ANONYMOUS *ANALYTICS*
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REXLot Holdings

Betting on a Pipe Dream

The Basics

Ticker:	555.HK
Market Cap:	HK$4.8 billion
Recent Price:	HK$0.49
Target Price:	HK$0.12
Expected Return:	-75%
Opinion:	***Strong Sell***

The Quick and Dirty

- We believe REXLot has made materially false representations to the market. Our analysis of third-party documents, SAIC filings, and market share data shows that REXLot generates only a fraction of the revenue it publicly reports.

- REXLot's *de minimis* interest income suggests its publicly reported cash balance is grossly exaggerated.

- Since 2010, REXLot has been cumulatively free cash flow negative. REXLot has used convertible bond offerings to finance dividends and acquire suspect companies with no discernable assets or operations.

You should have expected us

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As evident by the contents of our research and analysis, we expend considerable time and effort to ensure that our research analysis and written materials are complete and accurate, we strive for accuracy and completeness to support our opinions, and we have a good-faith belief in everything we write - but such information is presented "as is," without warranty of any kind, whether express or implied. All expressions of opinion are subject to change without notice, and we make no representation, express or implied, as to the accuracy, timeliness, or completeness of any such opinions and information or with regard to the results to be obtained from its use, and we makes no representation that we will update any information on this. **You should assume that all statements contained herein are our opinion and are not statements of fact – even if certain statements can be perceived as such. That way, we don't have to sacrifice our (hopefully) entertaining writing style by starting every sentence with "In our opinion" as advised by our team of neurotic and overpriced lawyers.**

We believe that the publication of our opinions and the underlying facts about the public companies we research is in the public interest, and that publication is justified due to the fact that public investors and the market are connected in a common interest in the true value and share price of the public companies we research. We are exercising our right to express such opinions in a public forum. Any investment involves substantial risks, including complete loss of capital. Any forecasts or estimates are for illustrative purpose only and should not be taken as limitations of the maximum possible loss or gain. Any information contained in this report may include forward-looking statements, expectations, and projections. You should assume that these types of statements, expectations, and projections may turn out to be incorrect.

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Don't be stupid and invest in the public markets unless you are prepared to do your own homework and due diligence.

Introduction

REXLot Holdings ("REXLot" or "the Company") is a Hong Kong-listed company engaged in the lottery business in China, trading under the ticker 555.HK.

REXLot operates both an online and an offline business. The online business consists of website and mobile platforms, and the offline business includes lottery machines and scratch cards. REXLot has promoted the online business as a growth opportunity, and promoted the traditional offline business as a stable, recurring source of revenue that funds dividend payouts.

However, our review and analysis shows that the scale of both these businesses are a mere fraction of what REXLot claims, demonstrating to us that REXLot has committed securities fraud by making repeated false and misleading representations regarding its financial and operational performance to the market.

Based on our detailed analysis of publicly available information including REXLot's HK filings, third-party documentation, SAIC filings, and market research, we believe that REXLot has been wildly overstating revenue and profits, and that the cash balance REXLot reports is likely also grossly exaggerated.

Furthermore, REXLot has been issuing substantial amounts of debt to finance dividend payments and make questionable acquisitions. Based on the evidence, we believe REXLot will be cut off from the capital markets. Without the ability to raise funds, we expect REXLot will struggle to maintain its dividends and will likely collapse under the weight of its debt.

Ironically, we see investing in REXLot as a lot like playing the jackpot lottery – shareholders are betting on a pipe dream.

Lisa: Who's Professor Pigskin?
Homer: He's a pig who can predict football winners in advance.
Lisa: How is that possible?
Homer: Because he's got something no gambler's ever had. A system!

-The Simpsons

REXLot operates both an online and offline lottery business in China.

Online business: the online business consists primarily of the lottery website www.okooo.com. For 2014, Okooo represented 100% of REXLot's web operations, and 36% of total reported revenue. Our research shows that Okooo's true revenue is a fraction of what REXLot reports to investors. Okooo is operated as a joint-venture between REXLot and an SOE partner. Both of these JV partners provide public disclosures on Okooo's operations. However, these disclosures differ significantly, with the SOE partner reporting revenue figures for Okooo that are approximately 1/3 of those reported by REXLot.

Independent market share data also supports the lower revenue figures reported by the SOE partner.

Offline business: We believe that REXLot is inflating its offline business by overstating commission revenue from provincial customers. Government tender bids show that numerous provinces choose to purchase lottery machines as one-time buyouts rather than pay REXLot annual commission fees. These buyout contracts are significantly less lucrative, and generate a fraction of the revenue REXLot's financial statements suggest.

SAIC filings further support our view that REXLot is overstating its offline business revenue by at least 2x.

Cash Games: REXLot's reported interest income on its cash balance is between 0.12% to 0.27%. Meanwhile, a one-day call deposit in China offers at least an annualized rate of 0.8%. REXLot's *de minimis* interest income suggests that the cash balance it reports is grossly exaggerated.

Dividends: Since 2012, REXLot has paid out HK$583 million in dividends. However, in the last five years, REXLot has been free cash flow negative to the tune of approximately HK$1.9 billion. Accordingly, dividend payouts have been financed through the issuance of HK$3.3 billion in convertible bonds, which means investors have been financing their own dividends.

Mystery acquisition: Much of the funds from the convertible bonds have been used to acquire businesses with no assets or operations. We believe that these nebulous acquisitions are nothing more than a corrupt management team perpetuating a capex fraud to funnel a combination of fake profits and real money out of REXLot.

Captive Auditor: REXLot uses an obscure auditor who only has five Hong Kong-listed companies as clients, most of which are microcaps. This choice of auditor is unusual for a Company with a +US$600 million market cap.

Valuation: Based on the evidence and our analysis, we value *REXLot at HK$0.12 per share, implying 75% downside from their current price of HK$0.49.*

強烈沽售 – 御泰中彩(00555) 目標價: HK$0.12 潛在跌幅: 75%

御泰中彩主要業務包括線上及線下彩票業務。線上業務主要是澳客網 (www.okooo.com)，是御泰中彩的主要增長來源。線下業務主要是提供中國福利彩票 ("福彩") 和中國體育彩票("體彩") 的電腦彩票終端機銷售及維修，被御泰中彩管理層定為一個維持派息的穩健業務及集團根基。

線上業務被嚴重誇大：線上業務主要指澳客網 (www.okooo.com)，佔御泰中彩 2014 總收入 36% 及網上業務收入 100%。深入調研結果發現澳客網的收入被嚴重誇大。澳客網的營運公司是人民日報旗下人民網 (SH603000) 跟御泰中彩的合資公司。根據人民網 2013 和 2014 年年報對澳客網合資公司作出的合併財務披露，澳客網的實際收入只及御泰中彩披露的三分之一。

市場佔有率數據亦反映御泰中彩所披露的數據的嚴重誇大性。根據權威第三方市佔率數據，在美國上市的 500 萬彩票網 (US:WBAI) 的 2014 市佔率是澳客網的一倍，但收入卻少於御泰中彩所披露的澳客網的收入，充份反映出御泰中彩線上業務收入的不合理性。

根據權威第三方市佔率數據、500 萬彩票網的財務披露及人民網對澳客網的合併財務披露，我們相信澳客網業務大約只有御泰中彩披露的三分之一。

線下業務的謊言：線下收入主要來自電腦福彩終端機業務。據御泰中彩管理層的說法，所有線下福彩收入是以一定比率去提取所覆蓋省的電腦彩票銷售總額，即扣點模式 (commission method)。但多個省的福彩終端機投標/中標公告卻顯示福彩終端機供應商 (即御泰中彩的附屬深圳思樂數據技術有限公司) 的收入模式是一次性買斷 (buyout method)。行業專家亦指出一次性買斷模式和扣點模式的市場覆蓋率各佔大約一半。同樣的終端機，扣點模式比一次性買斷模式多賺至少一倍。

國家工商行政管理總局資料亦顯示深圳思樂數據技術有限公司的 2013 收入只有人民幣三億，御泰中彩披露的收入卻有接近人民幣六億半。

我們相信御泰中彩的線下業務被誇大了至少一倍。

對其他財務數據及公司營運的質疑

現金：御泰中彩在過去三年只有 0.12% 至 0.27% 的銀行利息收入，中國境內一天通知存款的年利率卻有 0.80%。反映公司所披露的現金被嚴重誇大。

股息：自 2012 年，御泰中彩共派出 5.83 億股息。過去五年，公司的自由現金流大約負十九億。同期，御泰中彩亦發行了總值三十三億的可換股債券。我們相信，御泰中彩過去幾年的股息基本上來自這些債券。

收購：過去幾年，大部分可換股債券資金都用於收購一些沒有實質資產及當時沒有業務的公司。在往後的公司年報，這些被收購的公司也再沒有被提及。我們有理由相信管理層籍着這些莫明奇妙的收購來偷取上市公司的資金及掩飾被誇大的盈利及現金。

