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YuuZoo: More troubling issues

Deals that went sour and insufficient information about franchise partners are some concerns for investors. **BY MAK YUEN TEEN**

IN my commentary, "YuuZoo Corporation – a governance nightmare" (BT, July 5), I focused on some key corporate governance concerns about YuuZoo Corporation since its listing on the SGX Mainboard in September 2014. This article discusses further issues relating to its disclosure and accounting.

Executive chairman Thomas Zilliacus described YuuZoo's investment in US-based Relativity Holdings as being "a tremendous fit where 1 plus 1 does truly equal 10". PHOTO: BLOOMBERG

INFOCOMM ASIA HOLDINGS (IAH)

YuuZoo's reverse takeover (RTO) circular mentioned the proposed purchase of Infocomm Asia Holdings (IAH), an online game provider, for US$36.6 million. On Feb 16, 2015, it announced a sale and purchase agreement to buy 100 per cent of IAH for 50 million shares at an issue price of S$1 each. The effective consideration was S$18 million at YuuZoo's last traded price of S$0.36.

After the proposed transaction, YuuZoo would have about 680 million issued shares. It said that "at S$1 per share, the enlarged Yuuzoo Group is valued at S$680 million". How does 680 million shares with a share price of 36 cents result in a company being valued at S$680 million?

The 2014 annual report shows that YuuZoo paid S$6.5 million to IAH to finance the purchase and sale of games on behalf of YuuZoo. On July 15, 2015, it announced legal action against IAH to collect S$6.46 million plus interest due. In December 2015, a settlement was announced whereby IAH was to pay the S$6.5 million debt plus interest by instalments. YuuZoo would now instead acquire 30 per cent of IAH for 15 million shares, valued at around S$2.9 million.

The YuuZoo shares received by IAH was to help pay back what it owes YuuZoo. IAH's last audited accounts reported a net loss of US$1.436 million and net tangible liabilities of around US$995,868. Without the investment by YuuZoo, IAH may have difficulty repaying the amount owing.

In fact, in its latest annual report, it has recognised total impairment losses of S$7.49 million on its IAH investment and receivables.

RELATIVITY HOLDINGS

On Oct 30, 2016, YuuZoo announced an investment of US$50 million to US$150 million in US-based Relativity Holdings LLC, subject to conditions precedent. The following day, YuuZoo executive chairman Thomas Zilliacus said that the transaction "has a tremendous fit where 1 plus 1 does truly equal 10". The press release also stated that "some market observers have compared the Relativity-YuuZoo deal to the recently announced acquisition of TimeWarner by AT&T". The latter deal was worth US$85 billion.

I searched the Internet for the astute market observer who had made that comparison. Instead, I found a Hollywood observer in the form of the *Hollywood Reporter*, which in an Oct 31 report titled "YuuZoo Who? Meet Relativity's Odd New Singapore Investor" described YuuZoo's press release as "bizarrely worded". It singled out Yuuzoo's statement about market observers comparing the deal with the TimeWarner-AT&T deal, and said, "Well, not quite". The only common element, it said, was the surprise element, describing the TimeWarner-AT&T deal as "epic" while "Relativity has been hanging by a thread since it emerged from bankruptcy in April".

YuuZoo's press release went further and said that "while the comparison between the two transactions is accurate, the YuuZoo-Relativity deal targets and reaches a much bigger global audience that includes the main focus of AT&T, i.e. USA and Latin America, but also Asia, Africa and Europe". Apparently, the comparison didn't quite do justice to the Yuuzoo-Relativity deal.

YuuZoo later announced that the initial investment would instead be US$15 million with an option to invest another US$135 million and that the investment was closed. However, on Feb 28, 2017, the transaction was cancelled due to conditions precedent not being met.

YuuZoo's latest annual report shows a payment of US$2.5 million to RM Bidder, a receiving party for the payment to Relativity Holdings LLC. No impairment allowance was recognised because management believe that the outstanding amount would be recoverable and based on advice "from an external legal firm of which one of the independent director of the Company is a partner of the law firm and also the internal legal counsel of YuuZoo Group".

