

20-F 1 f20f2020_wimihologram.htm ANNUAL REPORT

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2020

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report _____

For the transition period from _____ to _____

Commission file number 001-39257

WiMi Hologram Cloud Inc.
(Exact name of Registrant as specified in its charter)

Not Applicable
(Translation of Registrant's name into English)

Cayman Islands
(Jurisdiction of incorporation or organization)

No. 6, Xiaozhuang, #101A, Chaoyang District, Beijing
The People's Republic of China, 100020
(Address of principal executive offices)

Shuo Shi, Chief Executive and Operations Officer
sean@wimiar.com

No. 6, Xiaozhuang, #101A, Chaoyang District, Beijing
The People's Republic of China, 100020
Tel: +86-10-5338-4913

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol(s)	Name of each exchange on which registered
American depositary shares, each ADS represents two Class B ordinary shares, par value US\$0.0001 per share Class B ordinary shares, par value US\$0.0001 per share*	WIMI	NASDAQ Global Market

* Not for trading, but only in connection with the listing on the Nasdaq Global Market of American depositary shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: As of December 31, 2020, there were (i) 20,115,570 Class A ordinary shares issued and outstanding, par value US\$0.0001 per share, and (ii) 130,953,843 Class B ordinary shares issued and outstanding, par value US\$0.0001 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Emerging growth company	<input checked="" type="checkbox"/>

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 13(a) of the Exchange Act.

† The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. Yes No

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP <input checked="" type="checkbox"/>	International Financial Reporting Standards as issued by the International Accounting Standards Board <input type="checkbox"/>	Other <input type="checkbox"/>
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If "Other" has been checked in response to the previous question, indicate by check mark which financial statement Item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

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FORWARD-LOOKING STATEMENTS

This annual report on Form 20-F contains forward-looking statements that involve risks and uncertainties. All statements other than statements of historical facts are forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements.

You can identify these forward-looking statements by words or phrases such as “may,” “will,” “expect,” “anticipate,” “aim,” “estimate,” “intend,” “plan,” “believe,” “likely to” or other similar expressions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategies and financial needs. These forward-looking statements include, but are not limited to, statements about:

- our growth strategies;
- our future business development, financial condition and results of operations;
- our ability to retain, grow and engage our user base and expand our product offering;
- expected changes in our revenues, content-related costs and operating margins;
- our ability to retain key personnel and attract new talent;
- competition landscape in China’s holographic AR industry;
- general economic, political, demographic and business conditions in China and globally; and
- the regulatory environment in which we operate.

We would like to caution you not to place undue reliance on these forward-looking statements and you should read these statements in conjunction with the risk factors disclosed in “Item 3. Key Information—3.D. Risk Factors.” Other sections of this annual report include additional factors which could adversely impact our business and financial performance. Moreover, we operate in an evolving environment. New risk factors and uncertainties emerge from time to time and it is not possible for our management to predict all risk factors and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We qualify all of our forward-looking statements by these cautionary statements. We do not undertake any obligation to update or revise the forward-looking statements except as required under applicable law. You should read this annual report and the documents that we reference in this annual report completely and with the understanding that our actual future results may be materially different from what we expect.

You should not rely upon forward-looking statements as predictions of future events. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

INTRODUCTORY NOTE

Except where the context otherwise indicates and for the purpose of this annual report only:

- “ADSs” refer to the American depositary shares, each representing two Class B ordinary shares;
- “AR” refers to augmented reality, a technology that enhances the real world through the use of sensory information (visual, audio, or otherwise), which is added to the actual view of the real world;
- “China” or “PRC” refers to the People’s Republic of China, excluding, for the purpose of this annual report only, Taiwan, Hong Kong and Macau;
- “CPM” refers to cost per thousand impressions, a term used in traditional online advertising and marketing related to web traffic that measures the cost or expense incurred for every thousand potential customers who view the advertisement;
- “GAAP” refers to the generally accepted accounting principles in the United States;
- “HK\$”, “HKD” or “Hong Kong dollars” refer to the legal currency of the Hong Kong SAR;
- “ordinary shares” refer to ordinary shares consisted of our Class A ordinary shares, par value US\$0.0001 per share, and Class B ordinary shares, par value US\$0.0001 per share;
- “RMB” or “Renminbi” refers to the legal currency of the People’s Republic of China;
- “US\$”, “dollars”, “USD” or “U.S. dollars” refer to the legal currency of the United States;
- “View” refers to the number of time an advertisement is fetched (each time an advertisement is fetched, it is counted as one impression or one view or one impression); and
- “WIMI”, “WiMi Cayman”, “we”, “us”, “our company”, “the company”, “our”, or similar terms used in this annual report refer to WiMi Hologram Cloud Inc., a Cayman Islands exempted company, including its wholly-owned and majority-owned subsidiaries and, in the context of describing our operations and consolidated financial information, its VIEs and their subsidiaries.

Our reporting currency is the Renminbi. This annual report on Form 20-F also contains translations of certain foreign currency amounts into U.S. dollars for the convenience of the reader. Unless otherwise stated, all translations from Renminbi to U.S. dollars were made at RMB6.5249 to US\$1.00, representing the mid-point reference rate set by Peoples’ Bank of China on December 31, 2020. We make no representation that the Renminbi or U.S. dollar amounts referred to in this annual report could have been or could be converted into U.S. dollars or Renminbi, as the case may be, at any particular rate or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA.

The following selected consolidated statement of operations and comprehensive income (loss) data for the years ended December 31, 2018, 2019 and 2020, selected consolidated balance sheet data as of December 31, 2019 and 2020, and selected consolidated cash flow data for the years ended December 31, 2018, 2019 and 2020 have been derived from our audited consolidated financial statements included elsewhere in this annual report. The following selected consolidated balance sheet data as of December 31, 2018 has been derived from our audited consolidated financial statements not included in this annual report.

The selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and “Item 5. Operating and Financial Review and Prospects” included elsewhere in this annual report. The consolidated financial statements are prepared and presented in accordance with U.S. GAAP. Our historical results are not necessarily indicative of our results for any future periods.

The following table presents our selected consolidated statements of operations and comprehensive income (loss) for the years indicated.

