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TAL Education: A Real Business With Fake Financials Part I

<p>Report Date: June 13, 2018</p> <p>Company: TAL Education Group</p> <p>Ticker: (NYSE: TAL US)</p> <p>Industry: China For Profit Education</p> <p>Stock Price: \$45.65</p> <p>Market Cap: \$26.0 billion</p> <p>Average Daily Volume (90-day): \$171.6 million</p>	<ul style="list-style-type: none"> • Although TAL is a “real business”, it has been fraudulently overstating its profits since at least FY2016. • We estimate that during FY2016 through FY2018, TAL has overstated net income by at least 43.6%. Our estimates of profit inflation are based only on what we are able to quantify – fraudulent profit inflation likely exceeds this estimate. • We estimate that TAL’s cumulative net income margin during this period was only 8.8% (versus 12.4% reported); we estimate its FY2018 net income margin was only 10.4% (versus 11.6% reported). • We believe the fraud pervades the core Peiyou business and is migrating into TAL’s online businesses. • This is Part I in a series of reports. In this report, we cover two sets of fraudulent transactions that we estimate inflated TAL’s FY2016-FY2018 pre-tax profits by pre-tax profits by up to \$153.2 million, or 28.4%.
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Muddy Waters is short TAL Education.

Investors might recall the dark days of 2010 and 2011, during which numerous U.S.-listed China companies went down as frauds. It seemed like every new trading day brought revelations, resignations, or re-ratings. Companies were revealed to be frauds, regardless of their lead bankers, auditors, or top shareholders. According to the recent documentary, the China Hustle, there were approximately 400 frauds from China listed on U.S. exchanges.

When the dust settled, there were in hindsight certain indicia that were often present in the most troublesome companies:

- Too good to be true – often growing revenues and profits at breakneck paces in highly competitive industries,
- Balance sheets blowing out – significant CapEx, acquisitions, or investments, which often turned out to be fake uses of non-existent cash to get through audits,

- Significant non-cash transactions – this was one of the major flags of the granddaddy of all China frauds – Sino-Forest. Non-cash transactions are far too easily manufactured in China to be trustworthy.

There followed a retrenching period where many of the problematic companies were de-listed or became penny stocks. The perception was that the companies left standing were the “real” companies. However, what did not happen is as important as what did happen.

Out of literally hundreds of blatant frauds, almost no company chairman did any prison time. A Securities and Exchange Commission judge ordered that the practice licenses of the China affiliates of the Big Four, who had issued unqualified audit opinions to blowup after blowup, be suspended for six months. However, the suspensions never came into effect. Instead, the U.S. government settled with the affiliates for \$500,000 each, which is roughly equivalent to a yearly audit fee for one small client. In fact, it became difficult for the SEC to act against auditors because auditor working papers supposedly became “state secrets” that would subject an individual to prison time for providing them to a U.S. regulator. In other words, after about 400 frauds, **virtually nobody** has been meaningfully punished.

Charlie Munger is fond of saying “Show me the incentive, and I’ll show you the outcome”. Defrauding U.S. investors from China has proven to be a “heads I win, tails you lose” proposition. So, it does not shock us when we see that TAL began fraudulently creating profits as early as FY2016. Since the beginning of FY2016, the value of Chairman Zhang’s shares have skyrocketed from \$900 million to close to \$7.5 billion. The prospect of becoming Bobby Axelrod rich is a powerful incentive, especially when you have no downside if caught.

Summary

We estimate that TAL has fraudulently overstated its FY2016 – FY2018 results:

- Operating Profit, overstated by at least 21.6%
- Pre-tax Profit, overstated by at least 39.8%
- Net Income, overstated by at least 43.6%

The foregoing is only what we can quantify enough to estimate. We believe the fraud is more pervasive, and includes the core Peiyou business and is migrating into its online businesses. What we can quantify results from various fraudulent M&A transactions and investments. The below shows our estimates to historical numbers based only on what we can quantify:

	FY 2015	FY2016		FY2017		FY2018		Cumulative	
	As Reported	As Reported	Adjusted	As Reported	Adjusted	As Reported	Adjusted	As Reported	Adjusted
Revenue	434.0	619.95	616.46	1,043.10	1,015.08	1,715.02	1,691.07	3,378.06	3,322.61
Gross Profit	230.9	316.31	310.50	520.77	488.17	832.70	808.76	1,669.79	1,607.43
Operating Profit	67.3	85.05	69.92	134.59	97.63	208.60	184.66	428.25	352.21
Pre-tax Profit	77.2	136.90	69.87	154.58	92.38	246.99	223.05	538.48	385.31
Net Income	67.2	102.88	49.59	116.88	66.14	198.44	175.56	418.20	291.28

We estimate that TAL's profit margins have been significantly overstated for the past three fiscal years:

	FY 2015	FY2016		FY2017		FY2018		Cumulative	
	As Reported	As Reported	Adjusted	As Reported	Adjusted	As Reported	Adjusted	As Reported	Adjusted
Margins									
Gross Profit	53.2%	51.0%	50.4%	49.9%	48.1%	48.6%	47.8%	49.4%	48.4%
Operating Profit	15.5%	13.7%	11.3%	12.9%	9.6%	12.2%	10.9%	12.7%	10.6%
Pre-tax Profit	17.8%	22.1%	11.3%	14.8%	9.1%	14.4%	13.2%	15.9%	11.6%
Net Income	15.5%	16.6%	8.0%	11.2%	6.5%	11.6%	10.4%	12.4%	8.8%

The reality is that TAL's margins have deteriorated more than have been reported. To cover this up, the company has resorted to fraud. TAL combines the old school China fraud playbook of simply penciling in more favorable numbers with the more sophisticated asset parking fraud of Enron. (The well-known instance of Enron's asset parking is when it entered into sales of two electricity generating barges in Nigeria with secret agreements to repurchase them.) In this Part I, we detail two asset parking transactions that we estimate from FY2016 through FY2018 inflated TAL's pre-tax profits by up to \$153.2 million, or 28.4%.

Nobody has performed the highly detailed research on TAL that we have. Over several months, we retrieved over one thousand of pages of PRC government files on various entities belonging to, or associated with, TAL. We obtained and validated third-party credit reports on many of these entities. Our investigators made numerous site visits, and interviewed scores of people who worked in TAL, its partners, or had knowledge of its operations. In this report, we provide a detailed roadmap so that investors can recreate significant portions of our work.

TAL will almost certainly deny our conclusions. As we go back and forth with TAL, we ask investors to keep in mind Occam’s Razor. Occam’s Razor holds that when faced with competing explanations, one should select the one that requires the fewest assumptions. This report evidences numerous lies, obfuscations, and inconsistencies by TAL. As TAL selectively tries to explain them away, investors applying Occam’s Razor will be faced with these numerous improbable explanations that collectively should be almost impossible, versus a simple explanation from us: TAL is committing fraud.

How to Set Your Auditor Up for Failure

It is evident that TAL is starving its auditor, Deloitte China, of resources for the audit. Despite TAL’s massively increased complexity since its IPO, its audit fee has only grown at a CAGR of 2.8% since FY2011. During this time, its revenues and assets have grown at respective CAGRs of 45.4% and 42.6%. Audit fees, and therefore man-hours, have not kept pace with the expansion of the business. The graph below shows the fee versus complexity – in the forms of revenue and assets.

Former Crazy Eddie CFO Sam Antar discusses the importance of starving auditors of time when committing fraud (Crazy Eddie was a high-profile 1980s stock fraud). “The less time that [the auditor] had available to audit our books and records, the easier it was for us to dupe them into issuing clean audit opinions on our falsified reports.” (See <https://whitecollarfraud.com/crazy-eddie/crazy-eddie-fraud/>)

We note also that Deloitte China apparently had more China audit failures than any other audit firm –by one point in 2012, it had apparently accounted for 43% of the Big Four audit failures in China. (See <https://www.tradingfloor.com/posts/china-finance-worried-about-stock-fraud-look-at-the-auditors-199095522>)

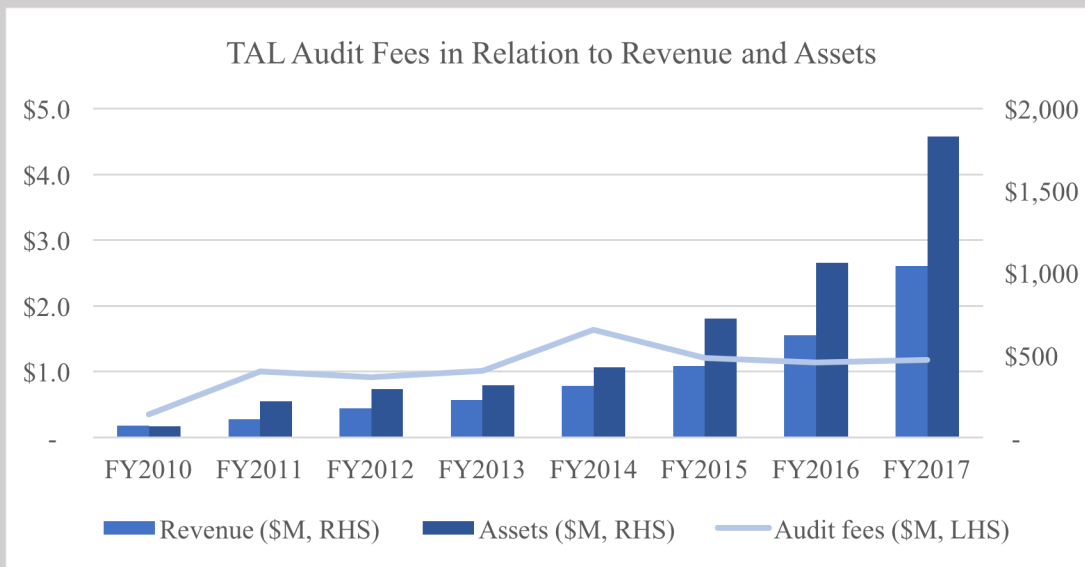


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Transaction 1 – Shunshun – Asset Parking Leading to Improper Profit Inflation of Approximately \$66.5 Million

- (7) In December 2015, the Group acquired 30% equity interest in Shunshun Bida who primarily engages in providing professional counseling services to students who desire to study abroad through its online- to-offline platform. The equity interest was acquired through the Group's purchase of its redeemable preferred shares. The Group recorded a gain of \$1,907,669 from transfer of a nonfinancial asset as part of consideration for this investment. There was no change in fair value of the investment in fiscal year 2016.

The highlighted text above is an important lie.¹

Through a series of transactions involving the disposal of a business to an investee, and then acquisition of the same investee, TAL booked approximately \$50 million of pre-tax profits through FY2018. We believe the disposal was a fraudulent asset parking transaction, and therefore substantially all of the reported profits are fraudulent. We estimate that these transactions additionally allowed TAL to improperly capitalize another \$16.5 million in losses. These transactions also involved the use of an obvious straw party, which raises the likelihood that transaction funds were diverted for personal benefit and/or roundtripped as revenue. TAL appears to have compounded the improprieties by penciling in fraudulent revenue numbers for the parked business.

The foundation of these transactions is a lie – a lie about the timing of TAL’s initial investment into a company called Beijing Shunshun Bida Information Consulting Co. Ltd. (“Shunshun”). We believe the fictitious investment date enabled these transactions to escape auditor and investor scrutiny, and hid the likely fact that TAL controlled the investee prior to transferring the business, Beijing Dongfangrenli Science & Commerce Co., Ltd. (“DFRL”). Regardless, it should be indisputable that TAL lied about timing, roundtripped a business in a way that generated substantial non-cash profits, and transacted with a straw counterparty. Fraudulent intent and actions are, in our view, the most logical conclusions to be drawn from these facts.

Background

TAL owned an overseas education intermediary consulting subsidiary called Dongfangrenli (“DFRL”). An overseas education intermediary is essentially a licensed broker for handling overseas school recruiting, applications, and placements. TAL bought this business in 2011.²

In FY 2016, TAL sold DFRL to a company for close to zero consideration. The buyer was a company called Beijing Shunshun Bida Information Consulting Co. Ltd (“Shunshun”). Unbeknownst apparently to TAL’s auditor and investors, TAL was already a significant investor in Shunshun when it acquired DFRL from TAL. Shunshun’s core business seems to have immediately pivoted to become DFRL.

¹ TAL FY2016 20-F, p. F-63

² TAL FY2012 20-F, p. 53, F-32

TAL then incrementally increased its investment in Shunshun, ultimately valuing the company at \$105.9 million (from an initial valuation of \$35.1 million in under a year).³ This rocketing valuation enabled TAL to book valuation gains of \$27.1 million on its earlier investments, and consolidate up to an estimated additional \$24.8 million of pre-tax profit.⁴ (We believe that of that \$24.8 million, approximately \$19.7 million is simply made up – i.e., from sales that never happened.⁵)

TAL not only booked fraudulent profits from the Shunshun / DFRL transactions – it improperly avoided consolidating \$16.5 million of losses Shunshun generated. This is important because following TAL’s initial investment, Shunshun appears to have built its business by selling a dollar for 30 cents.^{6,7}

TAL claims its first investment in Shunshun was in December 2015. This is a lie – and an important one. TAL’s actual first investment in Shunshun was five months earlier, in July 2015. TAL transferred DFRL to Shunshun the following month (August 2015). Therefore, the transfer of DFRL was a related party transaction, which ordinarily should receive more scrutiny than an arms-length transfer. We believe the apparent relative lack of scrutiny was foundational to improperly inflating profits. We also see the lie as an attempt to conceal that TAL was likely already effectively exerting control over Shunshun, which would have nullified TAL’s ability to book valuation gains.

If Deloitte were of the opinion that TAL and Shunshun were already under common control, then TAL would not have been able to apply purchase accounting. Consequently, TAL would not have accrued the fair value gains of \$27.1 million obtained through its multi-step investment in Shunshun.⁸

³ This figure is the fair value for purchase accounting purposes that TAL ascribed. The implied value of TAL’s most recent share purchase is \$116.5 million. See table “Shunshun Implied Fair Value and Investment Value”

⁴ TAL FY2016 20-F, pp. 44, F-63. TAL FY17 20-F, F-47. TAL states its first investment in December of 2015 included the transfer of unspecified nonfinancial assets that provided a fair value gain of \$1.9 million in 2015. The July 2016 acquisition of the 36% interest also yielded a \$25.2 million fair value gain from the re-measurement of its original 30% interest.

⁵ We believe it is reasonable to assume that the entire \$24.8 million of reported deferred revenue was booked without matching costs, as part of the goal of the parking seems to have been to de-consolidate losses.

⁶ Per SAIC financials, Shunshun’s consolidated CY2016 loss was RMB 101 million on revenue of RMB 43 million.

⁷ In making these assessments, we identified the various entities under Shunshun both by checking TAL’s FY2017 20-F Exhibit 8.1 (subsidiary list) and then checking the China SAIC files to locate additional undisclosed subsidiaries. For example, Beijing Sihai Bida is another Shunshun subsidiary that was established in 2016 and engaged in international immigration consulting. It is not reported in the TAL list of subsidiaries, has little to no revenue, and only contributed a small loss of Rmb -3.1 million in 2016.

⁸ <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/ASC/Roadmaps/us-aers-roadmap-to-common-control-transactions-2016.pdf>, “If the primary beneficiary of a variable interest entity (VIE) and the VIE are under common control, the primary beneficiary shall initially measure the assets, liabilities, and noncontrolling interests of the VIE at amounts at which they are carried in the accounts of the reporting entity that controls the VIE (or would be carried if the reporting entity issued financial statements prepared in conformity with generally accepted accounting principles [GAAP]).”

Audit Bumble: Missing Related Party Disclosure

TAL's auditor, Deloitte Touche Tohmatsu, failed in our view to do basic work that would have flagged the transfer of DFRL to Shunshun as a related party disclosure. SAIC ownership records can be checked online literally in seconds. We therefore assume that an average Deloitte auditor could have done this work within three billable hours. We struggle to understand how Deloitte did not connect the dots of the DFRL disposal as "consideration in a purchase agreement for a long-term investment" and Shunshun. Had Deloitte done this basic work, it would have spotted the lie in TAL's disclosure of the Shunshun investment timing. (It further surprises us that Deloitte would not note news reports from June 2015 reporting on TAL's investment in Shunshun.). Had Deloitte been aware of the relative timing of the investment and transfer, TAL's 20-F would have disclosed the DFRL transfer as a related party transaction, which U.S. GAAP mandates (emphasis added): "Transactions between related parties are considered to be related party transactions even though they may not be given accounting recognition. For example, an entity may receive services from a related party without charge and not record receipt of the service. While not providing accounting or measurement guidance for such transactions, *this Topic requires their disclosure nonetheless.*" (FASB ASC 850-10-5-5)

[Shunshun Was a Much Better Choice for Asset Parking than for Business Partnership](#)

If TAL had a good faith desire to invest in DFRL, there seemingly were far better alternatives to injecting it into Shunshun. When TAL acquired Shunshun, it essentially bought back a business it had reverse merged into a shell. Shunshun barely existed before it received TAL's money and DFRL.

TAL apparently received close to zero consideration from Shunshun for DFRL.⁹ However, TAL bought back DFRL (via Shunshun) at a purported implied **valuation of up to \$116.5 million**.¹⁰ The notion that Shunshun could create so much value with DFRL in such a short time fails the laugh test.

Shunshun had been formed only six months before TAL's July 2015 investment.¹¹ At inception, it was intended to be an online forum connecting Chinese interested in studying overseas with Chinese students who were already abroad. The purpose was to allow the prospective overseas students to ask for advice from the overseas students and overseas school administrators. To be clear, at inception Shunshun was intended to pursue a different business than international study intermediation.

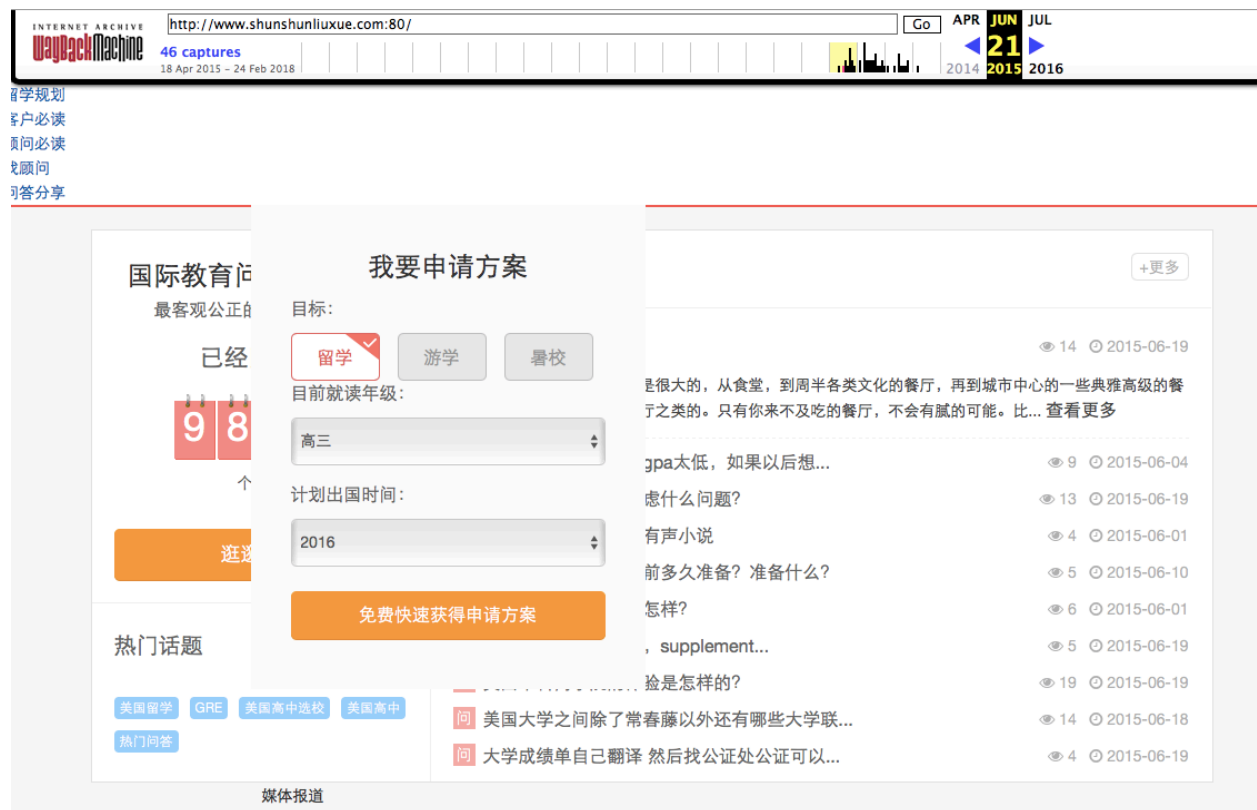
⁹ While DFRL's shareholders were paid by Shunshun, it does not appear that any funds were returned to TAL, not even the security deposit held by China's Ministry of Education as a kind of licensing bond. See footnotes 17, 18.