審計師：御泰中彩作為一間市值超過港幣五十億的上市公司，卻聘用四大或二線會計師行以外不知名的會計師行。這會計師行同時為御泰中彩大股東陳孝聰的另一間最大控股上市公司御濠娛樂 (00164) 作審計服務。這兩間以陳孝聰為主要股東的公司佔去這會計師行負責的僅五間上市公司的審計收入 55%，令人質疑這會計師行作為為公眾把關角色及防止上市公司欺詐的動力和能力。

REXLot's online business consists primarily of the lottery website www.okooo.com ("Okooo"), and to a lesser extent, its mobile platform where individuals can buy lottery tickets through texts or apps. Okooo is the crown jewel of the online business, representing 100% of all web operations,[1] and 36% of total reported revenue in 2014 (another 10% of revenue comes from the online mobile platform):

Breakdown of REXLot's Business Divisions
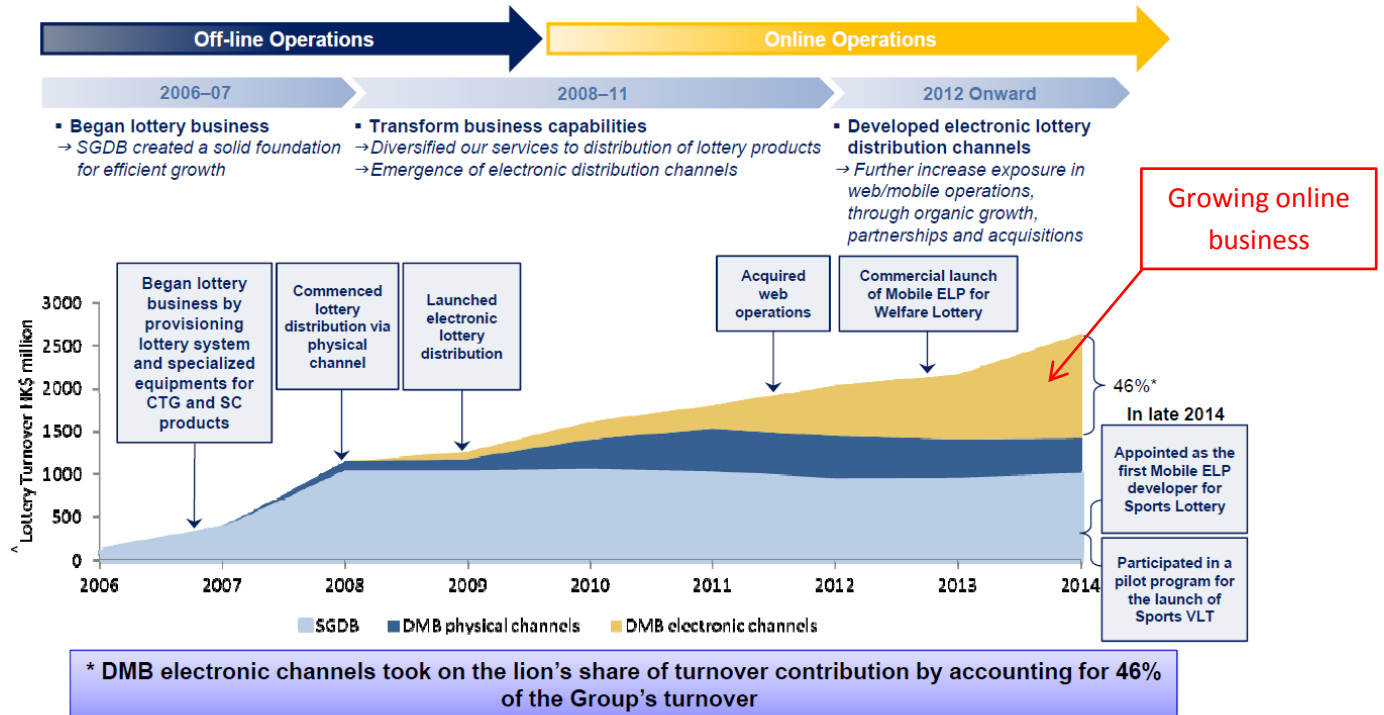
Source: March 2015 REXLot investor presentation, slide 19

Between 2009 and 2014, the online business has been REXLot's only growing segment. But despite Okooo's significance, REXLot has never discussed the operation. Except for a vague disclosure regarding the acquisition of Okooo in 2011,[2] there are no other mentions of the business in any of the 2011, 2012, or 2013 annual reports.

As we determined through our investigation and analysis, REXLot's unusual silence likely has to do with the fact that Okooo's reported numbers are vastly overstated.

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[1] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0331/LTN201503311645.pdf pg. 27
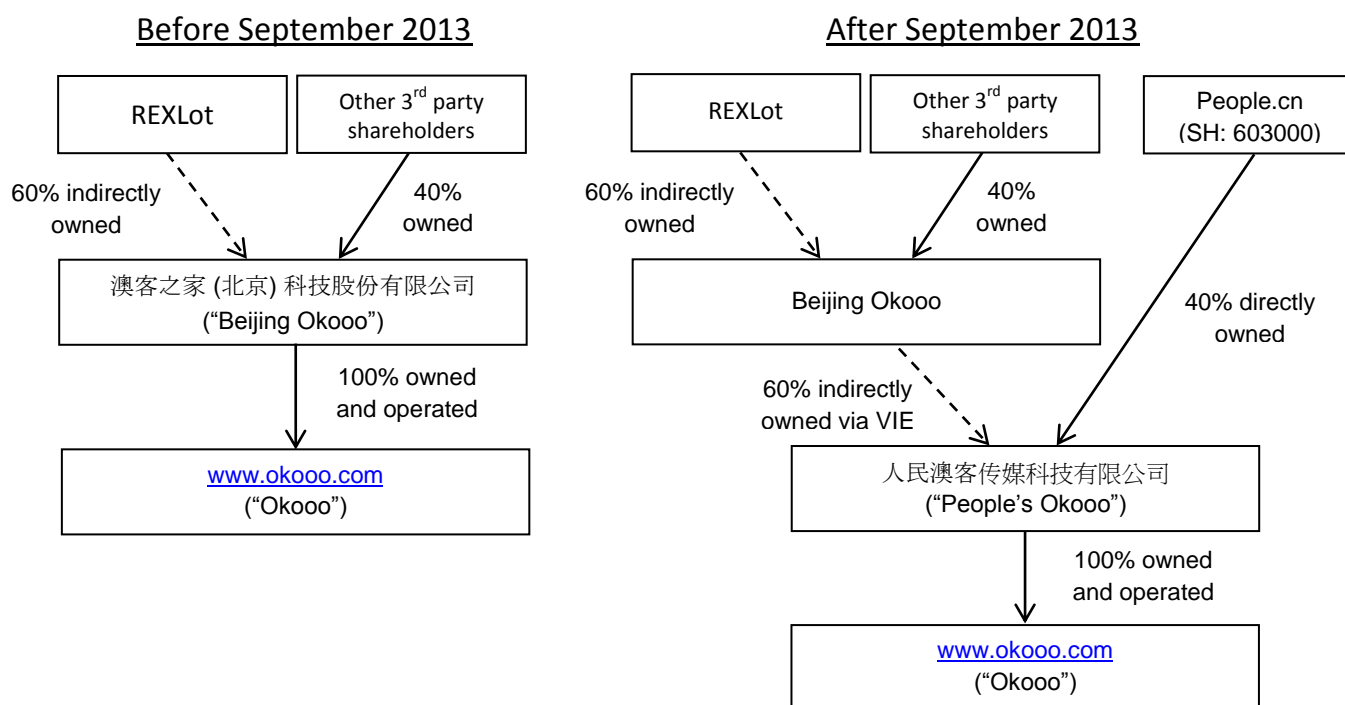[2] http://www.hkexnews.hk/listedco/listconews/SEHK/2012/0430/LTN20120430184.pdf pg. 150

In Need of a White Knight

REXLot acquired Okooo in 2011, but it wasn't long before problems followed. According to news articles, in May 2013, www.okooo.com was shut down for over 20 days. Okooo's official explanation seems to have been that their servers were down, and they did not have back-up servers.[3]

However, given the length of time the servers were down (20+ days is absurd), many users did not buy the official story. With users unable to withdraw their money, speculation ran rampant – suggestions that the system was hacked, that Okooo's personnel had been caught and questioned by police on failure to distribute all prize money, and that Okooo had sold unauthorized lottery tickets online.[4,5]

Following these events, Okooo suffered reputational and financial damage. To save Okooo, REXLot established a joint-venture with People.cn, called "People's Okooo", in September 2013. People.cn is a subsidiary of People's Daily, the official, and most influential newspaper in China, and is a listed company on the Shanghai Stock Exchange (SH:603000).

As part of the People's Okooo JV, People.cn took a 40% stake in Okooo (later reduced to 36.67% in 2014)[6], as well as control of three out of five board seats.[7] The following charts demonstrate the change in organizational structure:

Source: Daiwa Securities, our analysis

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[3] http://tieba.baidu.com/p/2359927872
[4] http://column.iresearch.cn/u/powersun/650192.shtml
[5] http://bbs.tianya.cn/post-837-77457-1.shtml
[6] People.cn AR 2014, pg. 154
[7] People.cn AR 2014, pg. 156

Today, Okooo's website clearly states that Okooo is "a brand under People.cn":

Despite Okooo being REXLot's primary online property and key revenue generator, there are no disclosures in REXLot's 2013 annual report that give shareholders any indication that REXLot had just lost a 40% economic interest and majority board control of Okooo to People.cn.