Selected Consolidated Statements of Operations and Comprehensive Income (Loss):	For the Years Ended December 31,			
	2018	2019	2020	2020
	RMB	RMB	RMB	USD
Operating revenues	225,271,564	319,181,424	766,013,586	117,398,517
Cost of revenues	(85,414,061)	(146,167,843)	(596,578,700)	(91,431,087)
Gross profit	139,857,503	173,013,581	169,434,886	25,967,430
Operating expenses	(39,054,908)	(60,162,041)	(322,851,417)	(49,479,904)
Income (loss) from operations	100,802,595	112,851,540	(153,416,531)	(23,512,474)
Other (expenses) income, net	(3,509,207)	(7,517,988)	11,363,289	1,741,527
Provision for income taxes	(8,075,596)	(3,129,080)	(2,904,681)	(445,169)
Net income (loss)	89,217,792	102,204,472	(144,957,923)	(21,770,947)
Less: Net income attributable to non-controlling interests	-	-	6,209,945	951,730
Net income (loss) attributable to WiMi Hologram Cloud, Inc.	89,217,792	102,204,472	(151,167,868)	(23,167,846)
Other comprehensive income (loss)	1,759,288	1,589,076	(38,876,201)	(5,958,130)
Less: Comprehensive income attributable to non-controlling interests	-	-	5,865,631	898,961
Comprehensive income (loss) attributable to WiMi Hologram Cloud, Inc.	90,977,080	103,793,548	(189,699,755)	(29,073,207)
WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES				
Basic	100,000,000	100,000,000	129,439,604	129,439,604
Diluted	100,922,621	108,611,133	129,439,604	129,439,604
EARNINGS PER SHARE				
Basic	0.89	1.02	(1.17)	(0.18)
Diluted	0.88	0.94	(1.17)	(0.18)

Non-GAAP Financial Data:⁽¹⁾

Non-GAAP net income attributable to WiMi Hologram Cloud, Inc.	89,217,792	102,204,472	40,250,590	6,168,766
NON-GAAP WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES				
Basic	100,000,000	100,000,000	129,439,604	129,439,604
Diluted ⁽²⁾	100,922,621	108,611,133	129,453,166	129,453,166
NON-GAAP EARNINGS PER SHARE				
Basic	0.89	1.02	0.31	0.05
Diluted	0.88	0.94	0.31	0.05

(1) See "Non-GAAP Financial Measures".

(2) The dilutive effect was due to 45,000 shares of unvested stock based compensation.

The following table presents our selected consolidated balance sheets as of December 31, 2018, 2019 and 2020.

Selected Consolidated Balance Sheet Data:	As of December 31,			
	2018	2019	2020	2020
	RMB	RMB	RMB	USD
Current assets	213,295,430	177,511,440	616,425,842	94,472,841
Other assets	394,187,996	385,987,073	555,995,843	85,211,396
Total assets	607,483,426	563,498,513	1,172,421,685	179,684,237
Total liabilities	288,561,957	140,783,496	163,369,762	25,037,894
Total WiMi Hologram Cloud, Inc. shareholders' equity	318,921,469	422,715,017	997,246,189	152,837,007
Non-controlling interests	-	-	11,805,734	1,809,336
Total shareholders' equity	318,921,469	422,715,017	1,009,051,923	154,646,343

The following table presents our selected consolidated cash flow data for the years indicated.

Selected Consolidated Cash Flow Data:	For the Years Ended December 31			
	2018	2019	2020	2020
	RMB	RMB	RMB	USD
Net cash provided by (used in) operating activities	99,452,205	143,955,544	(66,960,681)	(10,262,333)
Net cash used in investing activities	(98,597,356)	(126,479,892)	(228,129,543)	(34,962,918)
Net cash provided by (used in) financing activities	137,493,993	(40,974,000)	562,639,786	86,229,642
Effect of exchange rate on cash, cash equivalents and restricted cash	937,466	599,384	(28,489,442)	(4,366,263)
Net change in cash, cash equivalents and restricted cash	139,286,308	(22,898,964)	239,060,120	36,638,128
Cash, cash equivalents and restricted cash, beginning of year	12,661,634	151,947,942	129,048,978	19,777,924
Cash, cash equivalents and restricted cash, end of year	151,947,942	129,048,978	368,109,098	56,416,052

Non-GAAP Financial Measures

In evaluating our business, we consider and use the following non-GAAP financial measures as supplemental measures to review and assess our operating performance of non-GAAP net income (loss). The presentation of these non-GAAP financial measures is not intended to be considered in isolation or as a substitute for the financial information prepared in accordance with U.S. GAAP.

We define non-GAAP net income (loss) attributable to us as net income (loss) before stock compensation expenses.

Although stock compensation is an important aspect of the compensation of our employees, we exclude stock compensation expenses from non-GAAP net income (loss) attributable to us primarily because they are non-cash expenses and are partially discretionary in nature, which is not necessarily indicative of our ongoing business performance. We believe that it is useful to exclude stock compensation expenses for investors to better understand the long-term underlying performance of our core operations and to facilitate comparison of our results to our prior periods and to our peer companies.

We present these non-GAAP financial measures because they are used by our management to evaluate our operating performance and formulate our business plans. These non-GAAP financial measures enable our management to assess our operating results without considering the impact of non-cash charges of stock compensation expenses.

These non-GAAP financial measures are not defined under U.S. GAAP and are not presented in accordance with U.S. GAAP. These non-GAAP financial measures have limitations as analytical tools. One of the key limitations of using these non-GAAP financial measures is that they do not reflect all items of income and expense that affect our operations. Stock compensation expenses have been and may continue to be incurred in our business and are not reflected in the presentation of non-GAAP net income (loss). Further, these non-GAAP financial measures may differ from the non-GAAP financial measures used by other companies, including our peer companies, so their utility for comparison purposes may be limited.

We compensate for these limitations by reconciling our non-GAAP financial measures to the most directly comparable U.S. GAAP financial measures, which should be considered when evaluating our performance. We encourage you to review our financial information in its entirety and not rely on a single financial measure.

The following tables reconcile our non-GAAP net income attributable to us to the most directly comparable financial measures calculated in accordance with U.S. GAAP, which are net loss (income) attributable to our ordinary shareholders.