¹⁰ Implied valuation of the most recent tranche. See table "Shunshun Implied Fair Value and Investment Value"

¹¹ Shunshun China SAIC filings. The entity was originally called Beijing Blue Oak Information Consulting Co., Ltd: 北京蓝橡树信息咨询有限公司 and was founded on January 7, 2015. Blue Oak changed its name to "Beijing Shunshun Bida Information Consulting Co" on April 21, 2015.

Shunshun’s primary founder, Du Zhang, was 19 years old when he left Washington University without graduating to become a tech entrepreneur. Shunshun’s original website appears to have launched the next year, in March 2015 – only four months before TAL transferred DFRL to Shunshun.^{12,13} By June 2015, Zhang determined that the clearinghouse business did not work because the overseas students were unable to dedicate the time to answering the questions, and the advice was perceived as too subjective.¹⁴ (In 2014, Zhang had attempted an earlier – also venture-funded – version of the online overseas study clearinghouse, called Appliter. Shunshun was his second attempt in a year.^{15,16})

The below capture from the Waybackmachine.org as of June 21, 2015 (the month before TAL’s investment) gives the impression that Shunshun’s site had little traffic, and we would argue, highly questionable brand value. Shunshun seems a poor choice of a vessel in which to expand an existing, only tangentially related business. Regardless, enter TAL and DFRL.



¹² According to the “whois” of the website, www.shunshunliuxue.com, was created on March 6, 2015.

<https://www.whois.com/whois/shunshunliuxue.com>

¹³ rank2traffic.com states the site launched on March 6, 2015, and the waybackmachine.org first crawled the site on April 18, 2015 when it lacked even basic graphics.

¹⁴ <https://freewechat.com/a/MzAxMzY0Mzg2MA==/649664741/1>

¹⁵ <https://v6.itjuzi.com/company/timeline/22182> , <https://v6.itjuzi.com/investevents/9089>, http://edu.china.com.cn/2015-06/02/content_35714874.htm

¹⁶ <https://www.linkedin.com/in/lydiatang/>

Shunshun got into overseas education consulting by TAL essentially reverse merging that business into newly-formed Shunshun:

- Shunshun received DFRL for de minimis consideration.^{17,18} DFRL had been an overseas education intermediary when TAL acquired it in 2011.
- DFRL had the license that was necessary for Shunshun to operate as an overseas intermediary education consultant. The license was the reason TAL had purchased DFRL in the first place.¹⁹
- TAL contributed the overseas education website it had operated since 2011: <http://liuxue.com> (the URL means “study overseas”). TAL’s overseas study website had been generating traffic since 2011. Through the first six months of 2015, it had been generating from 61,900 to 87,800 sessions per month according to rank2traffic.com estimates. In contrast, Shunshun’s site generated an estimated zero sessions per month as of March 1st, and according to rank2traffic.com, sessions per month had ramped to 30,500 as of June 16th. Liuxue.com was transferred from TAL to Shunshun in December 2015, and for a period of time both were operating in parallel. Shunshunliuxue.com now redirects traffic to liuxue.com.
- TAL reportedly granted Shunshun access to its national customer database.²⁰

One might expect that Shunshun had to pay TAL for this new lease on corporate life. However, the opposite is true. TAL invested cash in Shunshun. The media reported TAL invested \$18 million, although TAL’s 20-F disclosure (which contains the lie about timing) says \$10.5 million.^{21,22} We understand TAL’s fair value for DFRL upon disposal was zero.²³

¹⁷ TAL FY2012 20-F, p. F-32, TAL FY2013 20-F, p. F-40, note 10: in FY2012 TAL acquired DFRL for its license and specifically ascribed to its license a value of \$823,934. The next year, FY13, TAL stated it revised its business strategy and decided to not develop the study abroad business. It wrote off \$594,162 and the balance of \$229,772 was to remain on deposit with the Education Bureau and recorded on TAL’s books as restricted cash.

¹⁸ TAL FY2016 20-F, p.3: in the year when TAL contributed DFRL to Shunshun, it may have recognized a small gain of US\$235,797 from disposal of investments as per its SEC 6-K filings for FY2016 Q2 and Q3. The gain was not described in detail and may have come from more than one source. Since the \$235,797 corresponds closely to the balance of \$229,772 on deposit as “restricted cash” and the rest of the investment in DFRL had been written off, we believe that the \$235,797 might actually represent a payment for the cash at the Education Bureau. Moreover, since TAL itself had just stepped up as the first and only investor to fund Shunshun approximately two weeks earlier, to the extent any actual cash changed hands, TAL is also the most likely source for that cash. In other words, if there was cash consideration paid, TAL likely just paid itself.

¹⁹ TAL FY2012 20-F, p. F-32; TAL FY2013 20-F, p. F-40, note 10

²⁰ <https://36kr.com/p/533806.html>, <http://pe.pedaily.cn/201506/20150613384056.shtml>, <https://www.chinaventure.com.cn/cmsmodel/news/detail/277936.shtml>, <http://www.qiepa.com/2015/06/9218/>

²¹ <https://freewechat.com/a/MzAxMzY0Mzg2MA==/649664741/1>, <http://www.asianentrepreneur.org/shunshun-liuxue-a-new-way-to-get-into-american-top-universities/>

²² TAL FY2016 20-F, p. F-62.

²³ In FY2013, TAL p. F-40 states that it revised its business strategy to not develop the study abroad business and wrote off \$594,162 and the balance of \$229,772 remained on deposit with the Education Bureau and recorded on TAL’s books as restricted cash.

Sloppy Audit Indicator

DFRL was transferred to Shunshun for zero to little consideration. It is our opinion that TAL's transfer of DFRL as partial consideration in a long-term investment should have been recorded among its non-cash investing and financing activities along with other non-cash activities, but it was not. Only payable items under non-cash investing and financing activities were shown, and other non-cash financing or investment activities are not reported. Because there is a non-cash investing disclosure, there should be a non-cash investment amount of at least \$1.9 million reported.

Non-cash investing and financing activities:

Payable for purchase of property and equipment	\$	730,911	\$	1,090,554	\$	3,478,617
Payable for investments and acquisitions		<u>122,054</u>		<u>1,911,031</u>		<u>3,022,079</u>

The accompanying notes are an integral part of these consolidated financial statements.

F- 9

References: ^{24,25}

This report details below the egregious accounting misdeeds we believe TAL committed after investing in Shunshun, but at this point we ask some fundamental questions: assuming that in mid-2015, TAL suddenly got bulled up on overseas education consulting (even though it had been in that business since 2011), was Shunshun, which was run by a 19-year-old and appears to have essentially failed at its core business within roughly three months, the obvious means for TAL to invest in overseas education consulting?²⁶ Why did TAL choose to reverse merge its business into Shunshun, rather than committing the resources internally at DFRL?

At the time TAL acquired the majority of Shunshun, it is clear that TAL was basically re-acquiring DFRL. Shunshun operated using DFRL's license.²⁷ DFRL as an entity booked 60% of Shunshun's consolidated revenues, 65% of its operating costs, and 41% of its SG&A.²⁸ As of

²⁴ TAL disclosed part of the consideration paid to acquire Shunshun was a nonfinancial asset. DFRL being a company with share equity is a financial asset, not a nonfinancial asset. The license could be considered a nonfinancial asset, but the license was owned by the entity and it was the entire entity which was transferred.

²⁵ TAL FY2016 20-F, p. F-9

²⁶ TAL FY2013 20-F, p. F-40, note 10: In FY2012 TAL acquired DFRL for its license and specifically ascribed to its license a value of \$823,934. The next year, FY13, TAL stated it revised its business strategy and decided to not develop the study abroad business. It wrote off \$594,162 and the balance of \$229,772 was to remain on deposit with the Education Bureau and recorded on TAL's books as restricted cash.

²⁷ Until March of 2018, Shunshun prominently displayed the DFRL license on both its liuxue.com and dongfangrenli.cn websites.^{27,27} The dongfangrenli.cn website has since been taken down while the liuxue.com website no longer displays this certificate. However, these websites can still be seen by accessing certain web archives and the waybackmachine.org.

²⁸ SAIC financials and third-party credit reports for Beijing DFRL and Shunshun.

December 31, 2016, DFRL apparently had 277 employees, versus Shunshun's 49 employees.²⁹ In CY2016, DFRL also provided 67.5% of Shunshun's deferred revenues as of December 31, 2016, which as we explain below, appear to be largely fraudulent. We conclude that TAL involved itself with Shunshun for the primary purpose of inflating earnings through parking DFRL.

Timeline: Reality vs. TAL's Fiction

Assuming one did not question the motives of the reverse merger of DFRL into Shunshun, the transaction timeline proceeded in a largely logical manner:

- On June 1, 2015, Shunshun brought in a new chairman and CEO, Yang Zhang.³⁰ Yang Zhang became the Chairman on June 25th, 2015.³¹
- As early as June 11th, Chinese media reported that TAL would be making an \$18 million investment into Shunshun.³² (Note that TAL disclosed it had only made a \$10.5 million investment in December of 2015.³³)
- On July 2nd, TAL chairman Zhang and two other TAL executives terminated DFRL's VIE agreement. DFRL was a "variable interest entity" or "VIE", which means that TAL did not actually own the company; however, it supposedly controlled it and therefore consolidated it due to the VIE agreement between TAL and DFRL. DFRL's actual owners were Chairman Bangxin Zhang, Yachao Liu, and Yunfeng Bai.
- On July 13th, Chairman Zhang, Liu, and Bai signed the shares transfer agreement between themselves, as individual shareholders, and Shunshun. (See Appendix A for the executed signature page.) Three days later, on July 16, 2015, the three, acting as the directors of DFRL, also approved the share transfer.
- On July 23rd, TAL officially became an equity investor in Shunshun – TAL was likely the first Shunshun investor to have actually funded its investment in the company. (See Appendix B.)
- The SAIC filings reflect that on July 30th, the DFRL transfer to Shunshun was officially recorded.³⁴ (See Appendix C.) Shunshun then appointed its CEO, Yang Zhang, to be DFRL's new Executive Director and Legal Representative on August 1, 2015.
- The DFRL share pledges were cancelled with the SAIC on August 3rd, 2015.³⁵

²⁹ China SAIC filings, Shunshun 2016AR, DFRL 2016AR – numbers are based on the number of employees for whom Social Insurance payments were made.

³⁰ http://edu.china.com.cn/2015-06/02/content_35714874.htm

³¹ Shunshun's SAIC file shows this as the date on which Yang Zhang became its Executive Director which is the equivalent to a Chairman of a small company with only one director. Once more directors were added in November 2015, his title was changed to Chairman.

³² <https://36kr.com/p/533806.html>, <http://pe.pedaily.cn/201506/20150613384056.shtml>, <https://www.chinaventure.com.cn/cmsmodel/news/detail/277936.shtml>, <http://www.qiepa.com/2015/06/9218/>

³³ TAL 2016 20F, p. 44, F-62.

³⁴ DFRL's China SAIC filings, 北京东方人力科贸发展有限公司

³⁵ TAL 2016 20F, p. 75

If all of this were on the up and up, why would TAL lie about the timeline, and claim it invested in Shunshun four months after it reversed merged its overseas education consulting business into Shunshun? Shunshun's 2015 Annual Report filed with the SAIC shows that TAL invested in Shunshun in July of 2015, which is consistent with Chinese media reports. However, TAL's 20-F disclosure is false – it states that it invested in Shunshun in December 2015, which would have been five months later than TAL really did invest.

Ironic Fact: TAL was likely the first Shunshun investor to actually record a cash contribution into the Shunshun entity.

TAL seems to have deliberately obfuscated DFRL was transferred to Shunshun. In the same 20-F in which TAL disclosed it owned 30% of Shunshun, it separately disclosed the disposal of DFRL.³⁶ Rather than admitting Shunshun bought DFRL, it obliquely refers to the buyer as a “long-term investment”. In our opinion, this failure to identify DFRL / Shunshun as a related party transaction is to avoid scrutiny of the propriety of the transactions and the subsequent valuation gains.

TAL Beijing, Beijing Dongfangrenli and its original shareholders entered into a series of contractual arrangements on December 27, 2011. In August 2015, all of the equity interests of Beijing Dongfangrenli were transferred as part of our consideration in a purchase agreement for a long-term investment. Thus TAL Beijing, Beijing Dongfangrenli and its original shareholders entered into a VIE Termination Agreement in July 2015. TAL Beijing approved to sign the VIE Termination Agreement by a written resolution. The pledges of the equity interests in Beijing Dongfangrenli were deregistered with the relevant local branch of the SAIC on August 3, 2015. As a result, the ownership structure of Beijing Dongfangrenli and TAL Beijing have been legally terminated.

DFRL's Name Change – Was it Sent into TAL's Witness Protection Program?

In both FY16 and FY17, DFRL was listed among TAL's disclosed major subsidiaries. However, in FY17, TAL changed the English translation slightly in what appears to be an attempt to imply it was not the same DFRL transferred out in FY16.

FY2016 Subsidiary list: Beijing Dongfangrenli Science & Commerce Co., Ltd.

FY2017 Subsidiary list: Beijing Dongfangrenli Trade Development Co., Ltd.

DFRL's Chinese name is the company's only legal name, and has never changed. While TAL may try to argue the new translations is equally valid, the change is unnecessary and seems to serve only one purpose: to create the false impression it is not the same DFRL.

³⁶ TAL FY2016 20-F, p. 75

How to Succeed in Investing Without Making Money: Purchase Accounting Games

Accounting rules around investments offer a perverse incentive for bad faith actors. If a company wants to inflate earnings, one option is to make a minority investment in another company, and then make subsequent investments at higher valuations. As the investor buys shares at higher prices, it books (non-cash) gains on its earlier purchases. Shunshun / DFRL was perfect for valuation manipulation because its constant thirst for new cash and its shareholders' willingness to exit quickly gave TAL multiple opportunities to manufacture gains. The most brazen part of this scheme was the insertion of a straw counterparty to effect a massive valuation bump – causing us to believe TAL's cash has likely been diverted for personal gain and / or to be roundtripped as revenue.

TAL states its first investment was in December of 2015 in the form of cash and certain unspecified nonfinancial assets. (As we showed above, TAL lied about the timing of the investment.) The transfer of this nonfinancial asset provided a small fair value gain of \$1.9 million in 2015.³⁷ Upon making this investment, TAL's reported the fair value for its 30% stake in Shunshun / DFRL as \$10.5 million.³⁸ This equates to an implied enterprise value of \$35.1 million.

Valuing Shunshun at \$35.1 million as of the actual time of TAL's investment in June/July 2015 strains credulity. At the time of the June 2015 announcement, Shunshun was a start-up with a small team, a simple website, and a desire to change business models.³⁹ Shunshun had launched its site on March 6, 2015, and within three months, had supposedly decided to redirect the business into overseas education consulting.

In June 2016, TAL purchased a controlling stake in Shunshun / DFRL from a straw party at an implied value of \$90.8 million.⁴⁰ TAL purportedly paid this straw party \$32.7 million in cash and stock, broken into \$19.1 million cash and common shares valued at \$13.6 million.⁴¹ This transaction also yielded a \$25.2 million fair value gain on TAL's initial 30% investment. It is hard to see how Shunshun / DFRL would rationally be valued at anything close to \$90 million, let alone TAL's then fair value for accounting purposes of \$103.7 million. In CY2017 Shunshun / DFRL was selling a dollar of a highly labor-intensive consulting service for about 35 cents, which, to be fair, was up from about 30 cents the year before. The \$90.8 million valuation fails our laugh test...with flying colors.

Shunshun's CY2015 – CY2017 financials are in Appendix E, showing its sales of a dollar for roughly 30 and 35 cents, respectively.⁴²

³⁷ TAL FY2016 20-F, pp. 44, F-63

³⁸ TAL FY2016 20-F, pp. 44, F-62, F-63

³⁹ http://edu.china.com.cn/2015-06/02/content_35714874.htm

⁴⁰ Shunshun's China SAIC files (shown below) state the acquisition was made on June 23, 2016. However, TAL's 20-F records it as July 31, 2016. See TAL 2017 20F pp. 9, F-13, F-47, F-67.

⁴¹ TAL 2016 20F, pp. F-63, F-47, F-48

⁴² This excludes Beijing Sihaibida Emigration Services Company, Ltd. 北京四海必达出入境服务有限公司, which according to its website, <http://www.sihaiyimin.com>, engages in assisting Chinese to emigrate to foreign countries. In CY2016 it accounted for 3.0% of Shunshun's consolidated loss with revenue of only \$12,000, or just 0.2% of the combined revenue in CY2016.

Stinky Transaction Leading to a Massive Valuation Gain

Shunshun hired a new chairman and CEO just prior to TAL's investment: Yang Zhang.⁴³ The 35-year old Mr. Zhang was a well-known figure in education in China, having written a book with his wife about his experience studying in the U.S. called "My Harvard Diary".^{44,45} He joined Shunshun in June 2015. His tenure was ultimately short, though, as it appears he left after only approximately 12 to 18 months.⁴⁶

Oddly for such a short tenure, he was granted 50% of the equity in the Shunshun entity. His shares appear to have fully vested, and he got liquidity for most of them after just one year. However, it was not TAL to whom he sold his shares. Surprise! The "buyer" was a newly-established Fujian company controlled by wife, Beixi Wang.⁴⁷

Beixi Wang established Fuzhou Minqing Forest Park Business Center Limited Partnership (Minqing) on May 26, 2016. Only two weeks later, on June 7th, 36% of Shunshun was transferred to Minqing. The transferors were her husband Yang Zhang and co-founders Du Zhang and Yuxiao Liu.⁴⁸ It is unclear what consideration, if any, Minqing paid to the transferors. It was from Minqing that TAL acquired its next stake in Shunshun / DFRL with the transfer to TAL being official as of June 23rd.^{49,50}

TAL purports that it purchased this 36% block for a total of \$32.7 million, at a fair value of \$103.7 million, which generated a valuation gain of \$25.2 million in FY2017.⁵¹

Shockingly, Minqing did not build upon its apparent overnight business success. It was de-registered October 10th. As of early 2017, though, Ms. Wang and her husband appeared to be traveling the world.⁵² On January 2, 2017, Mr. Zhang's personal blog, which had been dormant

⁴³ http://blog.sina.com.cn/s/blog_5a0624410102vvpt.html, <http://36kr.com/p/533626.html>, <http://tech.qq.com/a/20160329/052492.htm>, http://edu.china.com.cn/2015-06/02/content_35714874.htm.

