

Hailiang Education- China Hustle Déjà vu

April, 9th 2018

Hailiang Education is one of the hottest stocks on the NASDAQ, up 700% in the past 12 months. While some might show optimism in the company's prospects based on changing educational policies in China, to Citron this seems more like the good ole China Hustle. And guess what, they had the same underwriter as the recently halted Longfin Financial.

The logo consists of the words "THE CHINA HUSTLE" in a bold, sans-serif font. "THE CHINA" is in white, and "HUSTLE" is in red. The text is centered on a black rectangular background.

We question when the SEC will open an informal or formal investigation into a company that has disclosures and non-disclosures that should have investors holding onto their wallets?

Citron has a long history of reporting on Chinese companies and we played a central role in exposing many frauds in the 2010-2011 mania. Most of our successes were based on finding red flags that are universal in nature and do not need an intimate knowledge of the Chinese business environment.

In this report, we have simply decided, to itemize a series of red flags that would point to fraudulent practices at **Hailiang Education Group**.

It all starts at the underwriter, while there is plenty of capital available in both China and the US, Hailiang Education was brought public in August of 2015 by **Network 1 Financial**.

Network 1 Financial Securities.

What we do know is that **Network 1** has a history of multiple securities violations -

<https://www.prnewswire.com/news-releases/hailiang-education-group-inc-announces-pricing-of-best-efforts-initial-public-offering-300098504.html>

Network 1 seems to be the new Maxim or Rodman Renshaw when it comes to Chinese IPO's -

https://files.brokercheck.finra.org/firm/firm_13577.pdf

Longfin Financial employed Network 1 for their entrance to the public marketplace

<https://globenewswire.com/news-release/2017/09/06/1108616/0/en/Longfin-NASDAQ-LFIN-Appoints-Network-1-as-Lead-Underwriter-as-it-Ramps-Up-for-its-Proposed-Listing-on-NASDAQ.html>

Haillang Education has had 3 CFO's in less than 2 years

- **Jianguo Yu** (11/2017-Present) – employment agreement is only for 6 months
- **Yancheng Lee** (9/2016-11/2017) – left for “personal reasons”
<https://www.sec.gov/Archives/edgar/data/1596964/000119312517333679/d489867d6k.htm>
- **Lei Chen** (2014-9/2016) – left for “personal reasons”
<http://hailiang.mediaroom.com/2016-09-30-Haillang-Education-Announces-Changes-to-Management-Team-and-Board-Composition>

Auditor change from KPMG to Marcum After KPMG disclosed weakness

Page 98 of 2016 20-F notes:

“KPMG advised the Company of the material weaknesses relating to (i) lack of sufficient control as to the board or management approval on related party transactions and (ii) insufficient resources for financial information processing and reporting and lack of appropriate IFRS knowledge.”

<https://www.sec.gov/Archives/edgar/data/1596964/000119312516747468/d273750d20f.htm>

Yet, New auditor Marcum won't give green light on internal control over financial reporting either

Marcum opinion letter on page F-2 of 2017 20-F notes:

“We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.”

<https://www.sec.gov/Archives/edgar/data/1596964/000119312517319290/d476431d20f.htm>

🚩🚩🚩 Marcum Chairman Drew Bernstein happened to have been a board member and chair of the audit committee at old school Chinese RTO Orient Paper.

<https://www.cnbc.com/video/2012/04/04/accounting-scandals-facing-us-listed-chinese-firms.html>

🚩🚩🚩 Marcum was also the auditor of the most controversial NQ Mobile

<https://www.barrons.com/articles/muddy-waters-to-nq-mobile-your-auditor-is-biased-1414423229>

🚩🚩🚩 Hailiang Education Group seems to be taking a page out of the many Chinese RTO we have seen and is Transferring cash to related 3rd party which is owned by majority owner of HLG

- “Increasing amount of cash deposited and increasing amount allowed to be deposited at Hailiang Finance – owned by Hailiang Group which is controlled by HLG’s majority owner Feng Hailiang”
- 2017 Risk Factors section: “As of June 30, 2017, the balance of deposits we had with Hailiang Finance amounted to RMB462.7 million (approximately US\$68.3 million).
<https://www.sec.gov/Archives/edgar/data/1596964/000119312517319290/d476431d20f.htm>

🚩🚩🚩 Trying to take advantage of investor’s complacency, Hailiang has started to publish press releases with companies that are ambiguous in nature.

Here is a partnership with Pate’s Grammar School Trading Company on 9/25/17

<https://www.prnewswire.com/news-releases/hailiang-education-enters-into-strategic-cooperation-agreement-with-pates-grammar-school-300524805.html>

Pate’s Grammar School Trading Company was established just a week before on 9/18/17
(<https://beta.companieshouse.gov.uk/company/10968882>)

🚩🚩🚩 It shouldn't be surprising that 2 board members have resigned in the past 6 months for personal reasons.

On November 1, 2017, Mr. Ying Xin has notified the Board of his resignation as the Company’s principal general and Director, effective immediately.

<http://app.quotemedia.com/data/downloadFiling?webmasterId=101533&ref=11873483&type=HTML&symbol=HLG&companyName=Hailiang+Education+Group+Inc.&formType=6-K&dateFiled=2017-11-06>

The board of directors (the “Board”) of Hailiang Education Group Inc. (the “Company”) received the resignation of Mr. Lv Bo on August 17, 2017. Mr. Lv tendered his resignation as the Board Secretary of the Company due to personal reasons.

<http://app.quotemedia.com/data/downloadFiling?webmasterId=101533&ref=11758274&type=HTML&symbol=HLG&companyName=Hailiang+Education+Group+Inc.&formType=6-K&dateFiled=2017-08-17>

What has changed since 2010-2011?

Unlike many Chinese RTO’s, In a post-2011 environment both accountants and attorneys have forced companies like **Hailiang Education Group** to disclose the material weaknesses in their procedures.

Citron has NEVER seen anything as bad as Hailiang.

 “We identified a material weakness in our internal control over financial reporting as of June 30, 2017 and concluded that our internal control over financial reporting and our disclosure controls and procedures were not effective as of June 30, 2017.

 “As a result, we may be subject to a number of risks, including increased risks that we have or may not file our financial statements and related reports with the SEC on a timely basis and that there are errors in our reported financial statements and material misstatements in our reports and other documents filed with the SEC.”

“As a result, our management determined that our internal control over financial reporting and our disclosure controls and procedures were not effective as of June 30, 2017.”

 “However, although we have carried out measures to address the material weakness in our internal control over financial reporting, the implementation of these measures has not fully addressed the material weakness in our internal control over financial reporting and **we cannot assure you that these measures will be sufficient to remediate the material weakness identified in our evaluation or that we will not identify additional deficiencies or material weaknesses in the future.**”

 “The absence of effective internal control over financial reporting and disclosure controls and procedures increases the risk that we have not, or may in the future not, file our financial statements and related reports with the SEC on a timely basis, that there may be errors in our financial statements or material misstatements or omissions in our related reports and documents filed with the SEC.”

And finally, the F word...

"As a result, our business, financial condition, results of operations and prospects, as well as the trading price of our ADSs, may be materially and adversely affected. Moreover, ineffective internal control over financial reporting **significantly hinders our ability to prevent fraud.**"

What is refreshing is there are no analysts that are trying to defend this opaque company.



Conclusion

This report is not a reflection on all Chinese companies, rather it highlights the many warning signs that Citron has noticed in our years of uncovering fraud in Chinese RTOs. There is one thing we learned during the Chinese RTO era...if it looks like a duck and quacks like duck- odds are it's a duck. Quack Quack

Cautious Investing to All