Reconciliation of Net Income (Loss) Attributable to WiMi Hologram Cloud, Inc. to Non-GAAP Net Income Attributable to WiMi Hologram Cloud, Inc.:	For the Years Ended December 31,			
	2018	2019	2020	2020
	RMB	RMB	RMB	USD
Net income (loss) attributable to WiMi Hologram Cloud, Inc.	89,217,792	102,204,472	(151,167,868)	(23,167,846)
Stock compensation expenses	-	-	191,418,458	29,336,612
Non-GAAP net income attributable to WiMi Hologram Cloud, Inc.	89,217,792	102,204,472	40,250,590	6,168,766
WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES				
Basic	100,000,000	100,000,000	129,439,604	129,439,604
Diluted	100,922,621	108,611,133	129,439,604	129,439,604
EARNINGS PER SHARE				
Basic	0.89	1.02	(1.17)	(0.18)
Diluted	0.88	0.94	(1.17)	(0.18)
NON-GAAP WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES				
Basic	100,000,000	100,000,000	129,439,604	129,439,604
Diluted ⁽¹⁾	100,922,621	108,611,133	129,453,166	129,453,166
NON-GAAP EARNINGS PER SHARE				
Basic	0.89	1.02	0.31	0.05
Diluted	0.88	0.94	0.31	0.05

(1) The dilutive effect was due to 45,000 shares of unvested stock based compensation.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS**Risks Relating to Our Business and Industry***We operate in a relatively new and rapidly evolving market.*

We offer AR-based holographic services and products to cater to our customers' needs, focusing on providing an innovative, immersive and interactive holographic AR experience for our customers and end users. We also engage in the provision of central processing algorithm services and computer chip products to enterprise customers and the sales of comprehensive solutions for central processing algorithms and related services with software and hardware integration. Our holographic AR business primarily depends on the continuing development and growth of the holographic AR industry in China. Growth of the holographic AR industry in China is affected by numerous factors, including but not limited to, technological innovations, user experience, development of internet and internet-based services, regulatory environment, and macroeconomic environment. The markets for our products and services are relatively new and rapidly developing and are subject to significant challenges. In addition, our continued growth depends, in part, on our ability to respond to changes in the holographic AR industry, including rapid technological evolution, continued shifts in customer demands, introductions of new products and services and emergence of new industry standards and practices. Developing and integrating new content, products, services or infrastructure could be expensive and time-consuming, and these efforts may not yield the benefits we expect to achieve.

In addition, as the holographic AR industry in China is relatively young, there are few proven methods of projecting customer demand or available industry standards on which we can rely. Some of our current monetization methods are also in a relatively preliminary stage. We cannot assure you that our attempts to monetize our current offerings will continue to be successful, profitable or accepted, and therefore the profit potential of our business is difficult to gauge. Our growth prospects should be considered in light of the risks and uncertainties that fast-growing early-stage companies with limited operating history in an evolving industry may encounter, including, among others, risks and uncertainties regarding our ability to:

- continue to develop new software and related solutions that are appealing to end users;
- enrich our holographic AR content portfolio;
- maintain stable relationships with other key participants in the holographic AR value chain;
- expand our products and services into more use cases; and
- expand into new geographic markets with high growth potential.

We believe that the application demand for holographic 3D vision in the semiconductor industry is growing rapidly and represents promising market potentials. We began to develop our semiconductor business and explore the relevant applications of holographic 3D vision in the semiconductor industry and the provision of computer chip products and the sales of comprehensive solutions for central processing algorithms to enterprise customers in July 2020. If the demand for our services and products is not sustained, does not increase, if companies in the semiconductor industry expand too aggressively in light of the increase in demand, or if we cannot take appropriate or effective actions in a timely manner during any industry-wide downturns, such as reducing our costs to sufficiently offset declines in demand for our services, our results of operations for our semiconductor business may be adversely affected.

Addressing these risks and uncertainties will require significant capital expenditures and allocation of valuable management and employee resources. We cannot assure you that we will succeed in any of these aspects or that the holographic AR industry in China will continue to grow at a rapid pace. If we fail to successfully address any of the above risks and uncertainties, the size of our user base, our revenue and profits may decline.

Our competitive position and results of operations could be harmed if we do not compete effectively.

The markets for our products and services are characterized by intense competition, new industry standards, limited barriers to entry, disruptive technology developments, short product life cycles, customer price sensitivity and frequent product introductions (including alternatives with limited functionality available at lower costs or free of charge). Any of these factors could create downward pressure on pricing and profitability and could adversely affect our ability to attract new customers. Our future success will depend on our continued ability to enhance our existing products and services, introduce new products and services in a timely and cost-effective manner, meet changing customer expectations and needs, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Furthermore, we are a small-size company as compared to some of the well-established enterprises that could potentially enter the holographic AR market and semiconductor industry. Some of our current and potential competitors enjoy competitive advantages such as greater financial, technical, sales, marketing and other resources, broader brand awareness, and access to larger customer bases. As a result of these advantages, potential and current customers might select the products and services of our competitors, causing a loss of our market share.

We are a relatively young company, and we may not be able to sustain our rapid growth, effectively manage our growth or implement our business strategies.

We have a limited operating history. Our holographic AR business was launched in 2015 and our semiconductor business was launched in July 2020. Although we have experienced significant growth since our business was launched, our historical growth rate may not be indicative of our future performance. We may not be able to achieve similar results or grow at the same rate as we had in the past. As our business and the holographic AR market and the semiconductor industry in China continue to develop, we may need to adjust our product and service offerings or modify our business model. These adjustments may not achieve expected results and may have a material and adverse impact on our financial conditions and results of operations.

In addition, our rapid growth and expansion have placed, and continue to place, a significant strain on our management and resources. This level of significant growth may not be sustainable or achievable at all in the future. We believe that our continued growth will depend on many factors, including our ability to develop new sources of revenues, diversify monetization methods, attract and retain customers, continue developing innovative hologram-related technologies, increase brand awareness, expand into new market segments, and adjust to the rapidly changing regulatory environment in China. We cannot assure you that we will achieve any of the above, and our failure to do so may materially and adversely affect our business and results of operations.

