with three subscribers in July 2020 pursuant to which the subscribers agreed to subscribe an aggregate of 300 million shares for an approximately total consideration of HK$13.8 million.

ii. The negotiation with the Plaintiff is currently on-going. The chief executive officer of the Company, Mr. Jiang Chao, represents the Company in the negotiations.

iii. The Company have continued to speed up the collection of receivables during Q1 and Q2 2020, the Company has collected certain amount of receivables from its debtors.

iv. The Company has started tightening operating cash flow by cutting costs such as payroll and rent. From Q2 2019 to Q2 2020, administrative expense has reduced by approximately 27%. On top of the cost cutting measures already adopted, the Company is looking to further reduce monthly expenditures beginning in Q3 2020.

The Group will continue to make effort to implement the measures to improve the Group's operational performance and financial position so as to remove the Audit Qualification.

Audit Committee's view on the Audit Qualification

The audit committee of the Company ("**Audit Committee**") has reviewed the management's position as well as the Action Plan of the Group to address the Audit Qualification. The Audit Committee is in agreement with the management with respect to the Audit Qualification and the Group's ability to continue as a going concern, and in particular the actions or measures to be implemented by the management. There is no disagreement between the Audit Committee and the management's position on the Audit Qualification. The Audit Committee has also discussed with the management and has reviewed the current progress of the Action Plan to address the Audit Qualification. The Audit Committee is also of the view that the management shall continue its efforts in implementing the actions and measures set out in the Action Plan with the intention of mitigating the Group's liquidity pressure and removing the Audit Qualification.

Removal of the Audit Qualification

Based on the discussion with the Auditors, the Board is given to understand that the Auditors is unable to determine whether the above mentioned Action Plan is acceptable and adequate at the current stage since it will depend on the actual outcome of the Action Plan for the end of the financial year. Since the management's assessment of the Group's ability to continue as a going concern for the purposes of preparing the Group's consolidated financial statements for the year ending 31 December 2020 has to take into consideration of the then conditions and circumstances and could only be made at the end of the relevant reporting period, the Auditors is unable to ascertain at this moment whether the Audit Qualification can be removed in the next financial year purely based on the current progress of the Action Plan.

DETAILS OF THE IMPAIRMENT OF INTANGIBLE ASSETS AND GOODWILL IN RELATION TO THE DREAM WORLD GROUP

The Group assess the intangible assets and goodwill in relation to the Dream World Holdings Limited and its subsidiaries (the "**Dream World Group**") on yearly basis. Pursuant to para. 9 of HKAS 36 "Impairment of Assets" ("**HKAS 36**"), an entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. Accordingly, it is the Group's principal accounting policy, as disclosed in the annual report for FY2019, under the heading of "Principal Accounting Policies" in note 3 to the consolidated financial statements, that at the end of each reporting period, the Group assess whether there is any indication that its assets may be impaired. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying value of the asset is reduced to its recoverable amount. Impairment losses are recognised as expenses immediately.

The Group, on annual basis, appointed independent external valuer to assess the recoverable amount of the asset, including the intangible asset and goodwill associated to the film-based cultural theme park business and tourism focused project which was arising from the acquisition of Dream World Group in 2016. CW Financial Advisory Services Limited has been appointed by the Company to conduct impairment testing analysis and assess the recoverable amount of the Dream World Group as at 31 December 2019. The valuer has adopted discount cash flow method to derive the value in use of the Dream World Group.

Based on the recoverable amount of Dream World Group estimated by the valuer, the Company recorded an impairment loss of approximately HK$304.9 million on goodwill and impairment loss of HK$79 million on intangible assets for the Dream World Group for FY2019. The reasons for the recognition of impairment loss were mainly due to:

(a) operating right for the operation of the film-based cultural theme park

Through the acquisition of Dream World Group in FY2016, the Group obtained an operating right for the operation of the film-based cultural theme park for 40 years, which is based on land use right granted by the PRC government where the theme park is located.

Since the construction of the theme park has been delayed from the originally planned FY2019 to FY2021, the remaining useful life for the operating rights reduced by 2 years which affecting the future cash flow arising from the operation of theme park.

The major reasons leading to the delay were due to (i) change in government policy (i.e. fire safety ordinance), the management of the theme park has to change its construction plan and re-submit to the PRC government for approval in order to match the new requirements of fire safety ordinance; and (ii) the outbreak of COVID-19.

(b) event planning and management

The acquisition of Dream World Group also involved an event planning and management business (i.e. managing overseas artist concert held in the PRC). Due to the significant adverse impact on COVID-19, all of the concerts were suspended or cancelled during FY2019 and there will be less concerts to be arranged in coming years. Accordingly, the estimated cash flow from event planning and management is substantially less than last year scheduled.