⁴⁴ <https://baike.baidu.com/item/%E5%BC%A0%E6%9D%A8/3790952>

⁴⁵ Zhang Yang and Wang Beixi co-authored a book called "My Harvard Diary", 我的哈佛日记 https://www.amazon.cn/dp/B017SAF3BA/ref=sr_1_1?ie=UTF8&qid=1523838328&sr=8-1&keywords=我的哈佛的日记

⁴⁶ Based on interviews with a former Shunshun employee. Also later reported in mid-October 2016, <http://www.liuxue.com/abroad/news/78463.html>

⁴⁷ China SAIC filings, Fuzhou Minqing, est. May 26, 2016 and dissolved Oct 10, 2016. Wang Beixi is the 87.5% owner.

⁴⁸ China SAIC filings, Shunshun

⁴⁹ TAL FY2017, 20-F, p. F-47, once again there appears to be discrepancy in the date of the transaction with the 20-F reporting this occurring on July 31, while the SAIC files show the shareholding change taking place on June 23.

⁵⁰ The Chinese news reported this as a purchase of shares from the FREES Fund.⁵⁰ However, the SAIC files show that the FREES Fund did not relinquish its shares until November of 2016, about four and a half months later.

⁵¹ TAL FY2017, 20-F, p. F-47

⁵² In October 2016, TAL announced Yang Zhang would be leaving his day to day role as CEO of Shunshun to assist TAL with its company, Jiazhangbang. Mr. Zhang was to remain Chairman. However, a former Shunshun employee with whom our investigators spoke had been under the impression Mr. Zhang was already planning to leave in the summer of 2016.

since June 2015, came back to life, providing a travelogue of his family’s excursions in the first half of 2017 through Spain, the U.S., Canada, Japan, Thailand and China.⁵³

The valuation ascribed to this 36% of shares fails the laugh test, and the transaction structure fails the smell test. We do not know what really happened to the money and shares TAL purports to have paid, but we strongly suspect it was diverted for personal gain to TAL management and / or to be funneled back into TAL’s business somewhere as revenue. Regardless, TAL generated accounting profit that helped to obscure margin deterioration in its core business.

The below shows Fuzhou Minqing’s receipt of 36% of Shunshun’s shares from Yang Zhang, Du Zhang, and Yuxiao Liu (note that TAL’s increase in equity ownership took place in December 2015 when it brought its ownership up to 30%):

Before Changes		变更时间: 2016-06-07		Changes to Investors/Shareholders		变更事项: 投资人		After Changes	
		变更前:				变更后:			
	姓名	Reg. Cap. 金额	投资人类型	姓名	Reg. Cap. 金额		投资人类型		
Zhang Yang	张杨	70万	自然人股东	福州市闽清森林园田商务策划中心(有限合伙)	Fuzhou Minqing 51.43万	36%	法人股东		
TAL	北京学而思教育科技有限公司	21.36万	企业法人	北京学而思教育科技有限公司	TAL 42.86万	30%	企业法人		
FREEs	上海峰瑞投资中心(有限合伙)	20万	法人股东	Zhang Yang 张杨	25万		自然人股东		
Zhang Du	张都	6万	自然人股东	FREEs 上海峰瑞投资中心(有限合伙)	20万		法人股东		
Liu Yuxiao	刘雨骁	4万	自然人股东	Zhang Du 张都	2.14万		自然人股东		
		Total: 121.36 万元		Liu Yuxiao 刘雨骁	1.43万		自然人股东	Total: 142.86 万元	
		变更时间: 2015-12-10		Change to Registered Capital: 21.5 万元		变更事项: 注册资本			
		变更前: 121.36 万元				变更后: 142.86 万元			

The excerpts above and below from Shunshun’s SAIC shareholding change records show the complex re-arrangement involved in setting up Minqing’s entrance on June 7, 2016. Minqing held its 36% interest for just 16 days before the announcement of TAL’s acquisition of a controlling stake in Shunshun.⁵⁴

⁵³ <http://blog.sina.com.cn/alexzy>

⁵⁴ TAL Press Release, 2016-06-16, “TAL Education Group Has Increased Its Strategic Equity Stake in Shunshun Bida”

<p>3 投资人 2016-06-23</p> <p>Before 变更前</p> <p>福州市闽清森林园田商务策划中心(有限合伙), 法人股东; 北京学而思教育科技有限公司, 企业法人; 张杨, 自然人股东; 上海峰瑞投资中心(有限合伙), 法人股东; 张都, 自然人股东; 刘雨骁, 自然人股东。</p>	<p>Fuzhou Minqing Disappears June 23 2016</p>	<p>After 变更后</p> <p>北京学而思教育科技有限公司, 企业法人; 张杨, 自然人股东; 上海峰瑞投资中心(有限合伙), 法人股东; 张都, 自然人股东; 刘雨骁, 自然人股东。</p>
收起 ▲		
<p>4 投资人 2016-06-07</p> <p>Before 变更前</p> <p>张杨, 自然人股东; 北京学而思教育科技有限公司, 企业法人; 上海峰瑞投资中心(有限合伙), 法人股东; 张都, 自然人股东; 刘雨骁, 自然人股东。</p>	<p>Fuzhou Minqing Appears June 06 2016</p>	<p>After 变更后</p> <p>福州市闽清森林园田商务策划中心(有限合伙), 法人股东; 北京学而思教育科技有限公司, 企业法人; 张杨, 自然人股东; 上海峰瑞投资中心(有限合伙), 法人股东; 张都, 自然人股东; 刘雨骁, 自然人股东。</p>
收起 ▲		

The below is the SAIC record for Minqing showing Yang Zhang's wife as the controlling shareholder, having incorporated it just two weeks before the transfer:

Fuzhou Minqing Forest Park Business Center (LP)
福州市闽清森园田商务策划中心(有限合伙) 注销

统一社会信用代码: 91350124MA348KCK4M

执行事务合伙人: 王贝西 **Executive Director: Wang Beixi**

注销原因: 决议解散

注销日期: 2016年10月10日 **Deregistration date: 2016 Oct 10**

基础信息 行政许可信息 行政处罚信息 列入经营异常名录信息 列入严重违法失信企业名单(黑名单)信息

营业执照信息

统一社会信用代码: 91350124MA348KCK4M	企业名称: 福州市闽清森园田商务策划中心(有限合伙)
类型: 有限合伙企业	执行事务合伙人: 王贝西 Executive Director: Wang Beixi
合伙期限自: 2016年05月26日	合伙期限至:
登记机关: 闽清县市场监督管理局	成立日期: 2016年05月26日 Establishment date: 2016 May 26
登记状态: 注销	核准日期: 2016年05月26日
主要经营场所: 福建省福州市闽清县桂林乡四宝街55号	
经营范围: 市场调查、营销策划、商务策划服务。(依法须经批准的项目, 经相关部门批准后方可开展经营活动)	

In November 2016, TAL took its stake up to 80% by buying out FreeS Fund, which was a venture fund founded in September 2015.^{55,56} The table below shows the progression of TAL's investment in Shunshun to date, with corresponding fair value calculations on the left. The

⁵⁵ According to its China SAIC files, the FREEs Fund entity which invested in Shunshun, 上海峰瑞创业投资中心(有限合伙), was established in September 17, 2015.

⁵⁶ TAL 2016 20F, p. F-48

rapidly growing implied valuation on the right shows the increasing premiums paid for Shunshun during the ensuing rounds of investment.

Shunshun Implied Fair Value and Investment Value								
Action	Date	TAL's Shunshun Fair Value	TAL's Interest in Shunshun	Implied FV of 100% of Shunshun	Incremental Amount Invested	Incremental Equity Stake Acquired	Valuation Implied by Incremental Investment	
Initial investment ¹	Dec-15	\$ 10.5	30%	\$ 35.1	\$ 10.5	30%	\$ 35.1	
FV remeasurement	Jul-16	\$ 35.7	30%	\$ 119.1				
FY2017 Q2 investment ²	Jul-16	\$ 68.4	66%	\$ 103.7	\$ 32.7	36%	\$ 90.8	
FY2017 Q3 investment ³	Nov-16	\$ 84.7	80%	\$ 105.9	\$ 16.3	14%	\$ 116.5	

Unit: US\$ Millions

Notes:

¹Cash + nonfinancial asset w/FV of \$1.9m. ²\$19.1m cash + common stock w/FV of \$13.6m ³All cash

Q: What do TAL and Janet Jackson Have in Common?

A: They're in Control...And They Love It

Under accounting rules, TAL's ability to use purchase accounting and book valuation gains was predicated on the notion that it was not the controlling shareholder. It is obvious to us that TAL was effectively controlling Shunshun from the moment Shunshun agreed to absorb DFRL and build out the overseas intermediary consulting business. The entire chain of transactions screams pre-planned, as evidenced by the lie about timing and attempts to obfuscate DFRL's roundtrip; Shunshun's apparent lack of suitability for a legitimate partnership; the quick flips of equity by short-term shareholders at seemingly significant profits; and egregious valuations that fail the laugh test. The Occam's razor explanation in our view is that all of this was orchestrated by TAL from the beginning. The alternative would be to believe a series of individually improbable explanations for each of these issues (i.e., a series of coincidences) that we believe, when the probabilities are combined, would amount to nearly impossible.

[Win-Win? TAL Creates Yet Another Shunshun / DFRL Accounting Gain and a New Venture Capital Superstar](#)

TAL reported that it bought its most recent tranche from the FreeS Fund, supposedly paying \$16.3 million for this 14% interest (an implied valuation of \$116.5 million). The FreeS Fund, which was founded by a former partner at IDG named Feng Li, had only acquired its interest one year earlier, in November of 2015.⁵⁷ Mr. Li was reportedly instrumental in bringing in Yang Zhang to serve as chairman and CEO of Shunshun / DFRL.⁵⁸ According to an interview

⁵⁷ According to the SAIC files, in November 2015, the FREEs Fund became a 20% shareholder and contributed some capital, but the FREEs Fund company which became a shareholder in Shunshun, 上海峰瑞创业投资中心 (有限合伙) was not even established until September 17, 2015.

⁵⁸ http://blog.sina.com.cn/s/blog_5a0624410102vvpt.html

between FREEs Chairman Feng Li and Shunshun CEO Zhang, the FreeS Fund’s basis for the investment was only \$2 million.⁵⁹ Shunshun appears to be FreeS Fund’s first and only exit to date.⁶⁰ This apparent first exit is a highly auspicious start, given it was 8x within 12 months, an enviable IRR of roughly 715%.

FreeS Fund: The New King of China VC?

TAL chose to downplay the new fund’s massive initial success – it did not mention it by name in its disclosure, only referring to FreeS Fund as “a noncontrolling interest holder”. We think FreeS Fund’s stunning success deserves more recognition.

FreeS Fund reportedly has a limited partner-friendly fee structure that incentivizes FreeS to earn at least 3x on an investment. At 5x, FreeS Fund earns a 30% carry. Below is a slide from FreeS Fund’s marketing deck in 2015 explaining the structure.



We note that Mr. Li was at IDG when TAL transferred, and then bought back, Guangzhou 1-on-1 to / from an IDG portfolio company. These transactions, which are the focus of the second part of this report, generated for TAL approximately \$60 million in accounting profits.

⁵⁹ <http://tech.qq.com/a/20160329/052492.htm>

⁶⁰ <https://www.crunchbase.com/organization/freesfund#section-overview>

DFRL's Financials Appear to be Falsified, Giving TAL up to \$24.8 Million of Fraudulent Profit in FY 2018

When TAL acquired enough Shunshun / DFRL to begin consolidating the business, TAL reported Shunshun / DFRL purportedly had a deferred revenue balance of \$24.8 million.⁶¹ The timing of TAL's consolidating investment suggests that maximizing deferred revenue was an important goal of the re-acquisition. We believe that most – to all – of that deferred revenue fell to the pretax income line. We also believe that most – to all of it – is fraudulent.

Deferred revenue is a liability that results when a student prepays a fee, and remains on the balance sheet until the service has been delivered, which, in the case of Shunshun / DFRL, is placement at an overseas school and receipt of visa.⁶² When the service is delivered, the deferred revenue is recognized as revenue on the income statement.

There are generally costs to deliver the service that are matched to the deferred revenue as it is recognized. By consolidating Shunshun in July, TAL likely maximized the (real) deferred revenue and profit because the students admitted to study overseas should have been about to receive their visas, allowing TAL to recognize the deferred revenue. (Also, TAL's costs were largely already incurred). Regardless, we assume that fraudulent deferred revenue would have no matching costs – fraudulently creating marginally profitable revenue would not seem to be worth the risk of exposure.

At least \$19.7 million of Shunshun / DFRL's \$24.5 million deferred revenue balance appears purely fraudulent. PRC law requires that each corporate entity file financial statements with SAIC (the State Administration of Industry and Commerce) each year along with copious amounts of other data provided as part of the annual inspection. SAIC financials in our experience are often prepared by a relatively low-level accounting or finance department functionary who is essentially copying the financials provided to the tax bureau. Therefore, unless there is intervention by someone at the top of a company, we believe SAIC financials are usually going to present a pretty clear picture of the company's financials.

In the early days of exposing China frauds (2010-2011), firms such as MW often caught companies with their pants down by finding SAIC financials that completely contradicted their SEC filings. In early 2011, the frauds became attuned to this vulnerability, and almost certainly at the behest of top management, began filing fraudulent SAIC financials on a go forward basis as well as trying to amend their historical financials. There is no penalty in China for filing fraudulent financials with SAIC. (Tax fraud on the other hand is a serious crime.) It is therefore now rare to find a China fraud that is too lazy or stupid to file fraudulent financials with SAIC.

As a result, we look for indicia that the SAIC accounts are fraudulent – often these take the form of internal inconsistencies (e.g., balance sheet to income statement), inconsistencies with other group entities' financials, or significant amendments. There are two indicia of fraud in Shunshun

⁶¹ TAL FY2017 20-F, p. F-48

⁶² TAL FY17 Q1, FY17 Q3 Earnings Calls, for example: “Actually, the revenue recognition of the Shunshun business is based on they need to get an offer and they need to get a visa. So I think in general, most of them will come to recognize maybe in Q3 or Q4 next fiscal quarter.”

/ DFRL's financial statements. The first is significant post hoc changes to DFRL's SAIC accounts – these changes were executed just before TAL filed its 20-F disclosing the deferred revenue. Among the amendments was an improbable near three times increase in deferred revenue. Further, comparing the CY2016 deferred revenue balance to CY2017 recognized revenue makes the changed deferred revenue balance (which matches the 20-F) implausible.⁶³

Fraud Indicator #1:

The changes to DFRL's CY2016 financials added Rmb 129 million (~US \$19.7 million) to its assets and Rmb 131 million (~US \$19.7 million) to its liabilities. Its assets were substantially all composed of cash, pre-payments to suppliers (compensation to consultants), and other receivables from customers. DFRL's updated liabilities were almost entirely (97.4%) composed of pre-payments or advances from customers, or as listed in TAL's books, "deferred revenue".

These changes came on May 31, 2017, five months after calendar year end, over one month after its April earnings release for fiscal year 2017, and just under a month before its June submission of its audited financials and 20-F to the SEC.⁶⁴

The documents below will first show where the changes were found, how they match up with the detailed financial information in DFRL's credit report, and then we present a table to compare before and after.

⁶³ We also obtained Shunshun and DFRL's CY2017 SAIC financials and reviewed them to assess the conversion of CY2016 deferred revenue to CY2017 revenue. CFO Rong Luo explained on multiple occasions that a unique aspect of Shunshun's model is that revenue recognition can take up a full year, or longer. DFRL's CY2017 revenue totaled only Rmb53.4 million. This closely ties with the expected conversion of deferred revenue from the pre-amendment ~Rmb 74 million level as opposed to the post-amendment Rmb 199 million level.

⁶⁴ TAL FY2017 and Q4 6-K, dated April 28, 2017. The totals for current and non-current deferred revenue in the earnings release matches that in TAL's FY2017 20-F.

The below images are from the DFRL CY2016 SAIC annual report. At the top of the first page a note states that eight items had been changed.

2016 Annual Report
2016年度报告

8条修改记录 8 changes recorded

企业年报信息由该企业提供, 企业对其年报信息的真实性、合法性负责

Report date: 2017-5-30
填报时间: 2017年5月30日

The information in this report is provided by the company, the company is responsible for accuracy and legality of the reported information.

基本信息

· 统一社会信用代码/注册号: 91110105700175135G

· 企业通信地址: 北京市朝阳区工人体育场北路甲2号盈科中心B栋12层1201-1203单元

· 企业联系电话: 010-65915866

Company Name: Dongfangrenli Science & Commerce Co. Ltd.

· 企业名称: 北京东方人力科贸发展有限公司

· 邮政编码: 100000

· 企业电子邮箱: dgyx@shunshunliuxue.com

Changed Information

修改信息

Ref#	Modifications	Before Change	After Change	Date of Change
序号	修改事项	修改前	修改后	修改日期
1	2	1507.5545	14404.817	2017年5月31日
2	2	-5134.5548	-5314.7794	2017年5月31日

序号	修改事项	修改前	修改后	修改日期
3	2	7418.846	20496.3331	2017年5月31日
4	2	2203.2266	2591.8577	2017年5月31日
5	2	-5911.2915	-6091.5161	2017年5月31日

修改信息

序号	修改事项	修改前	修改后	修改日期
6	2	74.0185	115.6503	2017年5月31日
7	2	-5134.5548	-5314.7794	2017年5月31日

序号	修改事项	修改前	修改后	修改日期
8	2	2203.2266	2591.8577	2017年5月31日

共 查询到 8 条记录 共 2 页

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This annual report only provides the value of the numerical changes, not what line items in the financials were amended.⁶⁵ By comparing these numbers to the SAIC financials and a third-party credit report, we could verify with a high degree of confidence that the post-change numbers matched the final 2016 figures.⁶⁶ The eight changes were:

Itemization of Amendments in the CY2016 DFRL SAIC Financials							
Ref #	Item	RMB-Denominated			USD-Denominated		
		Amended	Original	Changes	Amended	Original	Changes
1	Total Assets	144.0	15.1	129.0	21.6	2.3	19.3
2	Pre-tax Profit	(53.2)	(51.3)	(1.8)	(8.0)	(7.7)	(0.3)
3	Total Liabilities	205.0	74.2	130.8	30.7	11.1	19.6
4	Total Revenue	25.9	22.0	3.9	3.9	3.3	0.6
5	Shareholders' Equity	(60.9)	(59.1)	(1.8)	(9.1)	(8.9)	(0.3)
6	Total Tax	1.2	0.7	0.4	0.2	0.1	0.1
7	Net Income	(53.1)	(51.3)	(1.8)	(8.0)	(7.7)	(0.3)
8	Revenue from Primary Operations	25.9	22.0	3.9	3.9	3.3	0.6

Units: Rmb millions and US\$ millions

Source: CY2016 DFRL financials and credit report

FX rate: 6.67

The DFRL SAIC financial to credit report reconciliation is in Appendix D.