If we fail to keep up with industry trends or technological developments, our business, results of operations and financial condition may be materially and adversely affected.

The holographic AR industry and semiconductor industry are rapidly evolving and subject to continuous technological changes. Our success depends on our ability to continue to develop and implement services and solutions that anticipate and respond to rapid and continuing changes in technology and industry developments and offerings to serve the evolving needs of our customers. Our growth strategy is focused on responding to these types of developments by driving innovation that will enable us to expand our business into new growth areas. If we do not sufficiently invest in new technology and industry developments, or evolve and expand our business at sufficient speed and scale, or if we do not make the right strategic investments to respond to these developments and successfully drive innovation, our services and solutions, our results of operations, and our ability to develop and maintain a competitive advantage and continue to grow could be negatively affected. In addition, we operate in a quickly evolving environment, in which there currently are, and we expect will continue to be, new technology entrants. New services or technologies offered by competitors or new entrants may make our offerings less differentiated or less competitive, when compared to other alternatives, which may adversely affect our results of operations. Technological innovations may also require substantial capital expenditures in product development as well as in modification of products, services or infrastructure. We cannot assure you that we can obtain financing to cover such expenditure. Failure to adapt our products and services to such changes in an effective and timely manner could materially and adversely affect our business, financial condition and results of operations.

We incurred net loss and had net cash outflow from operating activities in 2020, and we may not be able to maintain profitability in the future.

We incurred net loss in 2020. We had net income from continuing operations of RMB89.2 million and RMB102.2 million in 2018 and 2019, respectively, and had net loss from continuing operations of RMB145.0 million (US\$21.8 million) in 2020. In addition, we had negative cash flows from operating activities in 2020. We generated positive cash flows from operating activities in the amount of RMB99.4 million and RMB144.0 million in 2018 and 2019, respectively. However, we had negative cash flows of RMB67.0 million in 2020. We have made significant investments in research and development, business acquisitions, and employee stock compensation expenses to develop and expand our business. We expect to continue to invest significantly in research and development to further develop and expand our business, and these investments may not result in an increase in revenue or positive cash flow from operating activities on a timely basis, or at all.

We may not maintain profitability, or we may incur substantial losses for a number of reasons, including the lack of demand for our products and services, increasing competition, challenging macro-economic environment due to the COVID-19 pandemic, and we may incur unforeseen expenses, or encounter difficulties, complications and delays in generating revenue or achieving profitability. If we are unable to achieve profitability, we may have to reduce the scale of our operations, which may impact our business growth and adversely affect our financial condition and results of operations. In addition, our continuous operation depends on our capability to improve operating cash flows as well as our capacity to obtain sufficient external equity or debt financing. If we do not succeed in doing so, we may have to limit the scale of our operations, which may limit our business growth and adversely affect our financial condition and results of operations.

If we cannot continue to develop, acquire, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.

The process of developing and acquiring new technology products and services and enhancing existing offerings is complex, costly and uncertain. If we fail to anticipate customers' rapidly changing needs and expectations, our market share and results of operations could suffer. We must make long-term investments, develop, acquire or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we misjudge customer needs in the future, our new products and services may not succeed and our revenues and earnings may be harmed. Additionally, any delay in the development, acquisition, marketing or launch of a new offering or enhancement to an existing offering could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenue or earnings.

We make significant investments in new products and services that may not achieve expected returns.

We have made and will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including holographic AR advertising solutions, mobile payment middleware, integrated holographic AR software, other AR-based holographic offerings, holographic 3D vision-related semiconductor application solutions, and central processing algorithms and related services, as well as new technology or new applications of existing technology. Investments in new technology are speculative. Commercial success depends on many factors, including but not limited to, innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of our services or products, unfavorably affecting our revenue and profits. We may not achieve significant revenue from new product, service or distribution channel investments, or new applications of existing new product, service or distribution channel investments, for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses may not be as high as the margins we have experienced historically. Furthermore, developing new technologies is complex and can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or offering new services could adversely affect our revenue and profits.

We cannot guarantee our monetization strategies will be successfully implemented or generate sustainable revenues and profit.

Our monetization model is evolving. We generate our revenues from holographic AR advertising services, payment middleware licensing, semiconductor products and related accessories, and central processing algorithms and related services with software and hardware integration, including customized central processing units, or CPUs, based on customers' specific demands. We plan to further increase revenue contribution from our other hologram-related monetization methods and semiconductor product offerings. If our strategic initiatives do not enhance our monetization ability or enable us to develop new approaches to monetization, we may not be able to maintain or increase our revenues or profits or recover any associated costs. In addition, we may in the future introduce new services to further diversify our revenue streams, including services with which we have little or no prior development or operating experience. If these new or enhanced services fail to engage customers, we may fail to attract or retain users or to generate sufficient revenues or profits to justify our investments, and our business and operating results may suffer as a result.

Our results of operations could materially suffer if we are not able to obtain sufficient pricing to enable us to meet our profitability expectations.

If we are not able to obtain sufficient pricing for our services and solutions, our revenues and profitability could materially suffer. The rates we are able to charge for our services and solutions are affected by a number of factors, including:

- general economic and political conditions;
- the competitive environment in our industry;
- our customers' desire to reduce their costs; and
- our ability to accurately estimate, attain and sustain contract revenues, margins and cash flows over the full contract period.

In addition, our profitability with respect to our services and solutions for new technologies may be different when compared to the profitability of our current business, due to factors such as the use of alternative pricing, the mix of work and the number of service providers, among others.

The competitive environment in our industry affects our ability to obtain favorable pricing in a number of ways, any of which could have a material negative impact on our results of operations. The less we are able to differentiate our services and solutions and/or clearly convey the value of our services and solutions, the more risk we have that they will be seen as commodities, with price being the driving factor in selecting a service provider. In addition, the introduction of new services or products by competitors could reduce our ability to obtain favorable pricing for the services or products we offer. Competitors may be willing, at times, to price contracts lower than us in an effort to enter new markets or increase market share. Further, if competitors develop and implement methodologies that yield greater efficiency and productivity, they may be better positioned to offer services similar to ours at lower prices.

We require a significant amount of capital to fund our research and development investments. If we cannot obtain sufficient capital on favorable terms or at all, our business, financial condition and prospects may be materially and adversely affected.