Normally, this restructuring and loss of control would have triggered accounting issues that, if recorded and properly disclosed, would have tipped off shareholders, including hits to revenue and income figures.

However, despite losing control of Okooo, REXLot's management decided to consolidate the results of the JV as part of its 2013 financial statements, effectively making it seem like nothing had happened. Later, in REXLot's 2014 annual report, Management would offer a rationalization for the 2013 consolidation by stating:

> "…it had been the Company's intention to increase its exposure in electronic lottery distribution platform especially on the web and mobile platforms. Such an intention naturally involves a plan to incrementally acquire the remaining interest in Beijing Okooo and additional interest in the [People's Okooo]."[8]

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[8] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0429/LTN20150429917.pdf pg. 25

In what must have been an embarrassing and awkward moment for REXLot, People.cn also consolidated the operations of People's Okooo following the JV. But unlike REXLot, People.cn actually had a valid accounting basis for the consolidation – it controlled three out of five board seats, and therefore had control of the entity.

In 2014, REXLot did an about-face and decided to de-consolidate Okooo from its 2014 financial results. In doing so, Management provided the following explanation:

> *"In January 2015, a self-inspection program was carried out by provincial lottery centers in China… As a result, the Group's internet based lottery distribution unit has temporarily suspended its internet lottery distribution services effective from March 2015 (the "Suspension"). It is uncertain when the operation of the Group's internet based lottery distribution unit will resume… The management is of the view that in practice, the Group no longer has the ability to unilaterally direct the relevant activities of the PRC Company. Hence, the Board resolved to deconsolidate [People's Okooo] and treat it as a long term investment of the Group."[9]*

It's not clear why Management would de-consolidate Okooo from its 2014 financial results when the online lottery suspension occurred in 2015. The explanation provided by REXLot is dubious at best. However, in de-consolidating Okooo, Management had little choice but to provide additional information on the unit in order to explain how the de-consolidation would affect REXLot's overall results.

Among the disclosures, Management broke out how much revenue Okooo contributed to REXLot in its 2015 investor presentation. While REXLot does not make the presentation readily available on its website (we wonder why) an analysis of the numbers shows that REXLot overstated Okooo's revenue by nearly 3x.

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[9] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0331/LTN201503311645.pdf pg. 44

Mismatched Disclosures between REXLot and People.cn

Recall that after the JV in 2013, both People.cn and REXLot had an ownership stake in Okooo and both consolidated the results into their financial statements for different reasons. Accordingly, both companies provide some level of disclosure regarding the operations of the JV. Save for minor differences between accounting standards and FX, these operating disclosures should be similar. However, the revenue generated by Okooo as reported by REXLot is 262% of that as reported by People.cn.

REXLot disclosures

According to REXLot's 2015 investor presentation, Okooo contributed HK$947 million (814M + 133M) in 2014 without de-consolidation (Management states in the 2014 financial results that all internet related operations were conducted through the Okooo platform):

	Turnover		EBITDA Margin		Market Size	Market Share		Rate cut
	2014 (HK$ mn)	2013 (HK$ mn)	2014 (%)	2013 (%)	2014 (RMB bn)	2014 (%)	2013 (%)	(%)
System and Games Development Business								
Welfare Computer Ticket Games	865	814	83%	84% (81% after charge offs)	150	49%	50%	0.94%
Welfare Scratch Cards Printing	95	96	43%	45%	18	24%	24%	1.5-2%
Sports Computer Ticket Games	51	53	23%	23%	n.a.	n.a.	n.a.	n.a.
Distribution and Marketing Business								
Point of Sales	302	328	71%	72%	34	28%	30%	2.5%
SMG (Physical shop & Call Center referral*)	107	118	42%	43%		3%	7%	5-6%
Web Operations^ (Okooo and others)	814	426	69% (58% after charge offs)	75% (63% after charge offs)	44#	36%	34%	3-4%
Mobile SMS/ELP Platform	402**	331	70% (58% after charge offs)	70% (64% after charge offs)	n.a.	n.a.	n.a.	3-3.5%

* Call center operation has been merged with the Web Operations and customers referral fee is paid to the Call Center
\# For SMG
^ The web operations units have been deconsolidated and carved-out from the Group account due to prudent accounting adjustments
** HK$133mn out of HK$402mn was referral operations done through Okooo and has been carved-out

Source: March 2015 REXLot investor presentation, slide 11

This HK$947 million figure is also contained in Daiwa Securities' research report dated 9 April 2015 (Daiwa Securities is one of the few brokers promoting REXLot, having served as underwriter to numerous REXLot bond issues):

All Internet-related lottery revenue and profit carved out

It is important to note that the reported 2014 results do not include any Internet-related lottery businesses. This represents roughly HKD947m worth of business, of which HKD814m came from its web operations business (mainly Okooo.com) and HKD133m from the Mobile ELP's referral business, which was classified as revenue from web operations (according to

People.cn disclosures

As a public company, People.cn also discloses Okooo's financial results. In its 2014 annual report, People.cn states that revenue from Okooo in 2014 was RMB286 million, or HK$361 million.[10] Again, People.cn consolidates Okooo, hence the disclosed results reflect the entirety of Okooo's operations:

<div align="center">

Current Year (2014)   **Prior Year (2013)**
Revenue   Net Income   Revenue   Net Income

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子公司名称	本期发生额				上期发生额			
	营业收入	净利润	综合收益总额	经营活动现金流量	营业收入	净利润	综合收益总额	经营活动现金流量
北京人民在线网络有限公司	130,152,364.67	26,239,410.48		28,972,074.65	94,188,208.11	11,817,016.69		22,408,769.30
环球时报在线(北京)文化传播有限公司	87,485,415.71	-3,410,650.79		-7,185,030.30	65,603,747.70	-9,946,104.66		-4,603,273.54
人民视讯文化有限公司	130,212,027.46	23,115,367.02		20,339,452.46	96,826,939.88	21,145,018.83		-2,792,740.94
成都古羌科技有限公司	126,462,195.71	41,404,086.01		44,211,322.05	109,950,642.15	35,405,450.77		26,249,855.07
人民澳客传媒科技有限公司	285,666,331.14	88,524,279.89		84,614,036.88	21,066,092.01	9,946,575.25		-21,279,966.98
北京文华在线科技发展有限公司	34,800,693.29	10,386,896.08		-2,844,579.91	14,825,215.39	997,052.71		4,132,500.37
微屏软件科技(上海)有限公司	84,113,014.99	59,422,972.70		55,677,398.11	10,563,111.04	-2,459,931.75		-10,287,150.99

其他说明：

People's Okooo (→ 人民澳客传媒科技有限公司)

People.cn's annual report also presents a minority interest section which further affirms that the above figures reflect the entire operations of Okooo.[11] As presented below, this table shows that 63.33%[12] of People's Okooo is owned by a third party (presumably a REXLot subsidiary), and that this third party is entitled to RMB56 million of net income. Accordingly, this implies that the total net income generated by Okooo in 2014 was RMB88.5 million (RMB56M ÷ 0.6333), which is consistent with the above disclosure by People.cn.

<div align="center">

2014 年年度报告

(2). 重要的非全资子公司

单位:元 币种:人民币

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子公司名称	少数股东持股比例	本期归属于少数股东的损益	本期向少数股东宣告分派的股利	期末少数股东权益余额
北京人民在线网络有限公司	40.00	10,495,764.19		27,690,664.68
环球时报在线(北京)文化传播有限公司	40.00	-1,364,260.32		10,341,607.45
人民视讯文化有限公司	49.00	11,326,529.84		40,388,734.32
成都古羌科技有限公司	30.75	12,742,340.78		39,764,752.38
人民澳客传媒科技有限公司	63.33	56,065,404.31		220,698,314.73
北京文华在线科技发展有限公司	65.00	9,772,306.49		33,040,529.13
微屏软件科技(上海)有限公司	65.00	21,195,802.41		47,950,877.44

子公司少数股东的持股比例不同于表决权比例的说明：

People's Okooo (→ 人民澳客传媒科技有限公司)

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[10] http://static.sse.com.cn/disclosure/listedinfo/announcement/c/2015-04-14/603000_2014_n.pdf pg. 158
[11] http://static.sse.com.cn/disclosure/listedinfo/announcement/c/2015-04-14/603000_2014_n.pdf pg. 157
[12] People.cn's ownership went from 40% to 36.67% in 2014.