⁶⁵ It is important to note that the SAIC financial are reported in units of ten-thousands or “万元”. This is a normal practice in China; however, the credit reports often display the data in thousands.

⁶⁶ The DFRL credit report was provided by a Chinese credit monitoring service that has access to more detailed information on the SAIC financials. We are able to verify that the credit reports are using current information by comparing the numbers presented for the major categories noted above to those shown in the current SAIC financials. When the credit reports' major categories (e.g. assets, liabilities, etc.) tie to those in SAIC financials, we assume that the credit report is current and substantially accurate.

As can be seen below, the major changes were to the liabilities (substantially all of which are deferred revenues) and the assets (cash, pre-paid expenses, and other receivables). We find it difficult to believe that the accounting team could overlook \$19.7 million in cash and payments collected from customers, and at the same time also forget about an equal amount of assets in the form of pre-payments to suppliers/consultants, other receivables, or cash. The total value of contracts signed by customers would have been closely monitored. Banks would have had detailed records of the deposits. Expenses paid out would likewise have run through the banks, and sufficient back-up would have been required for the payments to consultants.

Beijing Dongfangrenli Science & Commerce Co. Ltd SAIC Financial Reports with 2016 Changes							
Balance Sheet	CY2015		CY2016		CY2016 SAIC Amended (RMB)	CY2016 SAIC Original (RMB)	CY2016 SAIC Changes (RMB)
	RMB	USD	RMB	USD			
Cash	9.0	1.4	15.3	2.3			
Prepaid expenses	2.2	0.3	69.9	10.5			
Other receivables	1.4	0.2	55.4	8.3			
Total current assets	12.6	2.0	140.5	21.1			
Fixed assets	0.1	0.0	0.2	0.0			
Long-term receivables			3.3	0.5			
Total assets	12.7	2.0	144.0	21.6	144.0	15.1	129.0
Accounts Payable	1.4	0.2					
Advances from customers	11.2	1.8	199.6	29.9			
Payroll	1.8	0.3	3.4	0.5			
Other payables	8.4	1.3	1.0	0.1			
Tax payables	0.2	0.0	0.9	0.1			
Total liabilities	23.0	3.6	205.0	30.7	205.0	74.2	130.8
Capital	1.0	0.2	1.0	0.1			
Reserves			0.2	0.0			
Retained equity	(11.5)	(1.8)	(62.2)	(9.3)			
Shareholders' equity	(10.5)	(1.7)	(60.9)	(9.1)	(60.9)	(59.1)	(1.8)
Total equity and liabilities	12.7	2.0	144.0	21.6			
Income Statement	CY2015		CY2016		CY2016 SAIC Amended (RMB)	CY2016 SAIC Original (RMB)	CY2016 SAIC Changes (RMB)
	RMB	USD	RMB	USD			
Sales revenue	0.3	0.0	25.9	3.9	25.9	22.0	3.9
Sales from primary operations	0.3	0.0	25.9	3.9	25.9	22.0	3.9
Cost of sales	1.5	0.2	48.3	7.2			
Sales tax, etc.	0.0	0.0	0.1	0.0			
Gross profit	(1.2)	(0.2)	(22.5)	(3.4)			
Selling expense	6.0	1.0	6.3	0.9			
G&A expense	3.9	0.6	23.7	3.6			
Financial costs	0.0	0.0	0.7	0.1			
Operating income	(11.1)	(1.8)	(53.1)	(8.0)			
Pretax income	(11.1)	(1.8)	(53.1)	(8.0)	(53.1)	(51.3)	(1.8)
Income tax	0.0	0.0	0.0	0.0			
Net income	(11.1)	(1.8)	(53.1)	(8.0)	(53.1)	(51.3)	(1.8)

Units: Rmb millions and US\$ millions

Sources: DFRL CY2016 SAIC financials, CY2016 SAIC Annual Report, DFRL Credit Report

FX rates: CY2015: 6.31, CY2016: 6.67

Audit Question

Was Deloitte aware of the May 30, 2016 changes to DFRL's SAIC financials that added \$19.7 million in deferred revenue?

Fraud Indicator #2

Shunshun and DFRL's SAIC financials show a CY2016 deferred revenue to CY2017 recognized revenue conversion ratio that makes the changes to deferred revenue seem implausible.⁶⁷ We expected to see a very high percentage of year-end deferred revenues be recognized the following year. CFO Rong Luo explained on multiple occasions that a unique aspect of Shunshun's model is that revenue recognition can take up a full year, or longer.⁶⁸ Further, our interviews with two former Shunshun / DFRL employees indicated that substantially all consulting customers earn placements (and therefore Shunshun / DFRL is recognizing revenue).

If we look at DFRL on a standalone basis, we see that DFRL's CY2017 revenue totaled only Rmb 53.4 million. That is only 26.8% of the post-change deferred revenue of the Rmb 199.6 million as at the year-end of CY2016, which is an implausibly low conversion percentage. The pre-change conversion rate would have been 72.2% of the Rmb 68.9 million as at the year-end of CY2016, which is only a little lower than we would have expected. This comparison solidifies our opinion that the bulk of the reported deferred revenue TAL acquired is fraudulent.

The most reasonable explanation is a simple top-down manipulation that required corresponding changes at a lower-level subsidiary.

Book Cooking 101: Count Your Cash

The SAIC financial changes show a sloppy book cooking mistake – messing up the purported amount of cash in the bank. As shown below, the cash balance after the changes exceeds the pre-change total assets! Cash balances require little skill to check, therefore the odds that someone made such a mistake in preparing year-end financials are low.

Total Assets – Before Changes:	Rmb 15.1 million
Cash Balance – After Changes:	Rmb 15.3 million

⁶⁷ The CY2015-CY2017 SAIC financials for Shunshun and DFRL are presented in the section below.

⁶⁸ TAL FY17 Q1 earnings call. As described by CFO Rong Luo, the process to complete the application, obtain an acceptance into the overseas school, and obtain the visa is long and therefore the revenue recognition is often delayed 10 to 12 months.

Shunshun is a Dog

Shunshun / DFRL lost even more money in 2017 than in 2016 and shows numerous indicia of being a troubled business. At the end of the day, we do not believe that matters to TAL's management because it served its purpose, and TAL can engage in more fraud in the future to offset any losses it consolidates from Shunshun / DFRL.

Just prior to the release of this report, Shunshun and DFRL's 2017 SAIC financials became available. They are in Appendix E. The CY2016 and CY2017 performance of the two entities together displays two significant trends:

First, from 2016 to 2017, losses in the combined business have expanded, increasing 44% from Rmb (98.5) million to (141.5) million. Second, the conversion rate of combined deferred revenues as at the end of CY2016 to CY2017 recognized revenue has decreased significantly. If using the original (i.e., pre-change) CY2016 deferred revenue of Rmb 112.5 million, the conversion rate is only 68%, which is far short of its 84% rate the year before. (The rate would be 31% if using the post-change deferred revenues.) Based on interviews with Shunshun's consultants who state that virtually all students ultimately are placed in a school to attend, a 68% rate is much lower than we expected.⁶⁹

The table below shows the combined Shunshun and DFRL financials and compares the CY2015 and CY2016 deferred revenue to the following years' recognized revenues. Note, this differs from the calculation above, which examined this same ratio for DFRL as an individual entity.

Deferred Revenue to Revenue Conversion Rates Combined Shunshun & DFRL		
	RMB-Denominated	
Year	<u>2015</u>	<u>2016</u>
Deferred Revenue	50.90	243.30
Adjusted Deferred Revenue	50.90	112.50
Year	<u>2016.00</u>	<u>2017.00</u>
Revenues	42.96	76.47
Prior yr Liabilities to Current Year Revenues	84%	31%
Prior yr Adjusted Liabilities to Current Year Revenues	n/a	68%

Units: Rmb millions and US\$ millions

Source: China SAIC financials and credit reports

We therefore conclude that either the Shunshun consultants are doing a terrible job placing students overseas, or Shunshun's CY2016 deferred revenue numbers contain more fraud than we have been able to detect to date. We suspect it's both.

⁶⁹ After deducting the inflated deferred revenue suspected as fraud, the CY16 liabilities are Rmb 172.81 million (303.58-130.77) and CY17's recognized revenue of Rmb 76.47 million equates to a conversation rate of just 44.2%.

Sneak Preview of More Fraud?

From our analysis of the FY2018 earnings calls, we think that CFO Rong Luo's guidance for Shunshun's revenue predicts that they may once again amend results and/or simply claim greatly inflated revenues. In the Q2 earnings call, Rong Luo guided for Q3 2018 deferred revenues, stating:

“...we have acquired Shunshun from last year Q3. So when we consider a Q1 and Q2 top line growth, actually they can give us something, additional numbers over there which is around 5% growth rate perspective.”

- 2018 Q2 earning's call, CFO Rong Luo

In these comments, Rong Luo projects Shunshun's revenues in the first half to be based on a 5% growth rate year-on-year. However, just looking at FY2017 Q2 revenue alone we can see that this is an exaggeration. Five percent growth onto just FY2017 Q2's revenue of \$271.1 million is \$13.56 million (Rmb 90.3 million), which is already 27% higher than Shunshun's full year revenue reported to SAIC of Rmb 76.47 million. Moreover, in the Q3 2018 earnings call CFO Rong Luo adds that Q3 and Q4 “will be much better than that [in the first half]” causing us to suspect the company may again seek to inflate its revenues by an even greater degree. Because TAL's FY2018 20-F has not yet been released, and major amendments were made to the deferred revenues this time last year, we intend to continue to monitor the reporting on Shunshun's revenues and performance, as well as changes to the SAIC financials.

Reference: ⁷⁰

[The Impact of Restating TAL's Financials to Consolidate Shunshun from July 2015](#)

Our analysis of the Shunshun transaction being in substance an investment TAL made into itself is based upon on the glaring evidence of deception regarding TAL's initial investment date into Shunshun and injection of the critical asset of DFRL into Shunshun, which served to build out this overseas intermediary consulting business outside of TAL's own P&L and classify such expenses as investment capital.

⁷⁰ This conclusion is based on several of Rong Luo's statements about Shunshun in the Q2 and Q3 2018 earnings calls. Q2: a.) the combined First Leap, Shunshun, and another small acquired company would account for around 7-10% of the total revenue mix for Q2. We calculate that to be ~US\$31.9~45.6m. b.) Shunshun is now reported in the One-on-one category. In FY2018, the revenue contribution of one-on-one was 12.1% of total revenue, which works out to US\$55.2m. If you take out Shunshun, the Zhikang one-on-one business growth was “very well” and especially if compared to one or two years ago they “recovery so much.” FY17Q2 was 10.5% of total rev, or US\$28.5m, up 26.1% from FY16Q2. FY16Q2 was 13% of total rev, or US\$22.6m. If in Q2 one-on-one's growth was 40-60% then its revenue would be \$40m to \$46m and Shunshun's could be \$10m to \$16m. In Q3, Rong Luo reminds that Q2 is the “big season” for Shunshun.

Should TAL Impair Any of Shunshun's \$93 Million of Goodwill?

We see justifications for a significant impairment, including:

- Mounting losses: In CY 2017, Shunshun/DFRL's combined loss increased from \$14.8 million to \$21.0 million.
- Fewer contracts: Our fieldwork indicates that the peak for new client contracts was likely in CY2016.
- Staff reduction: The 2017 Annual Reports for Shunshun / DFRL show declining headcount. DFRL dropped the number of official employees for whom it made social welfare tax payments from 277 in CY2016 to 184 in CY2017. Shunshun slashed its staff in half from 49 to 24.
- Branch closures: Shunshun's website shows that it has cut its branch network by half, from 16 at peak to 8 offices in early CY2018. A Shunshun employee told our investigators two more closings are likely in the offing.
- Cash crunch: Shunshun's credit report (not including that of DFRL) shows its year-end cash position dropped from \$6.6 million (Rmb 42.9 million) in CY2016 to just \$36 thousand (Rmb 0.2 million) in CY2017.

We believe that TAL should restate its financials to include the costs to develop Shunshun consolidated as of the date of initial investment in July 2015 or the transfer of DFRL in August 2015. We estimate such a restatement would result in an additional decrease to operating and net profit of \$10.17 million in FY2015, and \$6.28 million in FY2016.

In addition to restating to consolidate Shunshun's combined FY2016 and FY2017 operational losses of (\$16.5) million, we also believe that the fair value gains accrued in FY2016 of \$1.9 million and FY2017 of \$25.2 million, as well as at least \$19.7 million in likely fraudulent FY2017 deferred revenue (that would enter TAL's books as revenue in FY2018) should be adjusted out of earnings.⁷¹ As of the end of FY2017, the revenue had not been recognized; however, based on company disclosures, we expect it to have been recognized over the course of FY2018.⁷² Moreover, we strongly suggest that investors and analysts consider the negative impact of the ongoing losses and low deferred revenue to revenue conversation rate at Shunshun and to make adjustments to FY2018 after the audited financials are released.

⁷¹ As TAL appears to have fraudulently inflated deferred revenue acquired from Shunshun via its subsidiary DFRL, we believe it was unlikely that the proper discounting of deferred revenue obtained through an acquisition per ASC 805 was applied – had it, the revenue would have been immediately reduced, and not dramatically increased almost a year later as seen through the SAIC amendments. Therefore, we believe it would be reasonable to apply a discount to the remaining balance of the deferred revenue based on the cost of delivering the deferred revenue - the remaining liability. We feel this discount would likely be substantial since the acquisition occurred in mid-summer, at which time applications should have been in and all or substantially all of Shunshun's work on the applications for fall 2016 entrance should be complete. However, to provide a conservative estimate; we did not.

⁷² TAL FY2017 1Q earnings call, CFO Rong Luo, "In July of 2017, Shunshun's CFO explained on the 2017 Q1 earnings call that Shunshun's revenue recognition is delayed by ten to twelve months." Additional discussion and references throughout this report.

What's Mine is Mine, What's Yours is Mine: DFRL Joins the List of Abusive VIE Transactions

We and many others have been warning for years about the risks to U.S. investors of the VIE structures common in China companies. (If you own China stocks and do not know the basics of the VIE structure and the related concerns, you have no business investing in these stocks.) By roundtripping DFRL, TAL now joins the ignominious list of VIE abusers – the Hall of Fame of which includes Gigamedia, ChinaCast Education, and Puda Coal.

After acquiring DFRL in 2011, TAL set the company up as one of its VIEs and began consolidating it. Prior to TAL transferring DFRL to its investee Shunshun, DFRL and TAL had to first cancel their VIE agreement. They completed the VIE termination on July 2, 2015 and the DFRL transfer to Shunshun was recorded with the SAIC on July 30, 2015. There are legitimate reasons why a company would cancel its VIE agreement, but parking the business to generate fraudulent profits is clearly not one of them.

Transaction 2 – Guangzhou One-on-One (GZ 1-1) – Asset Parking Leading to Estimated Improper Pre-Tax Profit Inflation of Approximately \$60 Million

TAL's Guangzhou One-on-One transactions were so egregious that "asset parking" would be a kind description. TAL's bad faith went much deeper – we believe that the asset transfer, which purportedly generated a substantial gain, never even took place. We conclude that this claimed transaction fraudulently inflated pre-tax profits by up to \$59.4 million from FY2016 through FY2018. In this case, TAL claimed to have transferred its Guangzhou one-on-one tutoring business while recognizing a \$50 million pre-tax gain. This purported gain accounted for 58.8% of FY2016 pre-tax income and 36.4% of net income. The consideration TAL received was equity in the recipient.

Only 15 months later, TAL claimed to have allowed "the buyer" to return the business in exchange for canceling the \$50 million equity TAL received in the first place. Not only did TAL not reverse the \$50 million pre-tax gain it had reported, it then consolidated \$9.4 million of deferred revenue upon reconsolidation. We suspect substantially all of this deferred revenue fell to the pre-tax income line. Moreover, we believe most – if not all – of this deferred revenue was fraudulent.

We see it as obvious that TAL always intended to take the business back, and that this series of transactions was executed for the sole reason of improperly generating accounting profits. The use of non-cash consideration (aka "funny money") on both legs is a screaming red flag. Scratching the surface, though, reveals an extraordinary set of facts – facts that cause us to believe that each purported transfer of the business was a complete sham. In other words, we believe TAL never transferred the substance of the business.

The GZ 1-1 purported sale and buyback were engineered non-cash transactions designed to create the \$50 million gain.

Background

In April 2015, TAL invested \$6.3 million into a company called Changing Education (“Changing Edu”).⁷³ Changing Edu operates a website that helps match tutors with students. The company was founded in 2013. TAL’s April 2015 investment was part of a Series B+ round that brought Changing Edu’s total venture funding to approximately \$30 million.⁷⁴ Four months later, in August 2015, TAL wrote a much bigger check to Changing Edu –purportedly \$30 million cash in Changing Edu’s Series C round.

TAL has a national tutoring business called “One on One”.^{75,76} When TAL reportedly invested the \$30 million in the C round, it also purportedly transferred its Guangzhou One on One (“GZ 1-1”) business to Changing Edu at a valuation of \$50 million.⁷⁷ Changing Edu issued TAL \$50 million of redeemable preferred shares as purported consideration.⁷⁸ TAL claims it transferred the GZ 1-1 business as part of this larger investment in Changing Edu.

When TAL claimed to have disposed of the “Guangzhou after-school one-on-one tutoring business component”, it did not transfer a corporate entity.⁷⁹ Instead, it appears to have transferred only a (likely small) portion of contracts related to the business – predominantly employment contracts for administration personnel. On the other hand, our diligence found that Changing Edu established a new entity in May 2015 to supposedly own the GZ 1-1 business. That entity was called Guangzhou Shujia Education Technology Co., Ltd. (Shujia).⁸⁰ Later, a

⁷³ Changing Edu is a Chinese internet company whose niche is matching K-12 students with teachers who make home visits to conduct one on one tutoring. Changing Edu is an overseas holding company with VIE operations in China. It was established in late 2014 by Liu Changke and received early investment from IDG, Trust Bridge, TAL, Sequoia Capital. As of the end of TAL’s FY2017, TAL was the largest individual outside investor. In Chinese, Changing Edu’s is called Qingqing Jiaoyu (轻轻教育) or Qingqing.⁷³ The VC investment tracking website Crunchbase calls this company Qingqing Jiajiao. In this document it will primarily be referred to as Changing Edu, but in interviews or source documents it may be referred to as Qingqing.

⁷⁴ TAL FY2016 20-F, p. F-66, TAL notes its first investment of \$6.3 million in April 2015 as being part of Changing Edu’s B+ round.

⁷⁵ TAL 2016 20-F, pp. 45-47

⁷⁶ TAL FY2016 20-F, p. F-66. According to TAL the “one on one” tutoring business delivers private and small, semi-private class tutoring to students. These “personalized premium services” are mostly offered in a one-on-one format, with a small portion of lower priced small-group classes, which typically consist of only two to six students.

⁷⁷ TAL FY2016 20-F, p. 44. In TAL’s financial reports, Guangzhou one on one is called “Guangzhou after-school one-on-one tutoring” and “Guangzhou Tutoring.” In China, it operates under the names Zhikang (智康), Aizhikang (爱智康). In this document it will be frequently abbreviated to “GZ 1-1”, but in referencing interviews or source documents we may refer to one of these other names.