Operating our holographic AR business and semiconductor business requires significant, continuous investment in acquiring, maintaining and upgrading contents and technologies. Historically, we have financed our operations primarily with net cash generated from operating activities, financial support from our shareholders and equity financings and loans from third parties. As part of our growth strategy, we plan to continue to invest substantial capital in our research and development activities in the future, which may require us to obtain additional equity or debt financing. Our ability to obtain additional financing in the future is subject to a number of uncertainties, including but not limited to those relating to:

- our future business development, financial condition and results of operations;
- general market conditions for financing activities; and
- macro-economic and other conditions in China and elsewhere.

Although we expect to rely increasingly on net cash provided by operating activities and financing through capital markets for our liquidity needs as our business continues to grow and after we become a public company, we cannot assure you that we will be successful in our efforts to diversify our sources of liquidity. If we raise additional funds through future issuances of equity or convertible debt securities, our existing shareholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our ordinary shares. Any debt financing that we secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, including the ability to pay dividends. This may make it more difficult for us to obtain additional capital to fund our research and pursue business opportunities, including potential acquisitions. If we cannot obtain sufficient capital to meet our capital needs, we may not be able to implement our growth strategies, and our business, financial condition and prospects may be materially and adversely affected.

If we fail to attract, retain and engage appropriately skilled personnel, including senior management and technology professionals, our business may be harmed.

Our future success depends on our retention of highly skilled executives and employees. Competition for well-qualified and skilled employees is intense, and our future success also depends on our continuing ability to attract, develop, motivate and retain highly qualified and skilled employees, including, in particular, software engineers, artificial intelligence scientists and AR technology professionals. Our continued ability to compete effectively depends on our ability to attract new employees and to retain and motivate existing employees. All of our senior management and key personnel are employees at will and, as a result, any of these employees could leave with little or no prior notice. If any member of our senior management team or other key employees leave our company, our ability to successfully operate our business and execute our business strategy could be adversely affected. In particular, such individuals are free to compete with us in the event that they leave. Furthermore, under PRC law, certain of our employees may have ownership rights to our intellectual property, which rights would continue in the event they left our company. We may also have to incur significant costs in identifying, hiring, training and retaining replacements of departing employees.

If existing or new customers are less willing to cooperate with us, our revenues and profits may be adversely affected.

We offer holographic AR advertising solutions primarily through contracts entered into with advertisers or third-party advertising agencies and middleware services primarily through contracts entered into with app developers and content providers. We offer semiconductor products and accessories, and design software for central processing units, and offer comprehensive solutions for central processing algorithms and related services with software and hardware integration to manufacturers of electronic products and internet information infrastructure service providers. We promote our products and services directly through our experienced and creative sales and marketing team by making direct office visits, attending conferences and industry exhibitions, and through word-of-mouth referral. Our ability to retain existing customers or attract new customers depends on many factors, some of which are out of our control, including:

- Our ability to innovate and rapidly respond to customer needs;
- The competitiveness of our pricing and payment terms for our customers, which may, in turn, be constrained by our capital and financial resources;
- Sufficient capital support;
- Our ability to acquire complementary technologies, products and businesses to enhance the features and functionality of our applications; and
- Brand awareness and reputation.

We cannot assure you that we will be able to continue retain these customers or attract new customers. If we fail to retain and enhance our business relationships with new and existing customers, our business and results of operations may be materially and adversely affected.

If we fail to successfully compete with other advertising platforms, media companies, AR or traditional advertisement producers, our revenues and profits may be adversely affected.

Revenue generated from our advertising business is affected by the online advertising industry in China and advertisers' allocation of budgets to Internet advertising and promotion in general, and specifically with respect to online holographic AR advertising. Companies that decide to advertise or promote online may utilize more established methods or channels for online advertising and promotion, such as key words advertising on established Chinese search engines, over in-video holographic AR advertising. In addition, we compete with media companies, AR or traditional advertisement producers. If the holographic AR advertising market size does not increase from current levels, if we are unable to capture and retain a sufficient share of that market, or if we are unable to compete effectively with our competitors, our ability to maintain or increase our current level of advertisement revenue and our profitability and prospects could be adversely affected.

Our products and software are highly technical and may contain undetected software bugs or vulnerabilities, which could manifest in ways that could seriously harm our reputation and our business.

Our products and software are highly technical and complex. Our software or any of our products may contain undetected software bugs, hardware errors, and other vulnerabilities. These bugs and errors can manifest in any number of ways in our products, including through diminished performance, security vulnerabilities, malfunctions, or even permanently disabled products. We have a practice of regularly updating our products and some errors in our products may be discovered only after a product has been used by users, and may in some cases be detected only under certain circumstances or after extended use. Any errors, bugs or other vulnerabilities discovered in our code or backend after release could damage our reputation, drive away users, allow third parties to manipulate or exploit our software, lower revenue and expose us to claims for damages, any of which could seriously harm our business.

Our business could be materially harmed by the ongoing coronavirus (COVID-19) pandemic.

The outbreak of novel coronavirus (COVID-19) starting from late January 2020 has spread rapidly to many parts of the world. In March 2020, the World Health Organization declared the COVID-19 as a pandemic. The pandemic has resulted in quarantines, travel restrictions, and the temporary closure of stores and business facilities in China for the first half of 2020. Given the rapidly expanding nature of the COVID-19 pandemic, and because substantially all of our business operations and our workforce are concentrated in China, we believe there is a substantial risk that our business, results of operations, and financial condition may be materially and adversely affected. Potential impact to our results of operations will also depend on future developments and new information that may emerge regarding the duration and severity of the COVID-19 and the actions taken by government authorities and other entities to contain the COVID-19 or mitigate its impact, almost all of which are beyond our control.