Since the Group's intangible assets and goodwill belongs to the operating rights of film-based cultural theme park business and tourism focused project, there was basis for making a reliable estimate of its fair value less cost of disposal. Accordingly, the Group performed an impairment assessment on the intangible assets and goodwill by applying the value-in-use calculation. Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit. The basis and assumptions applied for each of the value of the inputs used in the valuation and reasons for such changes are summarised below:

Major inputs/ key assumptions	**Value used**	**Reason for change**
Gross profit margin	2019: 60% (2018: 65%)	Gross profit margin decreased by 5% was mainly attributable from the event planning and management due to the suspension and cancellation of concerts in FY2019 as described above. The estimated gross profit margin for event planning and management is referenced to the actual gross profit margin achieved in FY2019. As FY2019's gross profit for event planning and management is lower than the previous estimate, the gross profit margin for value in use is also decreased. Since the gross profit margin of event planning and management is higher than the operation of theme park, it leads to the decrease in overall gross profit margin.
Average growth rate	2019: 12% (2018: 11%)	There is no change for the growth rate. The remaining useful life for the operating rights of theme park reduced by 2 years as described above, which led to the increase in average growth rate.
Long-term growth rate	2019: 2% (2018: 2%)	No change.
Discount rate	2019: 21% (2018: 23%)	The discount rate decrease as per last year's valuation is mainly due to the decrease in the equity risk premium. The equity risk premium applied in the valuation is referenced by Bloomberg Equity Risk Premium of China as at 31 December 2019.

DETAILS OF THE IMPAIRMENT LOSS ON GOODWILL FOR SPORTS SEGMENTS AND ENTERTAINMENT SEGMENT

As disclosed in the FY2019 Annual Report, the Company also recorded impairment loss on goodwill of approximately HK$139 million for the entertainment segment and approximately HK$52 million for the sports segment for FY2019 respectively. The reasons for the recognition of impairment loss were mainly due to:

(a) sports segment

Due to the general economic slowdown in the PRC and increased competition during FY2019, the revenue of sports segment decreased which led to the recognition of the impairment losses of the sports segment.

(b) entertainment segment

Due to the poor market sentiment and cautious spending resulting from political unrest in Hong Kong and the general economic slowdown in the PRC during FY2019, the revenue of entertainment segment decreased which led to the recognition of the impairment losses of the entertainment segment.

The reasons for change in key assumptions applied for the valuation disclosed in note 16 to the consolidated financial statements are summarized as below:

Major inputs/key assumptions	**Reasons for change**
Gross profit margin	Gross profit margin of FY2019 decreased by comparing with FY2018. The estimated gross profit margin for sports segment and entertainment segment was made reference to the actual gross profit margin achieved in FY2019. As FY2019's gross profit for sports segment and entertainment segment are lower than the previous estimate, the gross profit margin for value in use also decreased.
Average growth rate	There is no change for the growth rate (i.e. no growth rate except inflation).

Long-term growth rate	No change, only consider the inflation rate.
Discount rate	Change due to the cost of equity. By reference of Bloomberg of the cost of equity of same comparable companies of the latest two years.

MULTIPLE UNCERTAINTIES RELATING TO GOING CONCERN

As disclosed in the Corporate Governance Report contained in the FY2019 Annual Report, the Board confirmed that they are not aware of any material uncertainties relating to events or conditions that may cast significant doubt about the Group's ability to continue as a going concern.

However, taking into account the Audit Qualification, it indicates the existence of material uncertainties which may cast significant doubt on the Group's ability to continue as a going concern. As disclosed, the Company has commenced the Action Plan to remove the audit Qualification and has made certain progress.

The Group's ability to continue as a going concern will depend upon the actual outcome of the Action Plan. Assuming that the Company can successfully implement the aforesaid measures, the Company considers it would address the going concern issues. For the avoidance of doubt, in accordance with the applicable Hong Kong Standards on Auditing, the auditor needs to obtain sufficient appropriate audit evidence and to consider, based on the audit evidence to be obtained, whether material uncertainty exists regarding the Group's ability to continue as going concern. As such, assuming the successful implementation of the Action Plan in time with sufficient and appropriate audit evidence can be provided, the Audit Qualification is expected to be removed in the consolidated financial statements of the Company for the year ending 31 December 2020.

The above additional information does not affect other information contained in the FY2019 Annual Results Announcement or the FY2019 Annual Report and save for those disclosed above, all other information contained in the FY2019 Annual Results Announcement and the FY2019 Annual Report remains unchanged.

By order of the Board
China Digital Culture (Group) Limited
Hsu Tung Chi
Chairman

Hong Kong, 15 October 2020

As at the date of this announcement, the executive Directors are Mr. Hsu Tung Chi and Ms. Zhang Jing. The independent non-executive Directors are Mr. Kwok Chi Sun, Vincent, Mr. Wong Tak Shing and Mr. Gou Yanlin.

This announcement, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the GEM Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief, (i) the information contained in this announcement is accurate and complete in all material respects and not misleading or deceptive; and (ii) there are no other matters the omission of which would make any statement in this announcement misleading.

This announcement will remain on GEM website on the "Latest Listed Company Information" page for at least 7 days from the date of its posting and on the website of the Company at http://www.cdculture.com.