⁷⁸ TAL FY2016 20-F, p. F-63

⁷⁹ TAL FY2016 20-F, p. F-66.

⁸⁰ Shujia’s Chinese name is 广州塾家教育科技有限公司

senior TAL manager previously from TAL's Chengdu 1-1 operation was put in control of Shujia while Changing Edu / Shujia purportedly owned GZ 1-1.

How did we learn about Shujia and what did we know about it?

We learned about Shujia from multiple conversations our investigators had with GZ 1-1 and Changing Edu staff. In the course of our diligence we also obtained SAIC financials and credit reports for Changing Edu's VIE, Shanghai company, and Guangzhou companies. Shujia was established on April 3, 2016. In our interviews with Changing Edu former managers, we learned that Shujia had been planned as a "Special Purpose Entity" to be the counterparty in the GZ 1-1 transaction. In our interviews we also learned that TAL was not interested in taking Shujia as part of the purported re-acquisition. Shujia was originally 100% held by Shanghai Qingqing. Changing Edu's co-founder, Guozhi Hu was the original Executive Director and Legal Representative. On January 20, 2016, Guozhi Hu was replaced in these positions by Mr. Xiansuo Lin, who had previously acted in a similar capacity for four of TAL's branch offices in Chengdu. Mr. Lin remained the listed representative for Shujia until November of 2017, at which time he was replaced by Changing Edu's Chairman, Changke Liu. By this time, it appears Shujia had largely become an orphaned company. In January 2018, a local tax office in Guangzhou posted Shujia as among its list of "irregular tax payers", meaning that the company had not kept up with basic administrative reporting and tax payment compliance. After the "re-acquisition" of GZ 1-1, Mr. Lin appears to have returned to rejoined TAL in Beijing with a promotion.

Sources: Shujia SAIC files and National Tax Office Guangzhou Yuexiu District Announcement.⁸¹

TAL reported that just 15 months after the disposal, it was buying back GZ 1-1 at the same price because Changing Edu felt that GZ 1-1 "no longer fit with its overall business strategy".⁸² The consideration for the supposed repurchase was non-cash: merely cancellation of shares previously issued to TAL. (Sino-Forest reported billions of fraudulent sales and profits through non-cash transactions.) Upon reconsolidation, TAL did not reverse its previous \$50 million gain.⁸³ We believe this was contrived and that these transactions lacked substance.

We suspect that Changing Edu agreed to participate in this scheme because TAL had become a significant shareholder. Moreover, Changing Edu appears to have attracted notice as a top-tier venture investment with almost \$90 million of "funding" from TAL.⁸⁴

⁸¹ http://www.gd-n-tax.gov.cn/pub/003025/dq_51391/tzgg/201802/t20180212_1848338.html

⁸² TAL FY2017, p. F-49

⁸³ Instead, TAL's purchase price accounting for the GZ 1-1 re-acquisition presented the total purchase consideration of \$50,000,000 as netting out against \$49,999,939 (combined intangible assets: \$4.6m student base, -\$1.2m deferred tax liabilities, and \$46.6m goodwill) to just \$61.00, almost zero.

⁸⁴ <https://www.oddup.com/article/this-shanghai-based-startup-is-trying-to-disrupt-the-education-industry-lands-us-18m-funding>

At the time TAL first invested in Changing Edu, it was already a portfolio company of IDG.⁸⁵ Feng Li, whose new venture fund exited Shunshun for 8x in one year, was still with IDG at this time. He appears to have been closely involved in Changing Edu.⁸⁶

TAL's Investments into Changing Edu

The table below shows TAL's purported investments into Changing Edu, including the supposed return of GZ 1-1. This table does not include the recent \$55 million Round D from October 2017, in which TAL also participated.

Movement of TAL's Investments in Changing Education Inc.		
Item	US\$	Source
Cash , April 2015	\$ 6,315,790	TAL FY16 20-F, p. 66
Cash , August 2015	\$ 30,000,000	TAL FY16 20-F, p. 66
Gain from Disposal of GZ 1 on 1	\$ 50,000,000	TAL FY16 20-F, p. 66
Fair value gain	\$ 5,220,210	TAL FY16 20-F, F-63
2/29/16	\$ 91,536,000	TAL 2017 20-F, F-65
Cash	\$ 4,825,000	TAL 2017 20-F, F-65
Cash	\$ 17,861,744	TAL 2017 20-F, F-66
Re-Purchase of GZ 1 on 1	\$ (50,000,000)	TAL 2017 20-F, F-49
Fair value gain	\$ 1,400,256	TAL 2017 20-F, F-66
2/28/17	\$ 65,623,000	TAL 2017 20-F, F-65

References:^{87,88}

⁸⁵ https://www.marbridgeconsulting.com/marbridgedaily/2016-12-20/article/97231/tutor_matching_app_qingqing_jiajiao_raises_usd_18 mln_series_c

⁸⁶ <http://www.duozhi.com/index.php?m=content&a=share&catid=10&id=2900>

⁸⁷ TAL FY2016, p. F-66, this table does not show the FY2018 investments TAL made into Changing Edu.

⁸⁸ [Tutor Matching Service Qingqing Jiajiao Raises USD 55 Mln Series D](#), Duozhi.com, 10/30/17. TAL has not yet disclosed the exact amount invested.

We infer fraudulent intent pervades the entire chain of events. We detail 10 reasons why we believe the transactions were asset parking and were without substance:

- Personnel who were at GZ 1-1 during the times of purported transfers generally were unaware, or disagreed, that ownership had purportedly changed hands.
- During the period of purported non-ownership, TAL appears to have remained the lessee for substantially all the learning centers.
- It is improbable that TAL transferred a business without transferring cash or deferred revenue.
- TAL claims it accrued a \$12.5 million tax liability in the PRC from the \$50 million gain on purported disposal. We were unable to find evidence of this in SAIC financials.
- We believe that in August 2015, no rational actor would have paid \$50 million for GZ 1-1.
- If TAL is to be believed, Changing Edu was opening new GZ 1-1 learning centers even after it had decided that the business did not fit its strategic direction and decided to dispose of it.
- Websites and recruitment ads from the time of Changing Edu's purported ownership show TAL playing a key role, supporting our view that TAL never relinquished control of the business.
- Shujia's SAIC filing shows multiple indicia that TAL had effective control of the entity when Changing Edu purportedly owned GZ 1-1.
- Shujia's CY2015 / 2016 SAIC financials do not accord with the GZ 1-1 business's expected financial performance, indicating that Shujia was consolidating other Changing Edu businesses, and therefore likely not fully consolidating the GZ 1-1 business.
- The amount of deferred revenue TAL purported to have acquired with GZ 1-1 in November 2016 is not indicative of a business that Changing Edu was struggling to run.

Independent of the substance of the transaction, we believe that the \$9.4 million deferred revenue TAL claims to have acquired when it "re-acquired" GZ 1-1 is fraudulent. Based on the SAIC financials for the entity that we believe owns the business, TAL would have recognized approximately one-third of the deferred revenue in December, which we do not think is plausible.

1. Personnel who were at GZ 1-1 during the times of purported transfers generally were unaware, or disagreed, that ownership had purportedly changed hands.

Through our investigators' fieldwork, we learned that the transaction had been structured in a highly unusual way that we believe transferred the business in name only (if that) without transferring the substance. Many employees from that time were either unaware that GZ 1-1 purportedly had a new owner, or they disagreed with the proposition. Had TAL really intended to dispose of GZ 1-1, we would expect that employees would have been aware of the ownership change. Changing Edu appeared to be a high-profile VC-funded company that would not shy away from publicity, so the observation that there was so little awareness of its purported

ownership further supports our view that there was no intention to actually transfer this business.⁸⁹

Our investigators had a detailed conversation with a former Changing Edu manager who was familiar with the transaction structure. He provided key details on the highly unconventional transaction structure. The former manager's explanations cause us to believe that the transaction had been structured so as to 1) give TAL some evidence of a disposal, 2) minimize the burden imposed on Changing Edu, and 3) minimize the work involved in the planned re-acquisition. In short, those details support our view that this was a sham transaction.

It appears that upon purported disposal, TAL assigned to Shujia a small number of the contracts underlying the GZ 1-1 business – our impression is that it was mostly administration personnel employment contracts.⁹⁰ Upon purported re-acquisition, those contracts were largely reassigned to TAL. The former manager stated that then-existing student contracts were not assigned to Shujia. The former manager explained that no entity transferred, GZ 1-1 never completely left TAL, and it was never completely taken over by Shujia or Changing Edu. Therefore, important problems remained unresolved: namely, prior contracts signed with students, teachers, and landlords were not re-signed or transferred.

An excerpt from the conversation provides more color on his commentary:

Q: When Qingqing [Changing Edu] bought Zhikang [GZ 1-1], it was an independent company, so Qingqing was the shareholder?

A: No, it was a business. A business does not necessarily reside within a legal entity, so the point I just made was that the business was brought in. So, we were bringing this business of like 10-plus organizations in, but it did not have a company that was the body that was carrying them. So, at that time it was really complicated.

Q: So about students from that time or their families, for example, were the original tutoring contracts changed over to Qingqing?

A: Right, there were discussions of this kind, but in the end, we could not adopt this scheme. If we did there would be risks. Therefore, we avoided it and dropped it. We did not implement it.”

Further fieldwork showed this structuring left rank and file personnel largely unaware that GZ 1-1 had purportedly changed hands twice in recent years. Our investigators visited all 10 of the GZ 1-1 learning centers that were in operation at the time of the purported disposal.⁹¹ Including offsite interviews, our investigators spoke with over fifty different people with knowledge of the

⁸⁹ Per Crunchbase, early investors were Sequoia Capital, IDG, and Trustbridge Partners.

⁹⁰ Of all the staff our investigators interviewed, only back office staff stated that they had re-signed labor contracts with Changing Edu and/or Shujia. They generally understood the story to be that Haoweilai invested in Changing Edu and gave GZ 1-1 (Aizhikang) to Changing Edu, but Aizhikang operated independently from Changing; and, later Haoweilai brought GZ 1-1 back into Xueersi and the TAL group of companies.

⁹¹ The specific learning centers and their addresses were identified by visiting www.waybackmachine.org.

GZ 1-1 learning centers. This group includes teachers, staff, parents, Peiyou learning center staff (often located on a different floor in the same building), and building management.

When our investigators spoke to teachers present during the period of purported disposal, none thought that the GZ 1-1 or the “Aizhikang” business was acquired by Changing Edu. A few stated that the two companies had “a kind of cooperation”. Some described “Aizhikang” as an independent organization, but one that was still under the TAL group brand.⁹² Below is a sampling of comments from the interviews with the teachers and heads of learning centers:

- A teacher who worked at GZ 1-1 (2014-2016) and was paid by Xueersi (TAL) throughout the period who was asked about Changing Edu:

“In 2015 [GZ 1-1] used cards to track students, each learning center and student had a card, which showed Xueersi’s brand, then around September 2015 they started using a cell phone app from Changing Edu in place of the card. They used it for about three months and then changed back to using a card again.”

- A teacher who worked at GZ 1-1 (2016) whose contract was signed with Aizhikang / Haoweilai (TAL) who was asked about the Changing Edu acquisition:

“But it was still Aizhikang and part of [TAL]...Guangzhou was independent for a while, unlike other cities, not a branch company.”

- A learning center staff member during a site visit to the Huangsha learning center who was asked whether GZ 1-1 changed hands:

Q: I see it seems like you’re very familiar with the operation. How long have you been working here?

A: I’ve been here for a few years.

Q: A few years?

A: Yes, a few years’ time.

Q: I saw online that this... your "1 on 1" was sold to Qingqing [Changing] Education?

A: No, now we are Xueersi, now all of our financial receipts are "Xueersi."

Q: So you were brought back, or were you bought back?

A: This is a senior level matter, so I’m not clear about it.

Q: I saw online, Xueersi did not change. It seemed one-on-one was sold to someone.

⁹² As was shown in a job advertisement in a prior section, this confusion appears to be because Shujia was specifically marketing itself as “Aizhikang” and misrepresenting itself as being a part of the TAL brand.

A: I'm not familiar with this, we and Xueersi are the same group, we are all part of the Haoweilai group.

- A learning center staff member during a site visit to the Huayi learning center:

Q: I thought I saw online that there was some cooperation with Qingqing [Changing] Education?

A: There was before, for a brief time in the middle, but later it came back to the Group.

Q: Some kind of good relationship, it seems like they bought it back?

A: Seems like it could be, but I'm not clear about this, it's all decided at the senior level.

Q: Right, doing that kind of back and forth.

A: As far as these kinds of company things go I don't know too much.

The directors of the learning centers our investigators interviewed appeared to know a bit more about the relationship with Changing Edu, but they were very reluctant to talk. None affirmed there had been a purchase by Changing Edu, or a repurchase by TAL. They quickly, almost reflexively, described the relationship between Changing Edu and GZ 1-1 as "cooperation." When our investigators asked specific questions about contracts or the particulars of the Changing Edu cooperation or transaction, the conversations would quickly go from congenial to cold. We take this as an indication that they had been instructed or even threatened not to speak of the matter. Two excerpts from interviews with heads of learning centers are below.

- A former Guangzhou Changing Edu teacher (2015-2016) and now head of a GZ 1-1 school since 2016, when asked about the Changing Edu acquisition replied that:

"You can't call it 'bought', you can't call it 'bought'. It was just kind of cooperation."

- A former GZ 1-1 Head of School (2012-2016) when asked about the Changing Edu acquisition replied that:

"It was not purchased, there was just cooperation."

2. During the period of purported non-ownership, TAL appears to have remained the lessee for substantially all the learning centers.

TAL's CFO claims to have transferred 10 learning centers to Changing Edu, but SAIC files show only one lease was assumed by Shujia. This does not appear to be a clerical issue. The former Changing Edu senior manager confirmed that few learning center leases were transferred. A filing in a PRC lawsuit shows that over a half year after the purported disposal, TAL renewed

and pre-paid another full year’s rent on a GZ 1-1 learning center. If TAL were merely acting as an agent to pay the rents on Changing Edu’s behalf, then related party transaction disclosures with specifics would have been required. Yet, no such disclosures exist.

In the FY2016 Q3 earnings call prepared remarks, CFO Rong Luo announced that all 10 of the GZ 1-1 learning centers had been transferred to Changing Edu. He stated, “We exchanged 10 one-on-one learning centers in Guangzhou to Changing location, following the agreement signed in June 2015.”⁹³ TAL’s investor presentations from FY2016 Q3 also show that all 10 of the Guangzhou One-on-One Centers had been removed. The images below show the reduction from FY2016 Q2 to Q3, dropping from 10 to “ – “.

FY2016 Q2 Investor Presentation

City	Year of Entry	# of Small Class Centers	# of One-on-One Centers	# of Total Learning Centers
Beijing	2003	68	35	103
Shanghai	2008	30	9	39
Guangzhou	2009	18	10	28
Nanjing	2011	14	5	19

FY2016 Q3 Investor Presentation

City	Year of Entry	# of Small Class Centers	# of One-on-One Centers	# of Total Learning Centers
Beijing	2003	66	33	99
Shanghai	2008	30	9	39
Guangzhou	2009	22	–	22
Nanjing	2011	15	5	20

Shujia’s SAIC files show that in December 2015, the lease for one GZ 1-1 learning center, the Quzhuang learning center on the 6th floor of the Guangdong Huaxin Center building, was put into Shujia’s name.⁹⁴ The space leased was just 929 m², at a monthly rate of Rmb 65,959 (approximately \$10,000), and required a deposit of Rmb 138,513. This site also became Shujia’s new registered address.⁹⁵ It is located in a space next to one of TAL’s Peiyou Quzhang Service Centers.⁹⁶

When fraud is committed through proxy interest holders in China, we have found it is common for the physical locations of the proxy to be in or near those of the controlling parent. While moving Shujia’s official registered address into a former GZ 1-1 learning center might make sense from the perspective of taking over a business, it also fits the pattern of TAL keeping Changing Edu in close proximity (i.e., “on a short leash”). Changing Edu had other Guangzhou

⁹³ TAL FY2016, Q3 earnings call.

⁹⁴ Shujia’s SAIC files

⁹⁵ We believe that the fact this became its registered address and that it is located next to a TAL facility are both salient. First, Chinese companies are required to formally lease the space that they occupy as their registered address and provide a lease agreement to the SAIC as proof of such. Therefore, we see a reason for the change here. Second, moving Shujia’s main offices into former TAL GZ 1-1 space and adjacent to one of TAL’s Peiyou service centers is consistent with the view that TAL retained effective control of Shujia throughout the period of disposal.

⁹⁶ <http://sgz.speiyou.com>

businesses and could have consolidated its Changing Edu operations into one location independent of TAL.

This is likely the only learning center Shujia took over.⁹⁷ In the interview with the former Changing Edu senior manager, we learned that leases at many, if not most, of the learning centers were not transferred from TAL to Shujia.⁹⁸ Details within a 2016 Chinese lawsuit independently corroborate that TAL not only continued to lease GZ 1-1 learning center space after the time of the purported disposal, but was also paying the rent in advance.

In April 2016, when the GZ 1-1 Tianhe Huayi Learning Center supposedly belonged to Changing, TAL subsidiary Tianhe Xueersi prepaid rent in the amount of Rmb 6.2 million (almost \$0.9 million) for the period from April 1, 2016 to March 31, 2017.⁹⁹ Excerpts from the lawsuit are below in Chinese. Some of the relevant points from the lawsuit include:

- The location and area: The Tianhe Trade Building on the 3rd and 4th Floors.¹⁰⁰
- This matches GZ 1-1's learning center address for the 3rd floor. The 4th floor is for TAL's Peiyou training center (school).
- The lease term: The lease between Huayi and TAL started April 1, 2015 with a term of eight years.
- The payment terms: The rent should be prepaid in annual increments by March 5 each year.
- TAL made a payment to the landlord for the period of April 1, 2016 through March 31, 2017.

2015年3月30日, 华忆公司(甲方、出租方)与天河学而思(乙方、承租方)签订《天河购物中心租赁合同》两份(针对涉案物业中的三层、四层各签订一份, 除租赁标的物不一致外, 其余条款均一致), 约定甲方分别将坐落在甲方同意将涉案物业的三层、四层出租给乙方作课外辅导和人力资源培训业务使用, 建筑面积均为2344.82平方米(含分摊共用建筑面积)。租期8年, 2015年4月1日至2015年5月31日为免租装修期。2015年6月1日至2016年3月31日, 月租金额(含管理费及税)257930.2元, 110元/平方米, 年租金(含管理费及税)2579302元; 2016年4月1日至2017年3月31日, 月租金额(含管理费及税)257930.2元, 110元/平方米, 年租金(含管理费及税)3095162.4元。1、租金以合同年为结算周期, 由乙方在每年3月5日前以银行转账到指定账户的方式缴付下一个合同年租金给甲方。逢法定节假日顺延至节假日的次日。2、应甲方资金分配需要, 租金缴纳需分配至两个账户中, 租金账户分配情况如

⁹⁷ As will be discussed in a subsequent section, in an interview with a former Changing Edu senior manager, we learned that leases at many if not most of the learning centers were not transferred from TAL to Shujia.

⁹⁸ More from this interview is discussed above.