Furthermore, in the notes to its consolidated financial statements, People.cn explicitly states that:

> *"As of end of reporting period, there are 36 subsidiaries included in the scope of consolidation including People's Okooo, who generated revenue of RMB286 million during the period."[13]*

2　收入
(1)　驱动业务收入变化的因素分析

　　报告期内，公司在确保原有各项业务稳定增长的同时，将大力发展移动互联网业务作为未来战略发展方向之一，在该业务上加大投入，并取得较为丰厚的收益。截至报告期末，移动增值业务已跃居公司第二大主营业务，实现收入人民币 4.30 亿元，同比增长 68.97%。此外，随着公司在传媒产业链的深入布局，通过新设或并购方式控股的子公司在增厚公司收入方面起到了十分积极的作用，截至报告期末，公司纳入合并范围的子公司及孙公司已达 36 家，其中子公司人民澳客在报告期实现收入人民币 2.86 亿元，子公司古羌科技及微屏软件均已实现收购时作出的相应利润承诺。

It is clear that People.cn fully consolidates and reports all revenue generated by Okooo in its financial statements. It is also clear that REXLot and People.cn report very different revenue figures for Okooo:

Exhibit 1
Consolidated Okooo Revenue (2014)
(In HK$ millions)

REXLot – investor presentation	947
People.cn – annual report	361
Difference	***2.62x***

People.cn falls under the control of a PRC State-Owned Enterprise ("SOE") and is part of the official press site in China, and would have no reason to *understate* revenue from Okooo.

On the other hand, REXLot's online business is the Company's only growth driver, which gives Management incentive to exaggerate Okooo's operating results. Accordingly, we believe the inconsistent disclosures show that REXLot has been substantially inflating its online business.
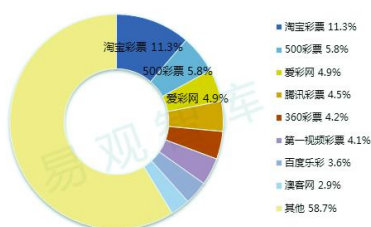
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[13] People.cn 2014 annual report, pg. 10

Supporting Evidence: Market Share

Another reason to believe REXLot is inflating Okooo's revenue is based on our review of market share data. We obtained market share information from www.enfodesk.com, which is a well-respected, premier data and internet analysis company in China, and considered independent from online lottery operators.
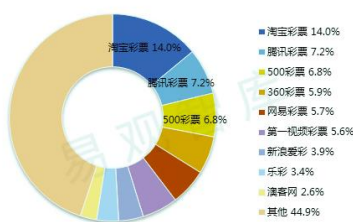
The following charts present the 2014 quarterly market share data for online lottery sales by operator:
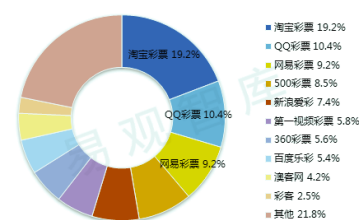

2014年第1季度中国PC端彩票市场销售份额

淘宝彩票 11.3%
500彩票 5.8%
爱彩网 4.9%
腾讯彩票 4.5%
360彩票 4.2%
第一视频彩 4.1%
百度乐彩 3.6%
淘客网 2.9%
其他 58.7%

数据说明：腾讯彩票含qq彩票、财付通彩票、菠菜延延彩票等；第一视频彩票PC端包含第一彩、中国足彩网，不含移动调查票365销量；具体数据据企业调研、访谈及易观方法论估算获得，易观会根据市场最新信息对历史数据进行微调。

来源：易观国际 易观智库 中国互联网商情
SOURCE: EnfoDesk © Analysys International
www.enfodesk.com
www.eguan.cn

2014年第2季度中国网络彩票PC端市场销售份额

淘宝彩票 14.0%
腾讯彩票 7.2%
500彩票 6.8%
360彩票 5.9%
网易彩票 5.7%
第一视频彩票 5.6%
新浪爱彩 3.9%
乐彩 3.4%
淘客网 2.6%
其他 44.9%

数据说明：腾讯彩票含QQ彩票、菠菜延延彩票等；第一视频彩票PC端含第一彩、中国足彩网，不含移动调查票365销量；具体数据据企业调研、访谈及易观方法论估算获得，最观会根据市场最新信息对历史数据进行微调。

来源：易观国际 易观智库
SOURCE: EnfoDesk © Analysys International
www.enfodesk.com
www.eguan.cn

2014年第3季度中国互联网彩票销售份额

淘宝彩票 19.2%
QQ彩票 10.4%
网易彩票 9.2%
500彩票 8.5%
新浪彩 7.4%
第一视频彩票 5.8%
360彩票 5.6%
百度乐彩 5.4%
淘客网 4.2%
彩票 2.5%
其他 21.8%

数据说明：网络彩票指互联网彩票及移动互联网彩票，互联网彩票端PC端；第一视频彩票包含第一彩、中国足彩网；具体数据据调研访谈及易观方法论估算获得，最观会根据市场最新信息对历史数据进行微调。

来源：EnfoDesk 易观智库
www.enfodesk.com

Source: http://www.enfodesk.com/SMinisite/newinfo/articledetail-id-406429.html,
http://www.enfodesk.com/SMinisite/newinfo/articledetail-id-410371.html,
http://www.enfodesk.com/SMinisite/newinfo/articledetail-id-418570.html

As per this data, Tencent (or QQ; 0700.HK), and Taobao (or Alibaba; BABA.NYSE) are the biggest industry players given the sheer volume of referral traffic from their core web properties. Apart from these big internet brands, 500.com (WBAI.NYSE) is also a major stand-alone online lottery operator.

Exhibit 2

2014 Online Lottery Market Share Data

	PC-end Market Share			Mobile-end Market Share			Online Revenue
	Q1	Q2	Q3	Q1	Q2	Q3	(RMB millions)
500.com	5.8%	6.8%	8.5%	8.5%	8.6%	9.7%	580
Okooo	2.9%	2.6%	4.2%	< 6.7%	< 6.4%	< 6.0%	746*

Source: www.enfodesk.com, 500.com revenue extracted from SEC filings
*Revenue of HK$947 million converted to RMB for comparison

This 2014 market share data shows that 500.com is twice the size of Okooo, capturing between 5.8% - 8.5% of PC-end online lottery sales, while Okooo capture between 2.9% - 4.2%. On the mobile-end side, 500.com captured 8.5% - 9.7% of the market, while Okooo's market share is not even ranked due to its insignificance.

Despite 500.com's substantial market share advantage, REXLot reports questionably higher revenue than its better-performing competitor, at RMB746 million for REXLot versus RMB580 million for 500.com. This purported higher revenue defies logic.

While the market share data throws into question REXLot's higher reported revenue, the data is consistent with the smaller Okooo revenue figure as reported by People.cn. Commission revenue for online lottery operators can be calculated by the following formula:

(Total online lottery sales) x (Market share) x (Commission rate, aka cut rate)

Online lottery sales in 2014 were RMB85 billion.[14] We also assume Okooo's market share was approximately 4.2% based on the share data from Exhibit 2. Finally, we know that the average cut rate for online lottery platforms is around 8%.[15] Putting these numbers into the formula, we get total 2014 revenue generated by Okooo as:

RMB85 billion x 4.2% x 8% = **RMB285.6 million**

This revenue number matches perfectly with People.cn's disclosure:

	Revenue 营业收入	Net Income 净利润	综合收益总额	经营活动现金流量	Revenue 营业收入	Net Income 净利润	综合收益总额	经营活动现金流量
子公司名称	本期发生额				上期发生额			
北京人民在线网络有限公司	130,152,364.67	26,239,410.48		28,972,074.65	94,188,208.11	11,817,016.69		22,408,769.30
环球时报在线(北京)文化传播有限公司	87,485,415.71	−3,410,650.79		−7,185,030.30	65,603,747.70	−9,946,104.66		−4,603,273.54
人民视讯文化有限公司	130,212,027.46	23,115,367.02		20,339,452.46	96,826,939.88	21,145,018.83		−2,792,740.94
成都古羌科技有限公司	126,462,195.71	41,404,086.01		44,211,322.05	109,950,642.15	35,405,450.77		26,249,855.07
人民澳客传媒科技有限公司	285,666,331.14	88,524,279.89		84,614,036.88	21,066,092.01	9,946,575.25		−21,279,966.98
北京文华在线科技发展有限公司	34,800,693.29	10,386,896.08		−2,844,579.91	14,825,215.39	997,052.71		4,132,500.37
微屏软件科技(上海)有限公司	84,113,014.99	59,422,972.70		55,677,398.11	10,563,111.04	−2,459,931.75		−10,287,150.99

其他说明：

People's Okooo

Once again, this independent data shows that REXLot has substantially inflated its web revenue. While REXLot's Management has tried to promote the online business as the Company's growth driver, market share data, as well as disclosures by its own JV partner show that REXLot's reported online revenue is fictitious and grossly exaggerated.

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[14] http://sports.sina.com.cn/l/2015-01-22/15037493024.shtml?c=spr_mthz_hao360_sports_home_t001
[15] http://tech.sina.com.cn/i/2014-01-23/02179120727.shtml

Management's Likely Excuse

Before 2014, Okooo's operations had been a mystery to investors. As we previously noted, except for a brief acquisition announcement, Management made no further mention of Okooo in any of its 2011, 2012, or 2013 annual reports.