Questions should be asked about why the deal was cancelled and the recoverability of the amount.

ETISALAT NIGERIA

On Nov 26, 2014, YuuZoo announced a "ground-breaking deal" with Etisalat to launch social e-commerce networks in Nigeria. There was no further announcement about any Etisalat deal until Jan 14, 2016, when YuuZoo announced a "rationalisation transaction agreement" with Mark Cramer-Roberts. It now said that a company called YuuZoo UK Social Solutions (YuuZoo UK) had signed an agreement with Etisalat's Nigerian arm for certain social e-commerce networks in Nigeria for one year starting from Aug 15, 2014.

YuuZoo UK was described as an affiliate of YZ Australia, which has an agreement with a YuuZoo subsidiary for certain UK franchise rights. The Etisalat agreement between YuuZoo UK and Etisalat Nigeria was in furtherance of those rights. YZ Australia is owned or controlled by Mr Cramer-Roberts. YuuZoo now proposed to acquire the Etisalat rights for US$1.96 million to be paid to Mr Cramer-Roberts through the issue of up to 20 million YuuZoo shares.

When YuuZoo announced the Etisalat deal in November 2014, there was no mention of YuuZoo UK. YuuZoo should clarify if they are the same deals, and if so, why there was no mention of YuuZoo UK in its 2014 announcement. If they are different deals, YuuZoo should explain why the two deals appear duplicative.

The UK Companies House website shows that Mr Cramer-Roberts owns or controls 75 per cent or more of YuuZoo UK Social Solutions and is one of its two officers. Based on its unaudited financial statements for financial year ended April 30, 2016, it has paid up capital of £1, net tangible liabilities of £179,571 and zero revenues.

Mr Cramer-Roberts happens to be one of the defendants named in the US lawsuit against YuuZoo, Mr Zilliacus and others mentioned in my previous commentary. Further, a report dated April 22, 2006, in the *Sydney Morning Herald* titled "The Cabinet: a recipe for disaster", said that Mr Cramer-Roberts and Ron Creevey had petitioned for bankruptcy in 2005 after Sydney investors lost A$20 million from the collapse of Sydney's biggest catering firm they co-founded.

Mr Creevey is the co-founder and a former substantial shareholder of Yuuzoo who resigned from all key positions in the YuuZoo group before the RTO.

In March 2017, it was widely reported in the Nigeria media that Etisalat Nigeria has a US$1.2 billion bond default and the parent was looking to sell it after debt restructuring. YuuZoo did not make any disclosure about the financial distress of this partner so it is unclear what impact this would have on YuuZoo's foray into Nigeria.

YuuZoo's latest annual report shows that YuuZoo issued shares to Mr Cramer-Roberts worth S$2.667 million, with the value of those shares recorded as an intangible asset. Amortisation expense of S$251,000 and an impairment loss of S$2.274 million was charged for the year. In other words, the intangible asset was deemed virtually worthless within a short time after the deal with Mr Cramer-Roberts.

MEDIA ROCK AND TELKONEX

A substantial source of revenue for YuuZoo is from sale of franchise licences. Many of its franchisees are in emerging markets where YuuZoo asserts that there is significant potential for growth of its business.

On April 21, 2016, YuuZoo announced a franchise agreement with Media Rock SA de CV, which it called a leading Mexican digital entertainment agency. There was little specific information about Media Rock. Instead, as with many of YuuZoo's announcements, it mentioned the population in the country and the total size of the market. YuuZoo said it would have access to Mexico's 120 million population and 34.4 million gamers. This seems a bit like a fisherman saying that his potential catch is all the fish in the ocean.

A search of the Internet found no website for Media Rock, which is surprising given that it is described as a leading digital entertainment agency. In fact, I couldn't find any information about Media Rock online.