⁹⁹ As reported in the credit report files for Guangzhou Xueersi Education Technology Co., Ltd files, Case Reference 广东省广州市中级人民法院民事判决书 (2017) 粤 01 民终 18443 号

¹⁰⁰ 华忆学习中心: 天河商贸大厦 3 楼

止。3、2016年6月1日国耀公司（甲方）与华忆公司（乙方）就涉案物业签订的《交接确认书》，内容：鉴于2016年5月30日，国耀公司（甲方）经招投标取得位于广州市天河区中山大道西8号天河购物中心二、三、四楼的租赁权，华忆公司（乙方）对该物业的租赁期至2016年3月31日已届满。经双方现场核实确认乙方移交的物业符合交付条件，自本交接确认书签署之日起乙方正式将该物业移交给甲方。乙方和天河学而思签署的租赁合同由甲方和天河学而思继续履行。乙方应按如下时间、金额将天河学而思已支付的保证金1131720.8元和预付到乙方账户的2016年4月1日至2017年3月31日租金6190324.8元，合计7322045.6元付给甲方。2016年8月25日前付2100000元，2016年9月25日前付3000000元，2016年12月25日前付2222045.6元。甲方指定收款账户开户名为江昭颜。基于乙方在2016年4月1日至5月30日期间对管理该物业的付出，甲方同意向乙方支付450000元补偿。上述补偿可在乙方支付最后一期款时直接抵扣等。4、2016年8月26日、2016年9月29日华忆公司转账至江昭颜的工商银行网上银行电子回单多份，金额合计5600000元。传讯公

Shujia's SAIC financials support the view that only one learning center lease was ever transferred from TAL. As established in the lawsuit, one year's lease expense for a single learning center of 2,345 m² could be over Rmb 3 million per year or Rmb 300,000 per month. Deposits could be equal to two or more months of rent. The site leased in Shujia's name was 929 m². Its monthly rent was just Rmb 65,959 and required a security deposit of Rmb 138,513.¹⁰¹ From our site visits, we found that the learning centers ranged in size from 20 to 50 classrooms, and use approximately 500 m² to 1000 m² of space.¹⁰²

Shujia's SAIC financial statements show prepayments of only Rmb 3,000 as of December 31, 2015. It therefore appears that no learning center deposits were transferred to Shujia nor paid in the four months in CY2015 immediately after Changing Edu supposedly took over GZ 1-1. As such, we believe TAL continued to pay the leases for most if not all of the other nine learning centers transferred.

Because TAL was an investor in Changing Edu, if it acted as a rent payment agent on behalf of Changing Edu, it would have been a related party transaction that we understand mandated disclosure.¹⁰³

¹⁰¹ Per the lease agreement contained in the Shujia SAIC files

¹⁰² The larger leases covering several thousand square meters involved both the larger Peiyong learning centers and the smaller 1-1 learning centers.

¹⁰³ TAL FY2017 20-F, p.106; FY2016 20-F, p. 111: For FY2016 and 2017, TAL reports loans, prepayments, and advances to related parties, but does not provide detail or which related party was the beneficiary or whether the amounts due were for the loans, advances, or other transactions. As at Feb 29, 2016 the current amounts due totaled US\$2.59 million and \$1.34 million non-current. The loans were made to three different parties. As at Feb 28, 2017 TAL had \$3.4 million in current amounts due from related parties. Additionally, the total deposits and lease payments for the learning centers would very likely be far in excess of these amounts. Therefore, we do not see an indication that prepayments made by TAL but not transferred and/or lease payments made by TAL on behalf of Shujia were reported fully and properly, if reported in any form at all.

Audit Failure: TAL's Missing Related Party Disclosures

TAL's related party disclosures generally fail to provide required detail. Opacity is the friend of fraud, and in this case is a failing on the part of Deloitte. In FY2016 and FY2017, TAL's related party disclosures do not identify the counter parties associated with current balances due, the nature of the transaction, nor the dollar amounts of the transactions themselves as required by ASC 850

ASC 850-10-50-1: The disclosures shall include:

- a. the nature of the relationship(s) involved,
- b. a description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements,
- c. The dollar amounts of the transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period,
- d. Amounts due from or to related parts as of the date of each balance sheet presented, and, if not otherwise apparent, the terms and manner of settlement..."

TAL's disclosures fall far short of meeting the requirements for the transactions involving learning center leases, teacher payments, and student tuition. Given the large number of investees in which TAL holds an interest for which it provides little or no detail, we suspect these findings represent only a small portion of larger systemic problems.

Reference: ¹⁰⁴

¹⁰⁴ TAL 2016 20-F, p. 111.

3. It is improbable that TAL transferred a business without transferring cash or deferred revenue.

We would have expected TAL's accounts to reflect cash and approximately \$5 million of deferred revenue liabilities transferred to Changing Edu along with the disposal. However, TAL's accounts show neither was transferred. GZ 1-1's deferred revenues arose from students' pre-payment of tuition, and are a liability because GZ 1-1 still needs to deliver the service. The cash would have largely resulted from pre-payments, and would have been used to fund the ongoing delivery of the services (e.g., teacher salaries, lease payments, and utilities). Not transferring these items *suggests the bank accounts, the cash collected from the students, as well as the student contracts remained with TAL*, yet GZ 1-1 would have had cash in- and outflows on a daily basis. The lack of deferred revenue and cash transfer reinforces our view that TAL was merely parking GZ 1-1 at Changing Edu with no intention of actually relinquishing control of the business.

US GAAP requires the parent company to remove all of the assets and liabilities related to the subsidiary or the group of assets from its book when control ceases. We checked TAL's financials and could see no-cash outflow or reduction in deferred revenue on TAL's books at the time of the purported disposal.

First, we can see that TAL transferred no cash to Changing Edu. TAL's statement of cash flows from investing activities in FY2016 shows no cash outflow specifically related to the disposal/transfer of GZ 1-1.¹⁰⁵ Per our understanding of accounting practices, cash transferred in connection with the disposal should be shown in an account distinct from TAL's equity investments in Changing Edu – in other words, it should not be added to any consideration paid for TAL's long-term investments. (Rather, transferred cash would normally be disclosed as a cash outflow due to a business disposal or transfer.) However, as can be seen in the investing section of TAL's FY2016 cash flow statement below, no such outflow was recorded.

¹⁰⁵ 2017 20-F, p. F-8

TAL FY2016 - Cash Flows from Investing Activities	
Payments from long-term investments	(118.590)
Purchase of term deposits	(87.632)
Purchase of property and equipment	(35.088)
Purchase of short-term investments	(27.470)
Acquisitions of businesses, net of cash acquired	(21.826)
Loan to third parties	(8.529)
Loan to employees	(6.471)
Loan to related parties	(3.815)
Restricted cash	(0.586)
Proceeds from maturity of term deposits	90.652
Proceeds from disposal of long-term investments	1.320
Repayment of loan to related parties	1.068
Proceeds from maturity of short-term investments	0.766
Repayment of loan to third parties	0.458
Proceeds from disposal of property and equipment	0.391
Net cash used in investing activities	(215.352)

Units: USD millions

Source: TAL FY2016 20-F

Audit Question

Was Deloitte aware that TAL's overly simplistic preparation of cash flows does not conform with U.S. GAAP requirements for foreign currency translation?

Second, we can see that TAL transferred no deferred revenue to Changing Edu. Reconciling the FY2016 balance sheet to the cash flow statement evidences no changes to the deferred revenue account as a result of the disposal of GZ 1-1. Based on TAL's description of GZ 1-1's operations, we would have expected to see about \$3.3 million to \$5 million (or more) of deferred revenue moving to Changing Edu if the disposal was carried out as a bona fide transaction.¹⁰⁶

¹⁰⁶ In the TAL FY16 Q2 earnings call, CFO Rong Luo provided enough data to estimate GZ 1 on 1's revenue for the quarter preceding the purported transfer would be about ~\$2.5 million. This calculation is detailed later in this section. In the course of our fieldwork we learned GZ 1-1 would seek to collect four to six months tuition in advance. Therefore as ~2.5 million equated to the recognition of revenue in 3 months, then even at zero growth, at least \$3.3million, but more likely around \$5 million or more in deferred revenue should have transferred.

Reconciliation of Deferred Revenue between Balance Sheet & Cash Flow Statement						
Year	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Deferred rev at beginning of the year	50.7	85.6	102.7	132.5	177.8	289.4
Deferred rev at the end of the year	85.6	102.7	132.5	177.8	289.4	519.0
Increase of deferred rev	34.9	17.1	29.9	45.2	111.6	229.6
Minus: acquired deferred rev						
Firstleap					(45.1)	
Shunshun						(24.8)
GZ 1 on 1						(9.4)
Changes of deferred rev per B/S	34.9	17.1	29.9	45.2	66.5	195.4
Changes of deferred rev per cash flow	34.9	16.9	29.9	45.2	66.4	193.2

4. TAL claims it accrued a \$12.5 million tax liability in the PRC from the \$50 million gain on purported disposal. We were unable to find evidence of this in SAIC financials.

The gains and tax accrual TAL claims in its SEC filings do not appear in its SAIC financials. TAL did not disclose which entity booked the purported gain and tax, but it stated that it was one of its VIEs. We checked the financials of the VIE that we believe held the GZ 1-1 business, but found no such accounts. To be thorough, we check the financials of TAL's other disclosed Guangzhou VIEs, but again came up empty. Finally, we checked the financials of TAL's three major Beijing VIEs that might have held GZ 1-1, and again none of them evidence the claimed amounts.

TAL claims it accrued a PRC tax liability equal to 25% of its purported \$50 million gain on disposal, which would have been \$12.5 million.

“Income tax expense was USD 33.5 million in fiscal year 2016 compared to USD 9.4 million in fiscal year 2015. The increase was mainly due to accrued one-off income tax expense of USD 12.5 million related to gains from disposal of one-on-one business in Guangzhou and...we used the Guangzhou one-on-one business as investment in Changing Education to exchange their stake. So this is kind of a disposal in accounting. So we gained \$50 million gain from there, and we need to apply 25% tax rate over there, which is a kind of special case.”

- 2016 Q4 earnings call, CFO, Rong Luo

China's Enterprise Income Tax rate is 25%. Luo's statement was codified in TAL's FY2016 Q2 6-K and its 20-Fs.

TAL claimed to have booked the gain and tax accrual in one of its VIEs. The 2016 FY2016 Q2 6-K claims its VIEs collectively accrued a tax liability of the appropriate size.¹⁰⁷ TAL's FY2016 20-F confirmed the VIEs booked the gain and tax accrual.¹⁰⁸

Income tax payable (including income tax payable of The consolidated VIEs without recourse to TAL Education Group of 4,193,507 and 14,880,773 as of February 28, 2015, and August 31, 2015, respectively)

Source: TAL FY2016 Q2 6-K

The most obvious entity to have booked the gain and tax is Guangzhou Xueersi Education Technology Co. Ltd. ("GZ XRS EdTech"), which we believe held the GZ 1-1 business. Its SAIC files show a branch company network whose addresses matched six of the ten GZ 1-1 learning centers, and former GZ 1-1 employees confirmed it was the operating entity. TAL's annual reports also explain that its "personalized premium service" (one-on-one tutoring) businesses are not operating through schools, but companies.¹⁰⁹ GZ XRS EdTech is the only disclosed entity in Guangzhou that operates education consulting businesses. Therefore, we believe GZ XRS EdTech is the VIE that would have shown the gains and losses of the transfer. However, its financials show no indication of the gain or tax accrual

To be even more thorough, we then fruitlessly reviewed the SAIC financials of the other three of TAL's disclosed Guangzhou VIEs for signs of this transaction (listed below).¹¹⁰ These schools are each licensed training centers.

- Guangzhou Yuexiu District Xueersi Learning School (Yuexiu School)
- Guangzhou Tianhe District Xueersi Learning Center (Tianhe School)¹¹¹
- Guangzhou Liwan District Xueersi Learning Center (Liwan School)

We checked the SAIC financials of three other Beijing VIEs.¹¹² Their financials as shown in their credit reports also show no sign of the disposal.

The 2015 SAIC for GZ XRS EdTech and TAL's three other Guangzhou entities are below.¹¹³ "GZ rev total" on the right represents the sum of all four entities. Even on a combined basis, the Guangzhou entities show no evidence of the accounting TAL claims.

¹⁰⁷ TAL 2016 Q2 6-K

¹⁰⁸ TAL FY16 20-F, p.F-3: Also shows the tax liability remained in place throughout the year: Income tax payable (including income tax payable of the consolidated VIEs without recourse to TAL Education Group of \$4,193,507 and \$15,525,069 as of February 28, 2015 and February 29, 2016, respectively).

¹⁰⁹ TAL FY17 20-F, p.26

¹¹⁰ Our analysis of TAL's other on-shore entities and review of its disclosures did not indicate any other entities that would be likely holders of the GZ 1-1 business.

¹¹¹ This school is mentioned again later in this report as the entity which leased the Tianhe Huayi Learning Center.

¹¹² Beijing Xueersi Network Technology Co., Ltd., or Xueersi Network; Beijing Xueersi Education Technology Co., Ltd., or Xueersi Education; Xinxin Xiangrong Education Technology (Beijing) Co., Ltd. (the original name of which is Beijing Dididaojia Education Technology Co., Ltd.)

¹¹³ Source: Credit Report: GZ XRS Ed Tech Co / MOE financial reports: Tianhe School, Xiuxue School, Liwan School

TAL's Guangzhou Entities - CY2015 Financials (RMB)					
	GZ XRS Ed	Tianhe	Yuexiu	Liwan	Combined
	Tech Co	School	School	School	TAL GZ
	<u>CY2015</u>	<u>CY2015</u>	<u>CY2015</u>	<u>CY2015</u>	<u>Total</u>
Sales	66.7	96.6	231.9	17.8	413.0
Cost	33.8	86.7	208.6	15.4	344.5
Sales tax etc	2.2	3.2	7.8	0.6	13.8
Gross margin	30.7	6.7	15.5	1.8	54.6
Sales exp	17.6				17.6
G&A exp	13.6	2.9	4.7	0.8	22.0
Financial costs	(1.6)	(0.8)	(2.9)	(0.1)	(5.4)
Operating profit	1.1	4.5	13.7	1.1	20.4
Other income	0.0000	0.0034	0.0049	0.0002	0.0084
Pre-tax income	1.1	4.5	13.7	1.1	20.4
Income tax		1.1	3.4	0.3	4.9
Net income	1.1	3.4	10.3	0.8	15.6

Unit: Rmb millions

Source: credit reports

TAL's Guangzhou Entities - CY2015 Financials (USD)					
	GZ XRS Ed	Tianhe	Yuexiu	Liwan	Combined
	Tech Co	School	School	School	TAL GZ
	<u>CY2015</u>	<u>CY2015</u>	<u>CY2015</u>	<u>CY2015</u>	<u>Total</u>
Sales	10.57	15.31	36.74	2.82	65.44
Cost	5.36	13.74	33.05	2.44	54.58
Sales tax etc	0.35	0.51	1.24	0.10	2.19
Gross margin	4.86	1.06	2.46	0.29	8.67
Sales exp	2.79				2.79
G&A exp	2.15	0.46	0.74	0.13	3.49
Financial costs	(0.25)	(0.13)	(0.46)	(0.02)	(0.86)
Operating profit	0.17	0.71	2.17	0.17	3.23
Other income		0.001	0.001	0.000	0.001
Pre-tax income	0.17	0.71	2.17	0.17	3.23
Income tax		0.17	0.54	0.05	0.76
Net income	0.17	0.54	1.63	0.13	2.47

Unit: USD millions

Source: credit reports

FX rate: CY2015: 6.31

The lack of evidence for both the gain and tax accrual in SAIC financials, MoE financials, and credit reports support our conclusion that the boomerang of GZ 1-1 was fraudulent asset parking and lacked substance.

5. We believe that in August 2015, no rational actor would have paid \$50 million for GZ 1-1.

As discussed above, we believe GZ XRS EdTech operated the GZ 1-1 business. TAL made additional disclosures that support our belief, and confirm that a \$50 million claimed sale price fails the laugh test. During the call on which the purported disposal was announced, Rong Luo guided to GZ 1-1's quarterly revenue having been approximately \$2.5 million, or \$10 million annualized.¹¹⁴ This adds support to our belief because GZ XRS EdTech reported CY2015 revenue close to that amount: RMB 66.7 million.¹¹⁵

TAL therefore purports that Changing Edu bought GZ 1-1 at a current-year PE ratio of over 150x. As shown above, from January through July 2015, GZ XRS EdTech showed net income of only \$0.17 million. If we annualize that, the number becomes \$0.29 million.¹¹⁶ The entity's operating / pre-tax / net margin was only 1.1%. At the time, TAL traded at a PE ratio of roughly 35x on a net margin of 15.3%.¹¹⁷

The \$50 million price tag is also surprising when compared to TAL's carrying value of the business of zero. (The table presenting TAL's changes in fair value in Changing Edu can be used to calculate that TAL recorded \$50.0 million as the consideration for GZ 1-1.¹¹⁸) Because both the consideration and the reported gain were \$50.0 million, we know the carrying value (i.e., the value of the net assets) was zero. While it is not impossible for net carrying value to be zero, it is improbable – even more so considering that GZ 1-1 had just expanded. Just prior to the August 2015 disposal, TAL stated it even added a new learning center, its tenth, so these new assets would not have had much accumulated depreciation.¹¹⁹ Presumably new students had signed up for the fall and winter sessions as well, so new additions to the student base (intangible asset) were also being made. In short, in such a dynamic situation, the probability of the carrying value being zero is also close to zero. This claim seems highly questionable.

An even bigger question, though, is: if this had been a real disposal, why in the world would TAL agree to take it back at the same price? That would be like winning the lottery and then throwing away the ticket before collecting the winnings.

¹¹⁴ FY2016 Q2 earnings call, CFO Rong Luo, "...our revenue from one-on-one in Guangzhou was around 10%, 9% in Q1 and 11% in Q2, of the overall one-on-one revenue" and "One-on-one performed better than expected, contributing to 13% to the overall revenue in Q2." FY16 Q2 revenue of \$173.33 million x 13% x 11% = US\$2.48 million x 4 = \$9.92 million

¹¹⁵ See GZ XRS EdTech financials in Appendix F.

¹¹⁶ At USD-CNY 6.57 as of December 31, 2015.

¹¹⁷ Assumes a share price of \$5.37, the average closing share price for August 2015, and FY2016 Q1 TTM results.

¹¹⁸ We can see this from the fair values presented regarding its Changing Edu investment in its FY17 20-F, p. F-65. The data is also presented in the table entitled, "The movement of TAL's investments in Changing Education Inc." in the "Background" on GZ 1-1.

¹¹⁹ TAL Investor presentations: June 2015 (FY16 Q1) p.12 and Nov 2015 (FY16 Q2) p.12

What did TAL tell Deloitte?

The GZ 1-1 transfer and buyback is a major related party transaction.

- What rationale or justification was provided to support the \$50 million gain?
- Having been executed without the transfer of an entity and for non-cash consideration, what rationale was presented to the auditor to make it comfortable the transaction was not a sham?

6. If TAL is to be believed, Changing Edu was opening new GZ 1-1 learning centers even after it had decided that the business did not fit its strategic direction and decided to dispose of it.