We believe that after the 2013 JV with People.cn, REXLot became aware that People.cn was breaking out the financial results of Okooo, which could potentially expose REXLot's misstatements. Therefore, in 2014 when Management had to de-consolidate Okooo and provide additional disclosures related to the unit, it seems that REXLot attempted to create a 'plug' line in order to explain away any discrepancies. Below is an organization chart of Okooo and its revenue flows, as presented by Daiwa Securities in their 9 April 2015 report:

Exhibit 3
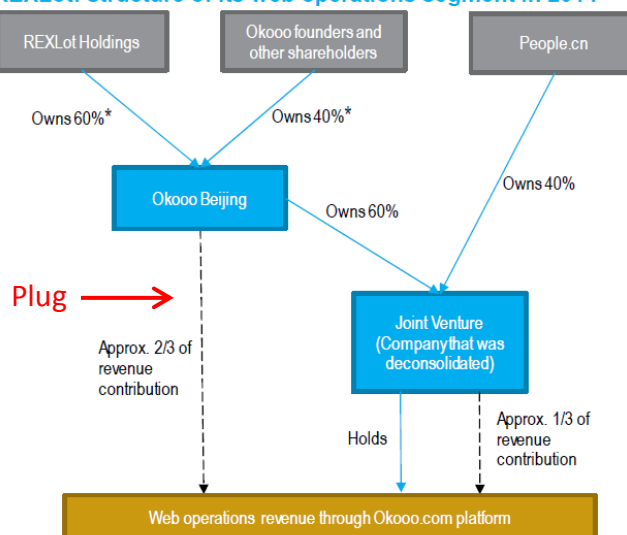
Source: Daiwa

*REXLot agreed to purchase 6.6% from one of the Okooo Beijing shareholders in late 2014, bringing its equity stake in Okooo Beijing to 66.6%.

Presumably, this chart was created by Daiwa with input and guidance from REXLot's Management. We believe this chart is a tool that Management will use in response to our findings. This chart shows that approximately 1/3 of the revenue from Okooo goes to the People's Okooo JV, while 2/3 go directly to REXLot's subsidiary. In this way, Management can deflect uncomfortable questions by claiming that the reason People.cn's disclosures show Okooo as 1/3 the size of what REXLot claims, is because People.cn only receives 1/3 the revenue from Okooo. The other 2/3, Management can claim, goes straight from Okooo to REXLot and therefore, People.cn never sees that amount, and thus does not consolidate it.

We reviewed this possible explanation, but find it completely lacks credibility for the following reasons:

First, People.cn states multiple times throughout its annual report that it **_fully_** consolidates the operations of People's Okooo, even going as far as to break out a minority interest section.

Second, independent market share data completely supports People.cn's version of Okooo's financial position.

Third, based on our research, we are confident that the 'plug' line highlighted above cannot exist nor can it justify the revenue discrepancy. In fact, no direct revenue line between Okooo and REXLot should exist. All the revenue generated by Okooo must go to the JV, and only then can it get redirected to REXLot.

Why?

When the JV was established in 2013, the website operating licenses were transferred to the People's Okooo JV:

Source: http://www.okooo.com/node/944.html

According to industry sources, commission revenue generated by an online lottery company is received directly from provincial lottery centers. These provincial lottery centers would not pay revenue to two different entities, but rather would <u>only</u> pay the entity that owns the operating license to run the lottery website. It is absurd to assume that a government institution that operates in a heavily-regulated industry would make a policy of paying a private operator that has no license to operate in the industry. Accordingly, all the revenue generated by www.okooo.com should go to the license holder (People's Okooo) first, and only then can 2/3 of the revenue be redirected to REXLot's subsidiary, Okooo Beijing.

Therefore, the 'plug' line presented in Exhibit 3 above is unlikely to exist, and is not valid justification to explain why REXLot's reported revenue for Okooo is nearly 3x greater than that reported by People.cn.

Offline Business

REXLot's traditional offline business consists primarily of Welfare Computer Ticket Games ("CTG"), Welfare scratch cards, and Sports CTG (these games are regulated by PRC government lottery agencies and aptly named because they fund welfare and social programs or go towards the promotion of sports in China).

The offline division is REXLot's legacy business and growth has been relatively flat since 2008, with the division reportedly generating approximately HK$1.4 billion in revenue annually, as per the following investor presentation slide:
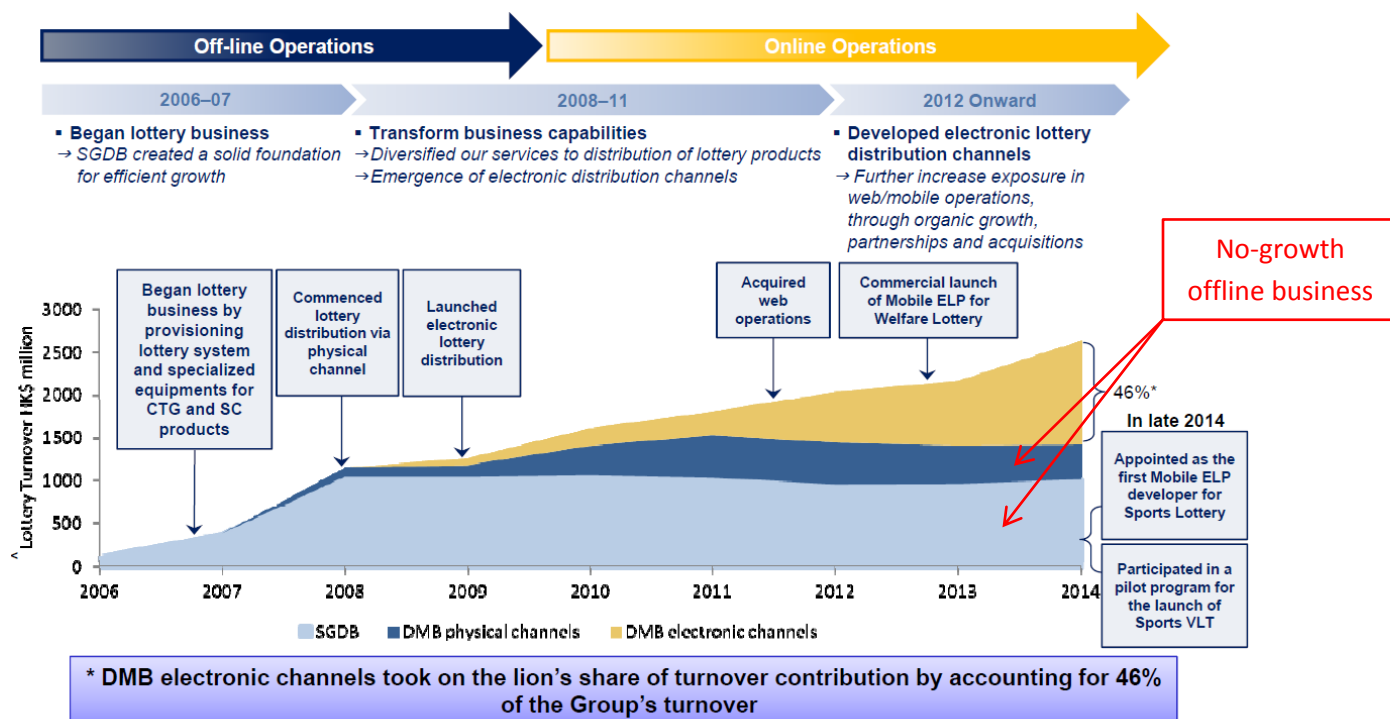
Source: March 2015 investor presentation, slide 19

With uncertainty surrounding the heavily regulated online lottery business, REXLot has promoted its offline business as a safe and reliable source of recurring revenue with limited downside. However, as with the online business, our research shows that REXLot has inflated its offline business as well.

The Offline Lottery Market

The vast majority of REXLot's offline revenue and EBITDA is generated by its Welfare CTG business. Accordingly, our discussion will focus on this market:

	Turnover		EBITDA Margin		Market Size	Market Share		Rate cut
	2014 (HK$ mn)	2013 (HK$ mn)	2014 (%)	2013 (%)	2014 (RMB bn)	2014 (%)	2013 (%)	(%)
System and Games Development Business								
Welfare Computer Ticket Games	865	814	83%	84% (81% after charge offs)	150	49%	50%	0.94%
Welfare Scratch Cards Printing	95	96	43%	45%	18	24%	24%	1.5-2%
Sports Computer Ticket Games	51	53	23%	23%	n.a.	n.a.	n.a.	n.a.
Distribution and Marketing Business								
Point of Sales	302	328	71%	72%	34	28%	30%	2.5%
SMG (Physical shop & Call Center referral*)	107	118	42%	43%	44#	3%	7%	5-6%
Web Operations^ (Okooo and others)	814	426	69% (58% after charge offs)	75% (63% after charge offs)		36%	34%	3-4%
Mobile SMS/ELP Platform	402**	331	70% (58% after charge offs)	70% (64% after charge offs)	n.a.	n.a.	n.a.	3-3.5%

* Call center operation has been merged with the Web Operations and customers referral fee is paid to the Call Center
\# For SMG
^ The web operations units have been deconsolidated and carved-out from the Group account due to prudent accounting adjustments
** HK$133mn out of HK$402mn was referral operations done through Okooo and has been carved-out

Source: 2015 investor presentation

There are three prominent players in China's Welfare CTG market, namely Sinodata Technology Co. Ltd. ("Sinodata")[16], Shenzhen General Lottery Technology ("SZ General")[17] and Guangzhou San Huan Yong Xin Technology Company ("GZSH").[18]

Welfare CTG requires lottery machines as well as back-end systems. To ensure compatibility, each province usually only picks one supplier for both. Sinodata is the subsidiary through which REXLot operates its Welfare CTG business, and is the largest market player covering 17 lottery provinces:

Welfare CTG Business

The Group's SGDB participates in the Welfare CTG business in China through Shenzhen Sinodata Technology Co Ltd ("Sinodata"). Sinodata is the leading lottery system and specialized equipment supplier for Welfare Lottery in China and has a long and proven track record of success in the field of lottery system and games development. During the year under review, Sinodata provided its professional services to 17 lottery provinces in China.