On Jan 24, 2017, YuuZoo announced a franchise licence sale to Telkonex, "an emerging telco player in Congo". An Internet search found a private limited company with that name based in India. On its very basic website, there is no information about the nature of its business and the contact e-mail is a gmail address. I cannot be sure that they are the same company but one of its two directors, Jean Levy Taine, was quoted in YuuZoo's press release. A website providing business information as of Feb 7, 2017 states that according to India's Ministry of Corporate Affairs, Telkonex last held its AGM on Nov 30, 2009, and its balance sheet was last filed on Aug 31, 2009. It has a paid-up capital of 100,000 Indian rupees (S$2,135).

ACCOUNTING ISSUES

YuuZoo has three sources of revenue: e-commerce revenue, franchises revenue and celebrity branded networks revenue. I will focus on the first two sources.

E-commerce revenue is earned through its YuuCollect platform. The YuuCollect service is used to transfer funds from an end-user to the end-user's deposit account with the merchant. YuuZoo charges the merchant a transaction fee.

Paragraph 8 of Financial Reporting Standard 18 (FRS18) states that, in an agency relationship, the amounts collected on behalf of the principal are not revenue, but instead the revenue is the amount of the commission. However, YuuZoo recognises the entire amount of cash collected from the end-user as revenue because it said that its platform is unique, that it has created an ecosystem without which the transaction would not have been possible, and that it takes an element of credit risk for the fund transfer.

This is one of the two emphasis of matter items raised by the external auditor RT LLP, which did not modify its opinion but highlighted that "significant judgement is required in assessing whether revenue should be recognised on a gross basis, or a net basis, based on the requirements of FRS18 Revenue Recognition". Questions should be directed at the auditor as to whether and how they have challenged management judgement on this matter.

FRANCHISES REVENUE

In 2016, YuuZoo revised its accounting policy for recognising revenue "for the sales of e-commerce platforms deemed as franchise sales and the corresponding fair value of the available-for-sale investments received as consideration". Previously, such franchise revenue was based on fair value calculated using the income approach, which relied on projections of future number of users and profits. In 2016, this was changed to a cost approach, whereby fair value was estimated based on cost of developing the platforms. This change was applied retrospectively and is a key audit matter in the auditor's report.

On May 18, 2017, YuuZoo explained changes to its business model for franchise sales and revenue recognition from these sales. Prior to 2015, the company sold its franchise packages for cash. In 2015, it changed to selling its franchise packages in return for shares in the companies that operate the franchise. This new model was based on advice received from a "Big 4" accounting firm (which it named in its latest annual report as KPMG). It then used another "Big 4" accounting firm (which it has not named) and a "leading US expert" to value those shares, which it previously identified as Charfi Valuation Services LLC, "a recognised New York-based investment bank". The New York Department of State website shows that Charfi filed as a domestic limited liability company in New York on July 11, 2014. There is little information online about Charfi.

Under YuuZoo's 2015 revenue recognition policy for franchise sales, the shares issued by the franchisees valued by the unnamed "Big 4" accounting firm and Charfi were recognised on the balance sheet as asset available for sales (AFS). The change in accounting policy for franchise sales in 2015 contributed to "network development fees and franchise sales" on its income statement increasing from S$11 million (restated) in 2014 to S$55 million in 2015, and AFS increasing from zero to S$55 million.

YuuZoo provides very little information about its franchisees, whose ability to generate future profits that underlie the valuation of the shares is clearly critical. As we have seen earlier in the case of Media Rock and Telkonex, some of the franchisees named by YuuZoo have little track record, if any. Not surprisingly, Moore Stephens LLP, the auditor for 2015, issued a disclaimer of opinion with this issue cited as a key reason.

In 2016, as a result of the accounting policy change, YuuZoo restated its 2015 revenue downwards by S$35.5 million or 39 per cent of FY2015 revenue and its AFS by the same amount, which represents 65 per cent of the FY2015 balance. It remains to be seen if further adjustments would be necessary.

YuuZoo describes itself as "one of the world's fastest growing third generation social e-commerce networks". Keeping up with its corporate governance issues has proven to be quite a challenge.

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