TAL's timeline has it reacquiring GZ 1-1 in November 2016. However, Changing Edu began increasing the store base by about 30% seemingly as it was deciding it wanted out of the business. During the period Changing EDU purportedly owned GZ 1-1, the number of learning centers also reportedly increased from 10 to 14.¹²⁰ One of the new learning centers opened at the end of November 2016 (before GZ 1-1's purported return), and two more opened in February 2017.¹²¹ In total, three of the four new learning centers opened after ownership purportedly reverted to TAL, implying that Changing Edu had committed to opening these locations around the same time it decided to dispose of the business. Assuming Changing Edu really did not want to continue to run the business, such incremental investments would have been illogical.

7. Websites and recruitment ads from the time of Changing Edu's purported ownership show TAL playing a key role, supporting our view that TAL never relinquished control of the business.

One of the first red flags we came across was the <http://gz.jiajiaoban.com> website, which showed no evidence that TAL had disposed of GZ 1-1. Online teacher recruiting ads from the time also show TAL having significant ongoing involvement.

The [jiajiaoban.com](http://gz.jiajiaoban.com) domain is a TAL-owned domain.¹²² Using the waybackmachine, we retrieved historical versions of the website from different points in time during the purported disposal. The website continued to list GZ 1-1 among TAL's brands, and the GZ 1-1 portion's "about us" page continued to feature only TAL (formerly known as Xueersi) during the period of supposed non-ownership. There were no indications of Shujia or Changing Edu, nor any

¹²⁰ TAL Investor Presentations from Q2 FY2016 to Q3 FY2017

¹²¹ According to the waybackmachine, the Baoercheng LC opened at the end of November 2016, while the Haigangcheng and Dongshankou LC's opened at the end of Feb 2017.

¹²² TAL FY2016, 20-F, p. 53. www.jiajiaoba.com The different cities using this domain are each given a two-letter prefix based on the cities' initials. Gaungzhou's is "gz", making it <http://gz.jiajiaoban.com>; Shanghai is <http://sh.jiajiaoban.com>; Tianjin is <http://tj.jiajiaoban.com>; etc.

announcement of a change in ownership. The “about us” page from that time was exclusively about the “one on one” tutoring business and TAL, including its IPO photo.¹²³



¹²³ Historical information on the gz.jiajiaoban.com website retrieved from the [waybackmachine.org](http://www.waybackmachine.org). TAL’s stock ticker at the time of its IPO was XRS, an abbreviation for its former brand name Xueersi.

Looking at the details in the ads for teachers below shows us that the people responsible for selecting applicants worked in the GZ 1-1 headquarters, yet were still using TAL email addresses.^{124,125} The supposedly independent business continues to use TAL's web domain as its own.

October 2015:

华南理工大学 轻工科学与工程学院
South China University of Technology School of Light Industry and Engineering

学院首页 下载专区 学校首页 English Version

网站首页 学院概况 师资队伍 科学研究 本科生教育 研究生教育 实验室管理 党建工作 学生工作 学术通知 校友天地

当前位置: 首页 > 学生工作 > 就业信息

Guangzhou Xueersi Ed. Tech. Co., Zhikang 1 on 1 Recruitment

广州学而思教育科技有限公司智康1对1招聘信息

上传: 助理1 发布时间: 2015/10/9 15:18:09 浏览量: 42 Release date: 2015/10/9

学生工作

- 管理制度
- 团学新闻
- 统战新闻
- 团学通知
- 学工通知
- 党建工作
- 寻找身边感动
- 光荣榜
- 就业通知
- 就业信息

联系方式

办公室主任: 020-87112841
办公室副主任: 020-87112625
实验室设备管理: 020-87111147
科研秘书: 020-87111008
组织人事秘书: 020-87111008
本科生教务员: 020-87112625
本科生辅导员: 020-87113644
研究生辅导员: 020-87112841
专职辅导员: 020-87111131

单位介绍

好未来(原名学而思)国际教育集团成立于2003年,目前已在北京、上海、天津、广州、深圳等众多城市设立10多个分校共200多个教学点,拥有数千名专业教职员工,每年培训40万人次,且仅用8年时间便发展成为北京市乃至全国范围内知名度、美誉度颇高的中小学培训机构。

2010年10月21日,好未来正式登陆美国纽交所挂牌交易,成为国内首家在美国上市的中小学教育机构。智康1对1是好未来国际教育集团旗下的高端教育品牌,始创于2007年,是一家拥有众多小升初、中高考教育经验丰富的老师,以1对1辅导为主的中小学全科辅导机构。创建三年以来,现已在北京、天津、上海、广州、深圳、南京、武汉、成都、西安、杭州等多个城市设立分校,拥有全、兼职教师数千名,深受学生和家长的喜爱。

1. 中小学: 专职及兼职教师

岗位要求

招聘岗位:

中小学各科: 专职/兼职教师(备注: 兼职教师至少在职半年)

授课形式: 1对1/小组课 科目: 语文、数学、英语、物理、化学、小学奥数

薪资待遇:

1、专职教师: 8000-15000元/月 兼职教师: 80-100元/小时;
2、完善的培训机制(岗前岗后全日制培训), 广阔的职业生涯空间。

任职要求:

1、本科以上学历,专业不限;
2、参加常规教研,承担团队教研任务;
3、愿意遵循公司的工作安排;
4、沟通表达能力强,有责任心和教学热情。

应聘方式:

1、网申地址: <https://jinsheju.net/f/W314wL> (推荐);
2、招聘邮箱: zhaopingzkk@100tal.com。

招聘流程: 初试——岗前培训——复试——终面——签约

公司网站: <http://gz.jiajiaoban.com/>
公司地址: 广州市天河区珠江新城花城大道18号建滔广场21楼 智康总部 广州学而思教育咨询有限公司
Tel: 020-38917514
E-mail: zhaopingzkk@100tal.com
微信公众号: 师说

2. 中小学: 专职教师

岗位要求

招聘岗位:

中小学各科: 专职教师

¹²⁴ Source: thewaybackmachine:

<http://web.archive.org/web/20150317005146/http://gz.jiajiaoban.com/e/20140626/53ab8f94a056b.shtml>, 珠江新城校区成立于2014年7月,位于广州市天河区珠江新城花城大道18号建滔广场3层。

¹²⁵ SAIC files for the GZ XRS Ed Tech Co. headquarters occupied space on the 21st, 22nd, and 23rd floors.

应聘方式:

1、网申地址: <https://jinshuju.net/f/W314wL> (推荐);

2、招聘邮箱: zhaopingzck@100tal.com。
 Contact email: zhaopinzzk@100tal.com

招聘流程: 初试——岗前培训——复试——终面——签约

公司网站: <http://gz.jiajiaoban.com/> Website: <http://gz.jiajiaoban.com/>

公司地址: 广州市天河区珠江新城花城大道18号建滔广场21楼 智康总部 广州爱智康师资选聘部

Tel: 020-38917514 Company address: Guangzhou Tianhe District, Zhujiang Xincheng Huacheng Blvd. 18, Jiantao Square, 21st Fl. Zhikang HQ Guangzhou

E-mail: zhaopingzck@100tal.com Guangzhou Aizhikang Teacher Selection Dept.

微信公众号: 师说

May 2016, eight months after the purported disposal:

Haoweilai Group - Aizhikang (Guangzhou) 2016 Campus Recruiting
 好未来集团·爱智康(广州分校) 2016校园招聘

广州 全职 本科 CET-4
 发布时间: 2016-05-21
 Release date: 2016-05-21

职位描述 Job description:

【招聘岗位】(专职老师每周工作三天)
 1对1: 中小学专职/兼职老师(备注: 兼职老师至少任职半年)

1 on 1: teacher specializing in middle and elementary/part-time
 (note: part-time teachers need to be able to work for at least a half year)

科目	语文	英语	物理	化学	初高中数学	小学奥数
人数	20	20	15	10	20	20

小组课: 中小学专职老师

科目	语文	英语	物理	化学	初高中数学	小学奥数
人数	10	10	10	10	20	20

【薪资】
 1对1专职教师: 月薪6500-12000
 1对1兼职教师: 70-90元/小时(大一以上均可)
 小组课专职老师: 月薪8000-15000

【任职要求】
 1、本科或以上学历, 专业不限
 2、态度诚恳, 有责任心和教学热情
 3、沟通表达能力强, 具有展现力
 4、参加常规教研, 承担团队教研任务

【应聘方式】
 1、网申地址: <https://jinshuju.net/f/W314wL>
 2、招聘咨询邮箱: zhaopingzck@100tal.com
 3、宣讲会、招聘会现场投递简历

Contact: zhaopinzzk@100tal.com

【晋升空间】
 1、名师路线: 普通老师→小组课老师→高端教师→明星教师
 2、管理路线: 普通老师→专员→主管→经理

【培训机制】
 1、岗前培训: 专业功底提升、授课技巧训练、素质拓展培训
 2、岗后培训: 上岗技能培训、专业功底提高、创意课堂设计

【招聘流程】
 初试——岗前培训——复试——终面——签约

【公司简介】

<http://www.yjby.com/mingqi/jobshow45746.html>

该信息已失效

好未来
 行业: 教育
 性质: 私营/民营企业
 规模: 1000人以上
 官网: <https://www.100tal.com/>

1 招聘海归硕士 15 学而思学而思
 2 海归求职网 16 短租
 3 icp备案证 17 400服务中心
 4 香港一日游攻略 18 备案信息
 5 应届生校园招聘 19 前滩未来街区
 6 海归招聘会 20 即将暴增牛教
 7 海归招聘 21 承兑汇源企业
 8 医会校园招聘 22 广州写字楼出租
 9 所有银行招聘 23 学而思咨询
 10 三亚房价 24 上海房价走势
 11 吉隆坡房价 25 学而思
 12 六年级小升初 26 深圳二手房走势
 13 未来10倍牛教 27 广州一日游
 14 10倍牛教 28 家长课程

相关公司推荐

尚学跨考教育 博士堂 快乐学习
 福建教育出版社 SMQ 阳光瑞博
 中铁芜湖建筑 美杰姆 戴氏教育

The teacher recruitment ad below shows Shujia marketing itself as GZ 1-1 and still as part of TAL, or specifically as “Aizhikang” and under the “Haoweilai” (TAL) brand flag. In the job posting, the Haoweilai / Aizhikang name is the headline. Guangzhou Shujia appears below it in smaller print as if it is a local subsidiary. The job description again opens with the Haoweilai / Aizhikang name. The company description states its name is Guangzhou Shujia then explains that “The Aizhikang Guangzhou branches and the Haoweilai Group share educational, market,

and brand resources, integrating educational resources, fusing internet technology and education.”

The ad goes on to describe the Haoweilai Group’s national network and closes by stating “Aizhikang is Haoweilai’s (previously known as Xueersi) Brand”.^{126,127}

Changke Liu, the founder of Changing Edu, appears at the bottom as the legal representative of Guangzhou Shujia, but there is no suggestion GZ 1-1 is outside of Haoweilai or actually belongs to Changing Edu.¹²⁸

Haoweilai Group - Aizhikang Small Class Teacher Job Announcement

好未来集团·爱智康小组课教师招聘

广州塾家教育科技有限公司

看看其他高薪职位>>

Guangzhou Shujia Educational Technology

好未来集团·爱智康小组课教师招聘 广州塾家教育科技有限公司

10-12万 五险一金 带薪年假 员工福利

10-12万

广州 1个月前

我感兴趣 请联系我

本科 | 工作年限不限 | 全职

五险一金 带薪年假 员工福利

职位描述:

好未来集团·爱智康小组课教师招聘简章【招聘岗位】中小小组课专职教师:科目 语文 英语 物理 初中数学 小学奥数人数 15 8 10 10 12【任职要求】1、具有专业的大班或小组课授课经验者优先2、本科或以上学历,专业不限3、讲课富有展现力,沟通表达能力强4、态度诚恳,有责任心和教学热情5、参加常规教研,承担团队教研任务【薪资】月薪: 8000-15000 元【福利】五险一金、节假日礼品、员工体检、回家基金、图书基金、旅游活动基金等【应聘方式】应聘唯一网申


¹²⁶ For those not able to read Chinese we point out a visual trick in the way this sentence is constructed. Literally this reads as: Aizhikang is Haowelai (formerly known as Xueersi) under the brand flag of”. Since Chinese grammar can be simplified and an apostrophe is not necessary, the reader first reads “Aizhikang is Haoweilai” with the rest about the old brand name and the part about “under the brand flag of” following innocuously like run of the mill marketing copy.

¹²⁷ TAL FY17 20-F, p.43, TAL previously operated under the name Xueersi. Its NYSE ticker was “XRS”. “In August 2013, we changed the name of TAL Education Technology (Beijing) Co., Ltd. to Beijing Century TAL Education Technology Co., Ltd. In addition, we changed our umbrella brand from “Xueersi” to “Haoweilai.”¹²⁸

https://www.liepin.com/job/21402372580.shtml?d_pageSize=15&d_headId=ea0079b42845d13c920ec83d020ba5e0&d_ckId=ea0079b42845d13c920ec83d020ba5e0&d_sfrom=search_comp_gs&d_curPage=0&d_posi=13

企业介绍: Guangzhou Shujia Educational Technology Co (aka Guangzhou Aizhikang) Intro:
广州懿家教育科技有限公司 (即广州爱智康) 简介 爱智康广州分校是一家中国领先的教育科技企业, 以科技驱动、人才亲密、品质领先为发展的核心目标。自2010年成立至今, 在广州4大区已开设10个校区, 拥有教职工超过300人, 近80%的教师来自于全国各地的高校; 每年, 有5000名学员走进广州爱智康的课堂, 获得家长和学生的的一致好评。爱智康广州分校与好未来教育集团共享教研资源、市场资源、品牌资源, 进行教育的资源整合, 促进科技互联网与教育融合, 致力于为孩子创造更美好的学习体验。爱智康简介 爱智康是为国内中小學生提供教育服务
 The Aizhikang Guanzhou branches and the Haoweilai Group share educational, market, and brand resources, integrating educational resources, fusing internet technology and education.

的高端品牌, 先后在北京、上海、广州、深圳、天津、杭州、成都、西安、南京、武汉、苏州、郑州等地成立分支机构, 目前已有近100所辅导中心, 数千名教职员工, 成为行业内领先、美誉度颇高的辅导品牌之一。爱智康始终专注于个性化教育, 主张“尊重每个孩子的学习天赋, 让学习更有效”。从成立之日起, 即集合优势资源组建师资队伍、完善教研体系、搭建考试资讯平台。并且改变传统1对1模式, 通过科学测评, 找到影响孩子学习的真实原因, 进行规划、上课、反馈、测试, 给孩子量身定制个性化解决方案。在这里, 孩子不仅能获得理想的成绩, 更能获得通往未来的知识和能力。爱智康是好未来 (前学而思集团) 旗下品牌。

工商信息: Aizhikang is under the flag of Haoweilai (previously known as Xueersi)
 法 人: 刘常科  Legal Rep: 注册资本: 100万人民币
 企业类型: 其他有限责任公司 Liu Changke 经营状态: 存续
 登记机关: 广州市越秀区工商行政管理局 规 模: 500-1000人
 行 业: 教育/培训/学术/科研/院校

TAL’s ongoing involvement in recruiting teachers for GZ 1-1 is another indicator that TAL never really relinquished control of its GZ 1-1 business.

8. Shujia’s SAIC filing shows multiple indicia that TAL had effective control of the entity when Changing Edu purportedly owned GZ 1-1.

Shujia was established in May 2015, about three months before the officially stated date for the transfer of GZ 1-1 to Changing Edu. Not long after the transfer, TAL’s fingerprints are in evidence in Shujia’s SAIC file.

The first piece of evidence comes in Shujia’s 2015 and 2016 SAIC filings. Both Shujia’s 2015 and 2016 SAIC Annual Reports display a TAL e-mail address as its contact email: gzzk_xb@100tal.com. They also show the website Shujia reported as its company website was: <http://gz.jiajiaoban.com>. The jiajiaoban.com domain is a TAL-owned domain.¹²⁹

¹²⁹ TAL FY2016, 20-F, p. 53. www.jiajiaoba.com The different cities using this domain are each given a two-letter prefix based on the cities’ initials. Guangzhou’s is “gz”, making it <http://gz.jiajiaoban.com>; Shanghai is <http://sh.jiajiaoban.com>; Tianjin is <http://tj.jiajiaoban.com>; etc.

2015 Annual Report

2016年度报告 2015年度报告

企业基本信息		Guangzhou Shujia Education Technology Co. Ltd.	
注册号	91440106331470605B	企业名称	广州塾家教育科技有限公司
企业联系电话	020-38619809	邮政编码	510000
企业通信地址	广州市天河区花城大道18号建滔广场2104爱智康		
Email: 电子邮箱	gzzk_xb@100tal.com	有限责任公司本年度是否发生股东（发起人）股权转让	否
企业经营状态	开业	是否有网站或网店	是
企业是否有对外投资设立企业信息	是	从业人数	该企业选择不公示

Company Website 网站或网店信息		
类型	名称	网址
网站	家教网_广州智康1对1_智康教育_学而思中小学一对一高端教育品牌	http://gz.jiajiaoban.com/

Guangzhou Zhikang 1 on 1 _ Zhikang Education_Xueersi Middle & Lower School One on One Premium Education Brand

Shareholder 股东及出资信息						
股东（发起人）	认缴出资额（万元）	认缴出资时间	认缴出资方式	实缴出资额（万元）	出资日期	出资方式
上海轻轻信息科技有限公司	100.000000	2035-04-01	货币、其他	20.000000	2015-05-06	货币

Shanghai Changing Information Technology Co. Ltd.

2016 Annual Report

2016年度报告 2015年度报告

企业基本信息		Guangzhou Shujia Education Technology Co. Ltd.	
注册号	91440106331470605B	企业名称	广州塾家教育科技有限公司
企业联系电话	020-38619809	邮政编码	510000
企业通信地址	广州市天河区花城大道18号建滔广场2104爱智康		
电子邮箱	gzzk_xb@100tal.com	有限责任公司本年度是否发生股东（发起人）股权转让	否
企业经营状态	开业	是否有网站或网店	是
企业是否有对外投资设立企业信息	是	从业人数	该企业选择不公示

Shujia’s SAIC files divulge that just over four months after the purported “disposal” of GZ 1-1, a TAL senior manager, Xiansuo Lin, joined Shujia as a minority shareholder, its Executive Director, and more importantly, its Legal Representative.¹³⁰ After the purported re-acquisition, we learned from an interview with a former Changing Edu manager that Mr. Lin returned to TAL, accepting a promotion and a posting with its corporate operations in Beijing. This appears to be corroborated by a recent Chinese news article that describes his position as a Brand Manager for the one-on-one business.¹³¹ We believe that Mr. Lin was TAL’s proxy at Shujia.

¹³⁰ According to China’s SAIC filings, Xiansuo Lin had been a well-known teacher in the Xueersi operation in Chengdu, and had risen to become a regional manager. In Chengdu, he was the listed as the legal representative for four different TAL branches.

¹³¹ <http://wemedia.ifeng.com/52448361/wemedia.shtml>

9. Shujia's CY2015 / 2016 SAIC financials do not accord with GZ 1-1 business's expected financial performance, indicating that Shujia was consolidating other Changing Edu businesses, and therefore likely not fully consolidating GZ 1-1 business.

Shujia's CY2015 revenues were less than one-third of what we would have expected, and its deferred revenue fell short by half. Its CY2016 financials displayed irregularities and did not match up with expected levels. As at December 31, 2016, one month after purportedly returning GZ 1-1 (purportedly including its assets and liabilities) to TAL, Shujia still showed deferred revenues on its books. This implies Shujia's financials consolidated other Changing Edu business, not GZ 1-1.