The impacts of COVID-19 on our business, financial condition, and results of operations include, but are not limited to, the following:

- We temporarily closed our offices and implemented work from home policy in February 2020, as required by relevant PRC regulatory authorities. Since March 16, 2020, our offices have reopened and have been fully operational.
- Our customers were negatively impacted by the outbreak and reduced their budgets for online advertising and marketing in 2020. As a result, our gross profit and net income for 2020 were negatively impacted. However, to date, none of our customers have terminated contracts with us.
- Certain of our customers were negatively impacted by the outbreak and reduced their budgets for MR software development in 2020. As a result, we reduced our future cash flow forecast and recorded an impairment in the amount of approximately RMB7.3 million (US\$1.1 million).
- The situation may worsen if the COVID-19 outbreak continues, and our customers may request additional time to pay us or fail to pay us on time, or at all, which may require us to record additional allowances. We have not experienced significant collection issues in 2020. We will continue to closely monitor our collections throughout 2021.
- The global stock markets have experienced, and may continue to experience, significant decline from the COVID-19 outbreak. It is possible that the price of our ADSs will decline significantly, in which case you may lose your investment.

While many of the restrictions on movement within China have been relaxed as of the date of this annual report, there is great uncertainty as to the future progress of the pandemic. Relaxation of restrictions on economic and social life may lead to new cases, which may lead to re-imposition of restrictions. Consequently, the continuance of COVID-19 pandemic may materially and adversely affect our business, financial condition and results of operations in the future. The extent to which this pandemic impacts our results of operations will depend on future developments, which are highly uncertain and unpredictable, including new outbreaks of COVID-19, the severity of the virus infection, the success or failure of efforts to contain or treat the cases, such as the availability of effective vaccines or cure, among others, and future actions we or the authorities may take in response to these developments.

Our failure to protect our intellectual property rights may undermine our competitive position.

We believe that our patents, copyrights, trademarks and other intellectual property are essential to our success. Please see Item 4.B. “Business Overview—Intellectual Property” for more details. We depend to a large extent on our ability to develop and maintain the intellectual property rights relating to AR technology, our hologram contents, and semiconductor products and software designs. We have devoted considerable time and energy to the development and improvement of our software, middleware, websites, and our IPs.

We rely primarily on a combination of patents, copyrights, trademarks and trade secrets laws, and contractual restrictions for the protection of the intellectual property used in our business. Nevertheless, these provide only limited protection and the actions we take to protect our intellectual property rights may not be adequate. Our trade secrets may become known or be independently discovered by our competitors. We may have no or limited rights to stop others’ use of our information. Moreover, to the extent that our employees or third parties with whom we do business use intellectual property owned by others in their work for us, disputes may arise as to the rights to such intellectual property. Furthermore, it is often difficult to maintain and enforce intellectual property rights in China. Statutory laws and regulations are subject to judicial interpretation and enforcement, and may not be applied consistently due to the lack of clear guidance on statutory interpretation. Contractual restrictions may be breached by counterparties, and there may not be adequate remedies available to us for any such breach. Accordingly, we may not be able to effectively protect our intellectual property rights or to enforce our contractual rights in China. Preventing any unauthorized use of our intellectual property is difficult and costly and the steps we take may be inadequate to prevent the misappropriation of our intellectual property. In the event that we resort to litigation to enforce our intellectual property rights, such litigation could result in substantial costs and a diversion of our managerial and financial resources. We can provide no assurance that we will prevail in such litigation. Any failure in protecting or enforcing our intellectual property rights could have a material adverse effect on our business, financial condition and results of operations.

We may not be able to protect our source code from copying if there is an unauthorized disclosure.

Source code, the detailed program commands for our middleware and software programs, is critical to our business. Although we license portions of our application and operating system source code to several licensees, we take significant measures to protect the secrecy of large portions of our source code. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins.

As our patents may expire and may not be extended, our patent rights may be contested, circumvented, invalidated or limited in scope, our patent rights may not protect us effectively. In particular, we may not be able to prevent others from developing or exploiting competing technologies, which could have a material and adverse effect on our business operations, financial condition and results of operations.

In China, the validity period of utility model patent rights or design patent rights is ten years and not extendable. As of December 31, 2020, we had 195 registered patents, 56 patent applications pending in China and no additional patent applications under the patent cooperation treaty. For our pending application, we cannot assure you that we will be granted patents pursuant to our pending applications. Even if our patent applications succeed, it is still uncertain whether these patents will be contested, circumvented or invalidated in the future. In addition, the rights granted under any issued patents may not provide us with sufficient protection or competitive advantages. The claims under any pending patents that issue from our patent applications may not be broad enough to prevent others from developing technologies that are similar to or that achieve results similar to ours. It is also possible that the intellectual property rights of others will bar us from licensing and from exploiting any patents that issue from our pending applications. Numerous U.S. and foreign issued patents and pending patent applications owned by others exist in the fields in which we have developed and are developing our technology. These patents and patent applications might have priority over our patent applications and could subject our patent applications to invalidation. Finally, in addition to those who may claim priority, any of our existing or pending patents may also be challenged by others on the basis that they are otherwise invalid or unenforceable.

Our services or solutions could infringe upon the intellectual property rights of others or we might lose our ability to utilize the intellectual property of others.

We cannot be sure that our services and solutions do not infringe on the intellectual property rights of third parties, and these third parties could claim that we or our customers are infringing upon their intellectual property rights. These claims could harm our reputation, cause us to incur substantial costs or prevent us from offering some services or solutions in the future. Any related proceedings could require us to expend significant resources over an extended period of time. Any claims or litigation in this area could be time-consuming and costly, damage our reputation and/or require us to incur additional costs to obtain the right to continue to offer a service or solution to our customers. If we cannot secure this right at all or on reasonable terms, or we cannot substitute alternative technology, our results of operations could be materially adversely affected. The risk of infringement claims against us may increase as we expand our industry software solutions.

In the operation of our AR holographic ads business, we do not enter into any agreements directly with the copyright owners of the videos in which ads are placed using our software. Consequently, there is no assurance that we will not be affected by disputes between platform operators, on the one hand, and copyright owners of such videos, on the other hand.

Additionally, in recent years, individuals and firms have purchased intellectual property assets in order to assert claims of infringement against technology providers and customers that use such technology. Any such action naming us or our customers could be costly to defend or lead to an expensive settlement or judgment against us. Moreover, such an action could result in an injunction being ordered against our customers or our own services or operations, causing further damages.