福彩電腦票業務

本集團的系統及遊戲開發業務透過深圳市思樂數據技術有限公司（「思樂」）從事中國福彩電腦票業務。思樂乃中國福利票券領先的彩票系統及專用設備供應商，在彩票系統及遊戲開發領域擁有優良往績。於回顧年內，思樂在中國17個彩票省份提供專業服務。

Source: http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0429/LTN20150429917.pdf pg. 8

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[16] http://english.sinodata.com.cn/web/AboutPage.aspx (深圳市思乐数据技术有限公司)

[17] http://www.genlot.com/ (深圳市穗彩科技开发有限公司)

[18] (广州市三环永新科技有限公司)

SZ General is a private company and the second largest market player, covering 10 lottery provinces.

GZSH is a subsidiary of China LotSynergy Holdings ("LotSynergy"), which is another Hong Kong-listed company (1371.HK). GZSH covers the provinces of Chongqing and Guangdong, of which Guangdong is the largest lottery province in China, with an 8% share of total lottery sales.

Historically, the provincial Welfare CTG lottery revenue model for operators has been based on the _**'commission model'**_. Under the commission model, lottery machines are provided to provincial lottery centers free-of-charge and the owners of the machines collect a commission cut from the province as compensation. The revenue formula for the commission model is fairly simple:

(National Welfare CTG sales) x (Market share) x (Commission rate) = Revenue

This is the revenue model that REXLot has been touting to investors. We can see from the Company's 2015 investor presentation that the total size of the Welfare CTG market in 2014 was RMB150 billion (HK$190 billion), REXLot's market share was 49%, and their commission rate was 0.94%:

| | Turnover | | EBITDA Margin | | Market Size | Market Share | | Rate cut |
	2014 (HK$ mn)	2013 (HK$ mn)	2014 (%)	2013 (%)	2014 (RMB bn)	2014 (%)	2013 (%)	(%)
System and Games Development Business								
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*Call center operation has been merged with the Web Operations and customers referral fee is paid to the Call Center
For SMG
^ The web operations units have been deconsolidated and carved-out from the Group account due to prudent accounting adjustments
** HK$133mn out of HK$402mn was referral operations done through Okooo and has been carved-out

Plugging these numbers into the commission model formula, we get:

HK$190 billion x 49% x 0.94% = **HK$875 million**

This HK$875 million figure is consistent with the HK$865 million figure REXLot reports as revenue from its Welfare CTG business. So, when Management explains REXLot's business with this type of simple clarity, it makes sense on the surface. However, this explanation is utterly misleading because the commission model is outdated and many provinces have long switched to a _**'buyout model'**_ which generates only a fraction of the revenue for suppliers like REXLot.

According to industry sources, the commission model was popular circa 2005 – 2006. At that time, provincial lottery offices were financially weaker and over 80% of lottery provinces preferred the commission model, which had no large upfront costs.

Today, approximately half the provincial lottery market operates through a one-off buyout model, wherein the provincial lottery office actually buys the machines from suppliers, and offers them a maintenance contract, usually lasting three to five years. This makes the buyout model less lucrative for suppliers. Furthermore, the provinces that have chosen to continue to operate on the commission model have reduced their cut rates to operators. Accordingly, the growth of lottery machine suppliers has been less than the growth of the overall Welfare CTG market.

Regarding the economics of the buyout model, each lottery machine costs ~RMB12,000 – RMB16,000 with varying maintenance fees depending on the contract terms. Below is an example of a recent tender and successful bid by Sinodata (REXLot) for Hunan province:

1,130 Lottery Machines Tender Result
福利彩票专用投注机1130台中标结果

来自：中国采招网（http://www.bidcenter.com.cn）　加入时间：2013-11-21　地 区：湖南

工程中标通知书▶
学校食堂招标▶
工商注册查询▶
农村污水处理　公司招标公告
食堂招标　企业注册查询
食堂厨房设备　人力资源考试

Tender result announcement – Hunan Welfare Lottery Center – Purchase of Lottery Machines

湖南省福利彩票发行中心湖南省福利彩票专用投注机单一来源采购中标信息公告

（政府采购编号：湘财采计 [2013]106号，省直代理编号：hnszzfcg-2013p-0620号）

湖南省省直机关政府采购中心受湖南省福利彩票发行中心的委托，对其所需湖南省福利彩票专用投注机进行单一来源采购。结果公告如下：

一、采购项目情况

1、采购项目名称：湖南省福利彩票发行中心湖南省福利彩票专用投注机单一来源采购
2、采购方式：单一来源
3、开标、评标、定标日期：2013年11月21日
4、采购方式批准部门：湖南省财政厅政府采购处

二、中标信息结果

Quantity: 1,130
Unit cost: RMB 15,800
Winning unit: Sinodata

包号	货物名称	数量	单价	中标总价	中标候选单位	联系方式
整包	湖南省福利彩票发行中心湖南省福利彩票专用投注机	1130台	15800元/台	17854000元	深圳市思乐数据技术有限公司 王岩13924602948

中标总金额　壹仟柒佰捌拾伍万肆仟元整

Total amount: RMB17.854 million

三、评标委员会成员及监标人名单

1、评标委员会成员：虞水俊、周铁军、唐江桦、曾佑林、林军
2、监标人（纪检监察）：李晔

四、采购人联系方式

名称：湖南省福利彩票发行中心　　地址：湖南省长沙市湘福路9号
项目答疑人：林军　　　　　　　　联系电话及传真：0731-84502031

五、集中采购机构联系方式

集中采购机构名称：湖南省省直机关政府采购中心
地 点：湖南省长沙市人民中路66号（省机关事务管理局综合楼7楼）
联系人：吴梦　　　　　　　　　　联系电话：0731-85166569
e-mail：hnszcgzx@163.com

六、中标供应商领取中标通知书时，需同时递交投标文件中技术参数电子版本。

七、投标供应商如对成交公告有异议的，请于此公告发布之日起七个工作日内，以书面形式向我中心提出质疑，地址：长沙市人民中路66号（省机关事务管理局6楼616室），联系电话：0731-85166575，联系人：李林军。

Source: http://www.bidcenter.com.cn/newscontent-14295239-4.html

As this winning bid shows, Hunan is one of the provinces that uses the buyout model instead of the commission model. This contract represents the purchase of 1,130 machines and related maintenance expenses for a total value of **RMB17.854 million**.

And how often do these purchase contracts come up? About once a year.

According to an industry expert and online sources, each lottery machine generates ticket sales of approximately RMB1 million annually,[19,20,21] and has a life cycle of 5 years (20% depreciation rate). We know that in 2013, Hunan's Welfare CTG sales were RMB6.03 billion[22] which means the province operates approximately 6,000 machines (RMB6.03B ÷ RMB1M). We can see that Hunan's tender for 1,130 machines is consistent with a ~20% life cycle rate. Therefore, under the buyout model, REXLot would generate approximately **RMB17.854 million** in revenue each year from Hunan province.

By contrast, if Hunan used the commission model, then REXLot as the exclusive operator in the province would generate estimated revenue of:

Hunan Welfare CTG sales (2013*): RMB6.03 billion*
Commission rate assumption (as reported by REXLot): *0.94%*

$$RMB6.03 \text{ billion} \times 0.94\% = \textbf{RMB56.7 million}$$

From this example, we can see that the buyout model generates less than **_one-third_** the revenue of the commission model.

We believe that REXLot has been misleading investors by falsely implying that the commission model is the only model used in the Welfare CTG market. Accordingly, Management has inflated revenues by continuing to use this outdated revenue model, all the while its provincial customers have been switching to the buyout model.