In addition, we rely on third-party software in providing some of our services and solutions. If we lose our ability to continue using such software for any reason, including in the event that the software is found to infringe the rights of others, we will need to obtain substitute software or seek alternative means of obtaining the technology necessary to continue to provide such services and solutions. Our inability to replace such software, or to replace such software in a timely or cost-effective manner, could materially adversely affect our results of operations.

Third parties may register trademarks or domain names or purchase internet search engine keywords that are similar to our trademarks, brands or websites, or misappropriate our data and copy our platform, all of which could cause confusion to our users, divert online customers away from our products and services or harm our reputation.

Competitors and other third parties may purchase (i) trademarks that are similar to our trademarks and (ii) keywords that are confusingly similar to our brands or websites in internet search engine advertising programs and in the header and text of the resulting sponsored links or advertisements in order to divert potential customers from us to their websites. Preventing such unauthorized use is inherently difficult. If we are unable to prevent such unauthorized use, competitors and other third parties may continue to drive potential online customers away from our platform to competing, irrelevant or potentially offensive platform, which could harm our reputation and cause us to lose revenue.

Our business is highly dependent on the proper functioning and improvement of our information technology systems and infrastructure. Our business and operating results may be harmed by service disruptions, or by our failure to timely and effectively scale up and adjust our existing technology and infrastructure.

Our business depends on the continuous and reliable operation of our information technology (“IT”) systems. Our IT systems are vulnerable to damage or interruption as a result of fires, floods, earthquakes, power losses, telecommunications failures, undetected errors in software, computer viruses, hacking and other attempts to harm our IT systems. Disruptions, failures, unscheduled service interruptions or a decrease in connection speeds could damage our reputation and cause our customers and end-users to migrate to our competitors’ platforms. If we experience frequent or constant service disruptions, whether caused by failures of our own IT systems or those of third-party service providers, our user experience may be negatively affected, which in turn may have a material and adverse effect on our reputation and business. We may not be successful in minimizing the frequency or duration of service interruptions. As the number of our end-users increases and more user data are generated on our platform, we may be required to expand and adjust our technology and infrastructure to continue to reliably store and process content.

Our operations depend on the performance of the Internet infrastructure and fixed telecommunications networks in China, which may experience unexpected system failure, interruption, inadequacy or security breaches.

Almost all access to the Internet in China is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or the MIIT. Moreover, we primarily rely on a limited number of telecommunication service providers to provide us with data communications capacity through local telecommunications lines and Internet data centers to host our servers. We have limited access to alternative networks or services in the event of disruptions, failures or other problems with China's Internet infrastructure or the fixed telecommunications networks provided by telecommunication service providers. Web traffic in China has experienced significant growth during the past few years. Effective bandwidth and server storage at Internet data centers in large cities such as Beijing are scarce. With the expansion of our business, we may be required to upgrade our technology and infrastructure to keep up with the increasing traffic on our platform. We cannot assure you that the Internet infrastructure and the fixed telecommunications networks in China will be able to support the demands associated with the continued growth in Internet usage. If we cannot increase our capacity to deliver our online services, we may not be able to expand customer base, and the adoption of our services may be hindered, which could adversely impact our business and profitability.

In addition, we have no control over the costs of the services provided by telecommunication service providers. If the prices we pay for telecommunications and Internet services rise significantly, our results of operations may be materially and adversely affected. Furthermore, if Internet access fees or other charges to Internet users increase, some users may be prevented from accessing the mobile Internet and thus cause the growth of mobile Internet users to decelerate. Such deceleration may adversely affect our ability to continue to expand our user base.

We use third-party services and technologies in connection with our business, and any disruption to the provision of these services and technologies to us could result in adverse publicity and a slowdown in the growth of our users, which could materially and adversely affect our business, financial condition and results of operations.

Our business partially depends on services provided by, and relationships with, various third parties. Some third-party software we use in our operations is currently publicly available and free of charge. If the owner of any such software decides to charge users or no longer makes the software publicly available, we may need to incur significant costs to obtain licensing, find replacement software or develop it on our own. If we are unable to obtain licensing, find or develop replacement software at a reasonable cost, or at all, our business and operations may be adversely affected.

We exercise no control over the third parties with whom we have business arrangements. If such third parties increase their prices, fail to provide their services effectively, terminate their service or agreements or discontinue their relationships with us, we could suffer service interruptions, reduced revenues or increased costs, any of which may have a material adverse effect on our business, financial condition and results of operations.

If we are unable to collect our receivables or unbilled services, our results of operations, financial condition and cash flows could be adversely affected.

Our business depends on our ability to successfully and timely obtain payment from our customers of the amounts they owe us for work performed. We evaluate the financial condition of our customers and usually bill and collect on 30 to 60 day cycles. We have established allowances for losses of receivables and unbilled services. Actual losses on balances could differ from those that we currently anticipate, and, as a result, we might need to adjust our allowances. We might not accurately assess the creditworthiness of our customers. Macroeconomic conditions could also result in financial difficulties for our customers, including bankruptcy and insolvency. This could cause customers to delay payments to us, request modifications to their payment arrangements that could increase our receivables balance, or default on their payment obligations to us. Recovery of customer financing and timely collection of balances also depend on our ability to complete our contractual commitments and bill and collect our contracted revenues. If we are unable to meet our contractual requirements, we might experience delays in collection of and/or be unable to collect our customer balances, and if this occurs, our results of operations and cash flows could be adversely affected. In addition, if we experience an increase in the time to bill and collect for our services, our cash flows could be adversely affected.

If we fail to obtain or maintain the required licenses and approvals or if we fail to comply with laws and regulations applicable to our industry, our business, financial condition and results of operations may be materially and adversely affected.

The Internet industry in China is highly regulated, which requires certain licenses, permits, filings and approvals to conduct and develop business. Currently, we have obtained business performance permit, telecom value-added service license and network culture operation license business performance permit.

Due to the uncertainties of interpretation and implementation of existing and future laws and regulations, the licenses we held may not be sufficient to meet regulatory requirements, which may restrain our ability to expand our business scope and may subject us to fines or other regulatory actions by relevant regulators if our practice is deemed as violating relevant laws and regulations. As we further develop and expand our business scope, we may need to obtain additional qualifications, permits, approvals or licenses. Moreover, we may be required to obtain additional licenses or approvals if the PRC government adopts more stringent policies or regulations for our industry.

As the Internet industry in China is still at a relatively early stage of development, new laws and regulations may be adopted from time to time to address new issues that come to the authorities' attention. Considerable uncertainties still exist with respect to the interpretation and implementation of existing and future laws and regulations governing our business activities. We cannot assure you that we will not be found in violation of any future laws and regulations or any of the laws or regulations currently in effect due to changes in the relevant authorities' interpretation of these laws and regulations.

In accordance with the Notice on Adjusting the Scope and Standardizing the Examination and Approval Process of Network Culture Operation License ("Notice") of the Ministry of Culture and Tourism, dated May 14, 2019, any network culture operation licenses whose business scope contains online-games related activities remains valid, although such licenses may not be renewed by the Ministry of Culture and Tourism upon expiration thereof. It is not clear yet whether new licenses could be issued by an alternative governmental authority. As a result, there is risk that we may not have a valid license to conduct online-gaming activities after the expiration of such license.

As of the date of this annual report, we have not received any material penalties from the relevant government authorities for our past business operations. We cannot assure you, however, that the government authorities will not do so in the future. In addition, we may be required to obtain additional license or permits, and we cannot assure you that we will be able to timely obtain or maintain all the required licenses or permits or make all the necessary filings in the future. If we fail to obtain, hold or maintain any of the required licenses or permits or make the necessary filings on time or at all, we may be subject to various penalties, such as confiscation of the net revenues that were generated through the unlicensed activities, the imposition of fines and the discontinuation or restriction of our operations. Any such penalties may disrupt our business operations and materially and adversely affect our business, financial condition and results of operations.

We may be materially and adversely affected by the complexity, uncertainties and changes in PRC regulation of the Internet industry and companies.

The PRC government extensively regulates the Internet industry, including foreign ownership of, and the licensing and permit requirements pertaining to, companies in the Internet industry. These Internet-related laws and regulations are relatively new and evolving, and their interpretation and enforcement involve significant uncertainty. As a result, in certain circumstances it may be difficult to determine what actions or omissions may be deemed to be in violations of applicable laws and regulations. Issues, risks and uncertainties relating to PRC regulations of the Internet business include, but are not limited to, the following:

- There are uncertainties relating to the regulation of the Internet business in China, including evolving licensing practices and the requirement for real-name registrations. Permits, licenses or operations at some of our subsidiaries and PRC variable interest entity levels may be subject to challenge, we may not be able to timely obtain or maintain all the required licenses or approvals, permits, or to complete filing, registration or other formalities necessary for our present or future operations, and we may not be able to renew certain permits or licenses or renew certain filing or registration or other formalities. See “Item 3.D. Risk Factors—If we fail to obtain or maintain the required licenses and approvals or if we fail to comply with laws and regulations applicable to our industry, our business, financial condition and results of operations may be materially and adversely affected” and “Item 4.B. Business Overview- Regulation.”
- The evolving PRC regulatory system for the Internet industry may lead to the establishment of new regulatory agencies. For example, in May 2011, the State Council announced the establishment of a new department, the State Internet Information Office. The primary role of this new agency is to facilitate the policy-making and legislative development in this field to direct and coordinate with the relevant departments in connection with online content administration and to deal with cross-ministry regulatory matters in relation to the Internet industry. We are unable to determine what policies this new agency or any new agencies to be established in the future may have or how they may interpret existing laws, regulations and policies and how they may affect us. Further, new laws, regulations or policies may be promulgated or announced that will regulate Internet activities, including online video and online advertising businesses. If these new laws, regulations or policies are promulgated, additional licenses may be required for our operations. If our operations do not comply with these new regulations after they become effective, or if we fail to obtain any licenses required under these new laws and regulations, we could be subject to penalties.

The interpretation and application of existing PRC laws, regulations and policies and possible new laws, regulations or policies relating to the Internet industry have created substantial uncertainties regarding the legality of existing and future foreign investments in, and the businesses and activities of, Internet businesses in China, including our business. There are also risks that we may be found to violate the existing or future laws and regulations given the uncertainty and complexity of China’s regulation of Internet business.

Our business generates and processes a large amount of data, and we are required to comply with PRC laws and regulations relating to cyber security. These laws and regulations could create unexpected costs, subject us to enforcement actions for compliance failures, or restrict portions of our business or cause us to change our data practices or business model.

Our business generates and processes a large quantity of data. We face risks inherent in handling and protecting large volume of data. In particular, we face a number of challenges relating to data we collect through our game distribution platform and integrated holographic AR software offering, including:

- protecting the data in and hosted on our system, including against attacks on our system by outside parties or fraudulent behavior or improper use by our employees;
- addressing concerns related to privacy and sharing, safety, security and other factors; and
- complying with applicable laws, rules and regulations relating to the collection, use, storage, transfer, disclosure and security of personal information, including any requests from regulatory and government authorities relating to this data.

Governments around the world, including the PRC government, have enacted or are considering legislation related to online businesses. There may be an increase in legislation and regulation related to the collection and use of anonymous internet user data and unique device identifiers, such as IP address or mobile unique device identifiers, and other data protection and privacy regulation. The PRC regulatory and enforcement regime with regard to data security and data protection is evolving. We may be required by Chinese governmental authorities to share personal information and data that we collect to comply with PRC laws relating to cybersecurity. All these laws and regulations may result in additional expenses to us and any non-compliance may subject us to negative publicity which could harm our reputation and negatively affect the trading price of our ADSs. There are also uncertainties with respect to how these laws will be implemented in practice. PRC regulators have been increasingly focused on regulation in the areas of data security and data protection. We expect that these areas will receive greater attention and focus from regulators, as well as attract continued or greater public scrutiny and attention going forward, which could increase our compliance costs and subject us to heightened risks and challenges associated with data security and protection. If we are unable to manage these risks, we could become subject to penalties, fines, suspension of business and revocation of required licenses, and our reputation and results of operations could be materially and adversely affected. In addition, regulatory authorities around the world have recently adopted or are considering a number of legislative and regulatory proposals concerning data protection. These legislative and regulatory proposals, if adopted, and the uncertain interpretations and application thereof could, in addition to the possibility of fines, result in an order requiring that we change our data practices, which could have an adverse effect on our business and results of operations.