In fact, based on a simple internet search, we found that at least <u>eight</u> of REXLot's 17 provincial customers use the buyout model, as evidenced by public tenders that state purchase amounts rather than commission amounts:

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[19] http://finance.qq.com/a/20140224/007525_all.htm

[20]

http://www.xjcz.gov.cn/127?p_p_id=general_articles_INSTANCE_LxV4&p_p_lifecycle=0&p_p_state=maximized&p_p_mode=view&p_p_col_id=column-15&p_p_col_pos=1&p_p_col_count=2&_general_articles_INSTANCE_LxV4_struts_action=%2Fgsoft%2Fgeneral_articles%2Fview&_general_articles_INSTANCE_LxV4_articleId=92adf943-2e3c-456a-8fab-3ec13a24e90e&_general_articles_INSTANCE_LxV4_target=_blank

[21] http://www.cnbeta.com/articles/367327.htm

[22] http://www.mystockhk.com/UploadFiles/informationpdf/28154124511F7A5E.pdf pg. 11

Exhibit 4

Revenue Model Choice of Provinces Serviced by Sinodata

	Province	Revenue model
1	Shandong	n/a
2	Liaoning	n/a
3	Jiangxi	Buyout
4	Jiangsu	n/a
5	Yunan	Buyout
6	Anhui	Buyout
7	Guizhou	Buyout
8	Shaanxi	n/a
9	Hunan	Buyout
10	Hainan	n/a
11	Jilin	Buyout
12	Inner Mongolia	Buyout
13	Qinghai	n/a
14	Tianjin	n/a
15	Tibet	n/a
16	Fujian	Commission (0.52%)
17	Henan	Buyout

Source: compiled, based on announced tenders

But it gets worse for REXLot. Of the 17 provinces, we could only verify that Fujian province uses the commission model for Welfare CTG. And even then, Fujian only offers a cut rate of 0.52%, which is about half the average cut rate of 0.94% reported by REXLot:

Exhibit 5

Fujian Province Commission Rate

应答文件。根据采购文件相关规定并经采购文件的规定程序确定该家供应商为成交供应商，具体如下：合同包1：1、成交供应商：深圳市思乐数据技术有限公司；地址：深圳市南山区南油天安工业区7号厂房3楼B、C、D单元；联系人：朱毅；联系电话：0755-86332039、18603032705；2、成交报价：0.52%(成交报价为固定比率，供应商在合同期限内的回报为新系统投入使用后每年实际产生销售额的固定比率，即：回报=每年实际产生销售额×成交报价)。

Source: http://www.ccgp.gov.cn/cggg/dfbx/zbgg/201311/t20131121_3146193.shtml

This finding is in-line with industry sources who explained that the cut rate is generally 0.8% or lower. As another example, Guangdong province – China's largest lottery province – offers a cut rate of only 0.58%.[23]

How REXLot can claim it generates a 0.94% cut rate is anyone's guess. But what we are certain of is that REXLot has been overstating its Welfare CTG revenue by at least 2x by misleading investors into thinking that all its provincial customers use the commission model.

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[23] http://www.ccgp.gov.cn/cggg/dfgg/zbgg/201504/t20150408_5173942.htm

Supporting Evidence: SAIC Filings

We obtained and analyzed SAIC filings for Sinodata,[24] which is the subsidiary through which REXLot conducts all its Welfare CTG business.[25] According to its SAIC income statement, Sinodata generated revenue of RMB302 million in 2013 and paid taxes of RMB16 million:

Exhibit 6
2013 Income Statement
(Shenzhen Sinodata Technology Co Ltd)

损益表		
编制单位：深圳市思乐数据技术有限公司		2013年12月31日 单位：人民币元
项 目	本月数 Current month	本年数 Current year
一、营业收入 Revenue	29856873.59	301647199.57
减：营业成本	11419153.61	125577391.77
营业税金及附加	399741.17	2222669.9
销售费用	2642615.66	17993807.51
管理费用	3915967.05	46214054.62
财务费用	141906.58	2776116.51
资产减值损失		2670629.34
加：公允价值变动收益（损失以"-"号填列）		
投资收益（损失以"-"号填列）		149969.24
其中：对联营企业和合营企业的投资收益		
二、营业利润（亏损以"-"号填列）	11337489.52	104342499.16
加：营业外收入	10000	213418.8
减：营业外支出	3122.34	917292.49
其中：非流动资产处置损失		
三、利润总额（亏损总额以"-"号填列）	11344367.18	103638625.47
减：所得税费用 Taxes	4944994.37	16166125.35
四、净利润（净亏损以"-"号填列）	6399372.81	87472500.12
五、每股收益：		
（一）基本每股收益		
（二）稀释每股收益		
六、其他综合收益		
七、综合收益总额	6399372.81	87472500.12

Source: Sinodata SAIC filings, 2013

REXLot Management claimed in its 2015 investor presentation that REXLot's Welfare CTG business generated revenue of HK$814 million, or RMB614 million. This is more than double the RMB302 million reported in Sinodata's SAIC filing.

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[24] By way of background, Chinese companies are required to file annual financial and business information with the State Administration for Industry and Commerce (SAIC). SAIC filings are public documents.
[25] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0429/LTN20150429917.pdf pg. 8

Based on our analysis, we believe the Sinodata SAIC filings are accurate and represent the true state of REXLot's Welfare CTG business. The supporting math is as follows:

The Welfare CTG market in 2013 was worth ~RMB129 billion[26]. As we previously stated, each lottery machine generates ticket sales of ~RMB1 million annually, which suggests there were 129,000 machines (RMB129 billion ÷ RMB1 million) operating in China in 2013.

REXLot further claims 50% market share in 2013, which means it was the operator/manufacturer of 64,500 machines that year (129,000 x 50%). Given the 50/50 split between provinces that have adopted the buyout model vs the commission model, 32,250 of these machines would be commission based, while the other half would have been sold through buyout contracts.

Total Commission model revenue (2013):

Number of machines in operation: *32,250*
Revenue per machine: *RMB1 million*
True cut rate: *0.58%*

$$32,250 \text{ x RMB1 million x } 0.58\% = \textbf{RMB187.1 million}$$

Note: we use the cut rate of 0.58% which is the average of posted cut rates we could find, namely those offered by Fujian province (0.52%), Guangdong province (0.58%), and Shanghai (0.65%)[27]. We have a hard time believing REXLot's stated cut rate of 0.94% is accurate given the evidence.

Total Buyout model revenue (2013):

Number of machines in operation: *32,250*
Purchase price per machine and associated maintenance fees (as per the Hunan tender): *RMB15,800*
Replacement cycle of machines: *5 years*

$$32,250 \text{ x RMB15,800 ÷ } 5 = \textbf{RMB101.9 million}$$

Based on our high-level math, we believe REXLot's Welfare CTG business should have generated approximately **RMB289 million** (RMB187.1million + RMB101.9 million) of revenue in 2013. This is consistent with the Sinodata SAIC filing showing revenue of RMB301.6 million in 2013.

Considering the public tender offers, the supporting Sinodata SAIC filing, and our market analysis, we are confident that REXLot has overstated its Welfare CTG business by 2x.

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[26] REXLot annual report 2013, pg. 6
[27] http://tech.hexun.com/2014-06-23/165955738.html

Cash Games

Given that it appears that REXLot is vastly overstating its revenue and profit figures, it is likely that the Company's reported cash balance is also fictitious. Since 2012, REXLot has kept a rolling cash balance of at least HK$800 million or more. Yet the interest income earned on this balance has been almost non-existent:

Exhibit 7
Interest Earned on Cash Balance
(In HK$ million)

	2012	**2013**	**2014**
Cash balance	896.9	1,146.3	1,293.0
Interest income	1.9	3.1	1.5
Interest rate	***0.21%***	***0.27%***	***0.12%***

Source: company annual reports

Between 2012 and 2014, the interest rate REXLot received on its cash balance has been ***0.27% or less, annually***. Meanwhile, a one-day call deposit in China offers at least an ***annualized rate of 0.8%.*** If REXLot indeed maintained a minimum cash balance of HK$800 million as reported in the financial statements, then the Company should have generated at minimum HK$6.4 million in interest income per year. REXLot's *de minimis* interest income suggests that the cash balance it reports publicly to investors is grossly inflated.

Dividend Payouts and Capital Raises

Part of REXLot's appeal – particularly to retail investors – is its dividend payout. Shares currently offer a dividend yield of 6.4%, and since 2012, the company has paid out HK$583 million to shareholders. On its own, these payouts provide a veneer of legitimacy to REXLot's reported financials. However, these dividends have not been funded through internally generated means. In fact, in the five years between 2010 – 2014, REXLot has been free cash flow negative to the tune of HK$1.9 billion:

Exhibit 8
Cash Flow Analysis
(HK$ millions)

	2010	2011	2012	2013	2014	Total
Operating cash flow	372	695	368	591	(898)	1,128
Capex - PPE	(135)	(129)	(53)	(34)	(66)	(417)
Acquisitions	(434)	(1,088)	(184)	(385)	(488)	(2,579)
Free cash flow	*(197)*	*(522)*	*130*	*172*	*(1,452)*	*(1,868)*

Source: company filings

Instead, the dividend payout has been funded through incessant and asinine capital raises:

Exhibit 9
Dividends Paid vs Capital Raises
(in HK$ millions)

	2011	2012	2013	2014	Total
Dividends paid	0	(143)	(149)	(291)	(583)
Issuance of convertible bonds	944	460	0	1,859	3,263
Net cash inflow	*944*	*317*	*(149)*	*1,568*	2,680

Source: company reports

Since 2011, REXLot has raised HK$3.3 billion through convertible bonds, which far eclipse the HK$583 million the Company has paid out to shareholders. The most egregious of these raises was in 2014, when the Company inexplicably raised HK$1.9 billion despite reporting over HK$1.1 billion cash on hand at year-end 2013.

Mystery Acquisitions

Aside from financing dividend payments, much of the cash raised seems to have gone towards a string of mysterious acquisitions. For example, from 2010 – 2014, REXLot spent HK$367 million acquiring:

- 2010: Winrest International Limited ("Winrest") for HK$176 million in cash[28]
- 2012: Berkeley Services Limited ("Berkeley") for HK$184 million in cash[29]
- 2014: 51% of Pointe Global Limited ("Pointe") for HK$7 million in cash with an option to acquire the remaining 49% for HK$100 million.[30]

Except for brief statements regarding their respective acquisitions, these companies were never heard from again in any follow-up discussions. How, or even if, these acquisitions contribute value to REXLot remains unclear.

For example, when Winrest was acquired in 2010, REXLot Management noted the *"fair value of the identifiable assets, liabilities and contingent liabilities of the acquired group of subsidiaries was considered as nil balance".*[31]

Moreover, Management noted that *"at the balance sheet date, [Winrest has] not yet commenced their lottery business and therefore they did not contribute any revenue nor profit to the Group".*[32]

It seems that HK$176 million of cold, hard cash buys… nothing.

The story is the same with the acquisition of Berkeley in 2012. REXLot paid HK$184 million in cash for a company that once again had no identifiable assets or business operations.[33]

The same happened again in 2014 when REXLot acquired a 51% interest in Pointe, which had no identifiable assets or business operations.[34] We fully expect that REXLot will exercise their option and acquire the other 49% of Pointe for HK$100 million. After all, it's hard to see these nebulous acquisitions of companies with no discernable assets or operations as anything more than a corrupt management team perpetuating a capex fraud to funnel a combination of fake profits and real money out of REXLot.

Without this report exposing Management's conduct, it seems like there would have been no end to these outrageous acquisitions. In the circular for the 2014 convertible bonds issue, Management states that 70% of the HK$1.9 billion raised will go towards *"the Group's business expansion through organic growth and potential joint venture and acquisition opportunities that may arise in the future."[35]*

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[28] http://www.hkexnews.hk/listedco/listconews/SEHK/2011/0429/LTN20110429369.pdf pg. 139, 140
[29] http://www.hkexnews.hk/listedco/listconews/SEHK/2013/0429/LTN20130429417.pdf pg. 171
[30] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0331/LTN201503311645.pdf pg. 188
[31] http://www.hkexnews.hk/listedco/listconews/SEHK/2011/0429/LTN20110429369.pdf pg. 139
[32] http://www.hkexnews.hk/listedco/listconews/SEHK/2011/0429/LTN20110429369.pdf pg. 140
[33] http://www.hkexnews.hk/listedco/listconews/SEHK/2013/0429/LTN20130429417.pdf pg. 171
[34] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0429/LTN20150429917.pdf pg. 188
[35] http://www.hkexnews.hk/listedco/listconews/SEHK/2014/0522/LTN20140522452.pdf pg. 28

In fact, we believe much of the proceeds from the 2014 convertible bonds issue have already left the Company. Shortly after the bonds were issued, the "prepayment" line item on the asset side of the balance sheet jumped from HK$947 million at year-end 2013 to HK$2.1 billion at year-end 2014.[36]

There is no coherent explanation of what this cash outflow is supposed to have paid for, but in the 2014 annual report, Management rationalizes this 124% jump in prepayments as:

1) 32% of the increase (HK$377 million) was due to the de-consolidation of Okooo.[37]
2) The remaining 68% increase (HK$801 million) was due to the *"ordinary course of business… made to expand the Group's existing off-line and on-line distribution platforms which is in line with the growing PRC lottery market."*[38]

Management's explanation for the remaining 68% increase in prepayments makes no sense. According to the Ministry of Finance, the Welfare CTG market (REXLot's main offline market) only grew by 10.9% in 2014.[39] Meanwhile, the online market has been crushed and in limbo due to regulatory issues.

It's hard to fathom what "growing PRC lottery market" REXLot is referring to in its statement. This leaves most of the HK$801 million that has already left the company unaccounted for. In all likelihood, Management will soon disclose that these prepayments went to the acquisition of yet more shell companies with no assets and no operations.

We don't imagine shareholders and bondholders will ever see much of this money again.

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[36] 2014 annual report
[37] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0429/LTN20150429917.pdf pg. 18
[38] http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0429/LTN20150429917.pdf pg. 18
[39] http://sports.sina.com.cn/l/2015-01-20/11517489963.shtml

REXLot's choice of auditor is a zero-tier Hong Kong CPA firm named Ting Ho Kwan & Chan ("THKC"). The use of such an obscure auditor is unusual for a listed company with a +US$600 million market cap. In fact, THKC is so small that it only has five clients listed on the Hong Kong Stock Exchange:

Exhibit 10
THKC Hong Kong Stock Exchange Clients

Company	Ticker	Market Cap (HK$ millions)	Auditing Fees 2014 (HK$)
REXLot Holdings Ltd	555.HK	4,831	3,277,000
REX Global Entertainment Holdings Ltd	164.HK	1,678	1,356,000
Cosmo Machinery Enterprises Ltd	118.HK	609	2,856,613
Creative Energy Solutions Holdings	8109.HK	429	398,000
Easy Repay Finance & Investment Ltd	8079.HK	227	400,000

Source: https://webb-site.com/dbpub/adviserships.asp?p=808108&hide=Y&sort=cagdn
https://webb-site.com/dbpub/adviserships.asp?p=6724 (David Webb runs an incredibly useful website), company filings

REXLot is by far THKC's largest HK-listed client. Interestingly, THKC's second biggest client is REX Global Entertainment, which is connected to REXLot through a substantial shareholder named Victor Chan How Chung.[40,41] Approximately 55% of THKC's 2014 auditing fees from HK-listed clients came from REXLot and REX Global Entertainment.

To be fair, there is nothing wrong with being a small firm. However, given the substantial revenue stream tied to REXLot, we question how much incentive THKC has to act seriously in its capacity as gatekeeper to the public and prevent fraud at REXLot.

For its part, it makes no sense for REXLot to choose THKC over a Big Four auditor or even a second-tier auditor. The additional fees would be miniscule compared to the valuation premium the market would assign REXLot if it switched to a brand name auditor.

REXLot's choice of auditor suggests that it has actively sought out a CPA without the experience or capabilities necessary to properly and thoroughly audit a large, listed corporation for improprieties.

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[40]

http://sdinotice.hkex.com.hk/di/NSAllSSList.aspx?sa2=as&sid=10089300&corpn=REXLot+Holdings+Ltd.&sd=28/05/2014&ed=12/05/2015&sa1=cl&scsd=28%2f05%2f2014&sced=28%2f05%2f2015&sc=555&src=MAIN&lang=EN&

[41]

http://sdinotice.hkex.com.hk/di/NSAllSSList.aspx?sa2=as&sid=22030107&corpn=REX+Global+Entertainment+Holdings+Ltd.&sd=29/11/2014&ed=23/12/2014&sa1=cl&scsd=28%2f05%2f2014&sced=28%2f05%2f2015&sc=164&src=MAIN&lang=EN&

In 2014, REXLot reported revenue of HK$2.6 billion including Okooo. As the evidence shows, we believe at least half of this revenue has been fabricated and the Company's true revenue is at most HK$1.3 billion.

Regarding income, Daiwa Securities states in their report that the net profit margin for Okooo is around 30%. Likewise, Sinodata's SAIC filing shows margins of 29% for the Welfare CTG business. Accordingly, we assign 30% net profit margins to our adjusted revenue to get 2014 net income of HK$395 million.

Finally, we note that most suspected frauds trade at low multiples of 3-4x due to overhanging concerns and issues of management integrity. We believe REXLot deserves a lower-end multiple given its heavy debt load, the fact that the offline business is not growing, and the fact that its online web operations have been shut down and are in jeopardy given the uncertain regulatory environment.

Exhibit 11
Valuation
(in HK$ millions)

Reported revenue	2,635
Actual revenue	1,318
Net profit margin	30%
Net profit	*395*
Applied P/E	3x
Implied market value	1,186
Current market value	4,831
Downside	**-75%**

Source: Our analysis

Accordingly, *we value shares of REXLot at HK$0.12, which implies 75% downside from their current price of HK$0.49.*

To conclude, our investigation and analysis shows that both of REXLot's businesses are a mere fraction of what the Company claims, demonstrating that REXLot has materially fabricated the scale of its business to the market, and thereby committed securities fraud.

Through our detailed analysis of publicly available information including REXLot's Hong Kong filings, third-party documentation, SAIC filings, and market research, we believe that there is substantial evidence that REXLot has been wildly overstating revenue and profits, and the cash balance that REXLot reports is likely also grossly exaggerated.

Given the evidence, we believe that shares of REXLot will be halted from trading and that it will be cut off from the capital markets. Without the ability to raise funds, we expect REXLot will struggle to maintain its dividends and likely collapse under the weight of its debt.

Opinion: *Strong Sell*