During the period of the purported disposal, Changing Edu had three entities running in Guangzhou. Guangzhou Qingqing (its online tutor matching platform), Guangzhou Shujia, and Guangzhou Zhidian (set up later to operate a new venture, the "Sharing Schools"). We reviewed SAIC financials of all three Changing Edu entities (shown in Appendix G).

Shujia's 2015 Revenue and Deferred Revenues:

Shujia's 2015 financials show revenue was too small to be consolidating the GZ 1-1 business. On the 2016 Q2 earnings call, Rong Luo advised that GZ 1-1's quarterly revenues as of August 2015 were approximately \$2.5 million.¹³² Even with flat growth, in the final four months of 2015, we should see revenue of approximately Rmb 21 million. However, Shujia's SAIC financials report only Rmb 5.75 million in 2015 or ~28% of the expected amount.¹³³

In contrast, GZ XRS EdTech's total revenue reported in CY2015 of Rmb 66.7 million (see Appendix F) is close to the estimate of Rmb 63.2 million (\$10 million) below for GZ 1-1's run rate.

The table below displays the calculations, currency conversion, and works out an annualized revenue run rate based on the FY16 Q2 (Aug 2015) data.

¹³² FY2016 Q2 earnings call, CFO Rong Luo

¹³³ Shujia's credit report

GZ 1 on 1 Annual Revenue Estimate			
Item	FY2016 Q2 Revenue (US\$)	FY2016 Q2 Revenue (RMB)	Annualized Revenue Est. (RMB)
TAL Total Rev.	173.3		
One on One as % of TAL Total Revenue	13%		
One on One Revenue	22.5	143.6	
GZ One on One as % of One on One Revenue	11%		
GZ One on One Revenue	2.5	15.8	63.2

Units: US\$ millions and Rmb millions

Source: FY2016 Q2 6-K, FY16Q2 earnings call

FX rate: Aug 31, 2015: 6.38

The relationship between Shujia's year-end deferred revenue and subsequent-year recognized revenue is inconsistent with our understanding of how GZ 1-1 operates, supporting our view that Shujia was not consolidating all of the GZ 1-1 business. In our field visits and interviews with staff and managers involved with GZ 1 on 1, we found that the learning centers normally collected four to six months of prepayments (deferred revenue). The table below shows that in other major cities, the prior year's collection of prepayments (deferred revenues) provided 35% to 40% of the following year's revenue. Shujia, however, collected only 17.8%.

City	Entity(ies)	Percentage
Beijing	Huanqiu Zhikang, Zhixuesi Beijing	38.7% ¹³⁴
Shanghai	Shanghai Xueersi Training Co. Ltd. ¹³⁵	35.6% ¹³⁶
Shenzhen	Shenzhen Xueersi Ed. Tech. ¹³⁷	39.9% ¹³⁸
Guangzhou	Guangzhou Shujia ¹³⁹	17.8% ¹⁴⁰

One month after purportedly returning GZ 1-1 to TAL, Shujia ended CY2016 with a deferred revenue balance of Rmb 31.8 million. At the same time, TAL reported that it had acquired a significant amount of deferred revenue on the re-acquisition: Rmb 65.2 million. The balance remaining on Shujia's balance sheet once again implies that Shujia was consolidating something other than GZ 1-1. To the extent we are correct, it could imply that TAL's accounts continued to reflect at least some of GZ 1-1's business.

We suspect Shujia was consolidating other Changing Edu businesses, possibly Guangzhou Qingqing, for the following reasons:

¹³⁴ (Rmb mm) 2015 deferred revenue: 121.9, 2016 revenue: 315.0

¹³⁵ Shanghai Xueersi Training Co., Ltd, credit report

¹³⁶ 2015 deferred revenue: 43.0 to 2016 revenue: 120.7, ratio of 1:2.8

¹³⁷ Shenzhen Xueersi Educational Consulting Co., Ltd, credit report

¹³⁸ 2016 deferred revenue: 42.8 to 2017 revenue: 107.3, ratio of 1:2.5 (CY2015 financials were unavailable.)

¹³⁹ Guangzhou Shujia Educational Technology Co. Ltd., Credit Report

¹⁴⁰ 2015 deferred revenue: 12.6 to 2016 revenue: 70.7, ratio of 1:5.6

- The vast majority of Shujia’s 2015 and 2016 revenue match up with the value of its “other receivables.” This suggests that Shujia was not simply recognizing tuition revenue from its accumulated pre-paid tuitions, but its revenue was coming from third party(ies) and collected at a later date.
- In 2015, Guangzhou Qingqing reported \$3.5 million (Rmb 22.2 million) in revenue. The next year, its revenue dropped to almost zero; however, Qingqing continued to operate its online tutor matching business in Guangzhou. Although we do not believe Guangzhou Qingqing has a robust business, it did not disappear – it is active even today.¹⁴¹ We suspect that in 2016, its revenues might have been temporarily moved over to Shujia.¹⁴²
- Shujia and the other Guangzhou businesses carry very low cash balances. While the balance sheet represents only a point in time, we find it peculiar and possibly significant. If Shujia were operating GZ 1-1, with or without TAL’s assistance, we expect it would need to hold more cash than shown on the balance sheet. The cash should be building up like a war chest that would go not just to future expenses, but also its planned growth.
- Guangzhou Zhidian was the entity initially used for Changing Edu partner Guozhi Hu’s new experiment in the Sharing Schools, “Sishujia”. In 2016, Guangzhou Zhidian showed very little activity. However, it appears that 10 or more Sharing School locations had been set up in Guangzhou in 2016.¹⁴³ Because it was opening new Sharing Schools, we would expect Guangzhou Zhidian’s accounts to show greater activity. Shujia meanwhile does report Rmb 3 million of “construction in process” at the end of CY2016. Since the GZ 1-1 businesses would have transferred out such assets, these should reflect the development of another “bricks and mortar” business. As such, we believe it might be possible that the business activities we see in Shujia might incorporate certain activities that were nominally for the Sharing Schools.¹⁴⁴

¹⁴¹ <https://www.changingedu.com/guangzhou>

¹⁴² Shujia now appears to be an orphaned company and was listed by the local tax authorities to be an “irregular tax payer”. Being an online business, it is possible that its sales have moved on and are being recorded by another of Changing Edu’s online business entities.

¹⁴³ <https://fudaoquan.com/p/12746.html>, An article from May 2016 article notes that close to 30 were established and 60 were planned by August 2016. However, hyperbole is rampant among start-ups, especially in China. A former Changing Edu manager we interviewed, stated that 10 to 20 Sharing Schools (originally under Changing Edu’s Zhidian company) were set up on CY2016.

¹⁴⁴ Hu Guozhi departed Changing Edu in 2016 and brought the Sharing Schools (Sishujia) with him into a new entity. Changing Edu’s Liu Chang Ke has continued to support him through investment, and he and TAL’s Zhang Bangxin are Directors at his new venture. http://epaper.21jingji.com/html/2017-06/02/content_63534.htm

10. The amount of deferred revenue TAL purported to have acquired with GZ 1-1 is not indicative of a business that Changing Edu was struggling to run.

Upon the purported re-acquisition, TAL claimed to have acquired \$9.43 million in deferred revenue. This is a fair value of the liability, so the actual amount of deferred revenue would likely have been higher.¹⁴⁵ (TAL disclosed that the accounting for the purchase price allocation had been determined by the group and with the assistance of an outside valuation appraiser.¹⁴⁶) Because GZ 1-1 was described as a low-margin business, we believe that its gross margin was less than 30%, and likely less than 15%. We estimate that the carrying value of deferred revenue – i.e., the prepaid tuition that had been collected – would have been \$10.5 million (Rmb 72.5 million) to \$13.5 million (Rmb 93.2 million).¹⁴⁷ We use \$10.8 million (Rmb 75 million) in our subsequent estimates.

As the table below shows, were the margins higher, the difference in carrying value would have been even greater. Even at a low margin, we are highly skeptical that Shujia’s GZ 1-1 could have generated \$9.43 million in deferred revenue. The low-end estimates of the carrying value of GZ 1-1’s deferred revenue exceed Shujia’s full-year revenue of Rmb 70.7 million, which supposedly would have included 11 months of GZ 1-1 operation. This also assumes all of the revenue Shujia reported was from GZ 1-1 and had no additions in December.

Estimated Carrying Value of Shujia's Deferred Revenue				
Deferred Revenue USD	Deferred Revenue RMB	Gross Margin	Pre-Discounted Deferred Revenue USD	Pre-Discounted Deferred Revenue RMB
9.43	65.2	10%	10.5	72.5
		15%	11.1	76.7
		30%	13.5	93.2
		50%	18.9	130.4

Units: USD millions and RMB millions

FX rate: Nov 30, 2016: 6.92

If the reported deferred revenue number is not fraudulent, it implies that the business was ramping with a large number of new student tutoring contracts. These circumstances seem

¹⁴⁵ Per ASC 805, deferred revenues are typically given a hair cut in this process with the discount being a function of the additional cost to deliver the service and fulfill the contract. GZ 1-1 would still need to pay teachers and other ongoing operational expenses. Although claimed to be a low-margin business, expenses such as marketing or pre-paid rents would be eliminated, and the deferred revenue should be adjusted downwards; therefore, if this discount was correctly applied, then the pre-discounted deferred revenues and the revenue run rate required to generate them would have been much higher. In short, if we assume ASC 805 was applied, the difference between the financial performance we see in the SAIC financials and the required revenue run rate would be even larger.

¹⁴⁶ FY2017 20-F, p. F-49

¹⁴⁷ Assuming a low gross margin of between 10% and 15%, the carrying value would have been about Rmb 75 million. If we used 26.5% gross margin implied by Shujia’s CY2016 SAIC financials, the carrying amount would be higher – approximately Rmb 89 million.

inconsistent with the purported rationale that Changing Edu felt GZ 1-1 was poor strategic fit for its tutoring business.

The \$9.4 million Deferred Revenue Purportedly Acquired with GZ 1-1 Seems Fraudulent

SAIC financials for GZ EdTech cause us to suspect that the \$9.4 million deferred revenue TAL reported buying with GZ 1-1 is fraudulent. As of November 30, 2016, TAL reports the fair value of the deferred revenue acquired was US\$9.43 million (Rmb 65.2 million). However, one month later TAL’s SAIC financials for the GZ Ed. Tech Co. display a pre-payment (deferred revenue) total of just Rmb 42.1 million.¹⁴⁸

SEC, 11/30/2016: Deferred Revenue RMB 64.9 million (\$9.43 million)
 Est. of Adjusted Carrying Value Deferred Revenue RMB 75 million (\$10.9 million)¹⁴⁹
 SAIC, GZ Ed. Tech Co, 12/31/2016: Pre-payments Rmb 42.1 million (\$6.13 million)

If TAL’s GZ Ed. Tech Co. acquired the deferred revenue, it would have booked the carrying value of approximately Rmb 75 million.¹⁵⁰ Although the deferred revenue balance prior to the purported buyback at GZ Xueersi Company is unknown, the balance at year end, just one month later, is. Its SAIC financials show it was just Rmb 42.1 million, or about half of the estimated carrying value of the purportedly transferred deferred revenue.

To achieve this reduction, at least Rmb 33 million would need to be recognized in a single month and no new prepayments from new or returning students could be accepted throughout December.

Changes in Deferred Revenue at GZ Xueersi Co.	Rmb
Pre-acquisition balance as of 11/31/2016	?
Acquired on Nov 30, 2016	75
Balance as of 11/31/2016	75+?
Additional deferred revenue added in Dec 2016	?
Balance as of 12/31/2016	42.1
Revenue recognized in Dec. 2016	32.9+?+?

Could GZ 1-1’s December 2016 revenue have been Rmb 33 million? That seems highly improbable.

In the table below, we use company-provided data to calculate the pro forma revenue that TAL acquired from all acquisitions in FY2016. In total, the maximum revenue GZ 1-1 could have

¹⁴⁸ Credit report Guangzhou Xueersi for year ending 12/31/2016, TAL’s GZ XRS EdTech Co. was the holding company for the GZ 1-1 business before the purported disposal, and based on interviews with former GZ 1-1 and Changing Edu employees, we believe this was unchanged after the purported return.
¹⁴⁹ The carrying value is applied here because the fair value adjustment will be made at the consolidation level.
¹⁵⁰ The lowest possible end of the range for the carrying value would be at zero gross margin, equating to Rmb 65.2 million. Even at this level, the claimed deferred revenue is twice that reported by GZXRS EdTech at year end.

accumulated over the nine months prior to the acquisition (and assuming ZERO revenue from other acquisitions, like Shunshun and Yaya) was \$19.64 million.^{151,152}

The average monthly GZ 1-1 revenue would be at most only Rmb 14.7 million, less than half of the Rmb 32.9+ million draw down needed to cover the difference between our low-end estimate of the deferred revenue's Rmb ~75 million carrying value and the Rmb 42.1 million shown on the SAIC files as at December 31, 2016.

GZ 1-1 Maximum Potential Annual & Average Monthly Revenue Prior to Purported Reacquisition		
Item	FY2017	Note on Source
Proforma FY2017 net revenues (All TAL revenue + rev from acquisitions)	1,062.7	TAL FY17 20-F, p.F-51
TAL Revenue (All TAL)	1043.1	TAL FY17 20-F, p.3
Combined revenue from all acquired cos. prior to M&A (9 mos.)	19.6	9 mos: March 1 to Nov. 30
Annualized (12 mos.)	26.2	
USD:RMB exchange rate	6.73	Avg for FY2017
Annualized (12 mos.) in RMB	176.3	
Avg. month revenue	14.7	

Units: USD millions and RMB millions

FX rate: CY2017: 6.73

In the spring of 2018, GZ XRS EdTech's CY2017 financials became available. This company, which we believe operates GZ 1-1, reported revenue of only \$9.8 million (Rmb 65.8 million). This is much lower than we would expect from the purported deferred revenue of \$9.4 million (Rmb 65.2 million). The deferred revenue amounts are pre-payments collected over four to six months, and are recognized when the tutoring sessions are provided. They should be a key indicator of the business size and revenue run rate. Were the \$9.4 million in deferred revenue real, GZ XRS EdTech's CY2017 revenue should have been two to three times larger (about \$19 million to \$30 million).¹⁵³

Conclusion:

With the help of a Changing Edu., a related party, TAL boosted profits and revenues in FY16, FY17, and FY18. The repurchase of GZ 1-1 with its \$50.0 million gain was instrumental in adding \$37.5 million to the bottom line in FY16 and converting profit compression into profit growth. The deferred revenues we believe TAL continued to recognize after the 2015 disposal

¹⁵¹ TAL 20-F, FY2017, p. F-51 Assuming all of the acquisitions were completed at the beginning of FY2017

¹⁵² Proforma –reported revenue = pre-acquisition revenue of acquired companies (this calculation assumes that Yaya and Shunshun provide zero revenue – however both had revenue in FY2016 prior to their acquisitions, therefore we consider the calculation below to be very conservative.)

¹⁵³ If the \$9.4 million in deferred revenue was already adjusted per ASC 850, then we estimate carrying value would be roughly Rmb 75 million, in which case the FY2017 revenue should be \$22.3 to \$33.4 million (Rmb 150 to 225 million).

flowed into its top line and down to its bottom line in FY2016 and FY2017. TAL's claim to \$9.43 million in deferred revenue upon the purported buyback appears to be largely if not entirely fraudulent and likely booked at 100% margin. We believe these gains would primarily have been recognized in FY2018.

We believe that GZ 1-1 was never truly disposed of as described by TAL. TAL retained the student contracts and revenues after the purported transfer and continued to pay most of the teachers and learning center lease payments. As such, TAL's claim to \$50 million in gains upon disposal appears fictitious. Our reviews of Shujia's business during the period of the alleged disposal find that Shujia's 2015 revenue and pre-payments were too small to accord with the size of the GZ 1-1 business it was said to have been given, while its 2016 financials appear to be comingled with other Changing Edu businesses. Even then, the claim to \$9.43 million in deferred revenue returning with GZ 1-1 would mean the pre-payments it collected exceeded its full year revenue by ~50%.

After assessing the numerous red flags and contradictions claimed by TAL, we conclude that TAL's purported transfer and requisition of GZ 1-1 was a sham. Although Changing Edu set up a new company, called Shujia, which was supposed to be managing this business, in substance the GZ 1-1 operation seem to have never fully left TAL's control.

Appendix A: DFRL Transfer Agreement Signature Page

3. 协议生效之后, 甲方将对公司的经营管理及债权债务不承担任何责任、义务。

第二条 股权转让价格

甲方和乙方一致同意, 根据本合同所规定的条件, 张邦鑫以人民币664,350元(大写人民币: 陆拾陆万肆仟叁佰伍拾元整)将其持有的东方人力64.5%股权转让给乙方; 刘亚超以人民币195,700元(大写人民币: 壹拾玖万伍仟柒佰元整)将其持有的东方人力19%股权转让给乙方; 白云峰以人民币149,950元(大写人民币: 壹拾肆万玖仟玖佰伍拾元整)将其持有的东方人力14.5%股权转让给乙方。

第三条 甲方声明和保证

1. 甲方为本协议第一条所转让股权的唯一真实的所有权人, 标的股权上不存在质押权、抵押权、质押权或其他权利负担或第三方权益或主张。
2. 甲方作为公司股东已完全履行了公司注册资本的出资义务。
3. 自本协议生效之日起, 甲方不再参与所转让股权所对应的公司财产、利润的分配。
4. 本协议项下股权转让完成后, 如乙方由于甲方的上述声明与保证不真实或不准确, 而遭受任何损失的, 甲方应赔偿乙方因此遭受的全部损失。

第四条 乙方声明和保证

1. 乙方以出资额为限对公司承担责任。
2. 乙方承认并履行公司章程修改后的章程。
3. 乙方保证按本合同第二条所规定的方式支付价款。

第五条 股权转让有关费用的负担

双方同意, 办理与本合同约定的股权转让手续所产生的有关税费由双方各自承担。

第六条 有关股东权利义务包括公司章程(含债权债务)的承受

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1. 本协议经甲、乙双方签字之日起生效。
 2. 本协议生效后, 如一方需修改本协议的, 须提前十个工作日以书面形式通知另一方, 并经双方书面协商一致后签订补充协议, 补充协议与本协议具有同等效力。
 3. 本协议执行过程中的未尽事宜, 甲乙双方应本着诚实信用的友好协商态度加以解决, 双方协商一致, 签订补充协议, 补充协议与本协议具有同等效力。
 4. 本协议之订立、效力、解释、终止及争议之解决均适用中华人民共和国法律之相关规定。
 5. 甲、乙双方应配合公司尽快办理所有相关变更的申报手续, 并办理相应的工商变更登记手续。
 6. 本协议正本一式3份, 甲方执1份, 乙方执2份, 其余报有关部门备案。
- 【以下无正文】

甲方:
张邦鑫
签署: _____

刘亚超
签署: _____

白云峰
签署: _____

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乙方:
北京顺顺必达法律服务咨询有限公司 (盖章)
授权签署人: _____



2015年7月13日

Signatures
Party A (left):
Bangxin Zhang, Yachao Liu, and Yunfeng Bai

Party B (above):
Beijing Shunshunbida
Legal Rep: Yang Zhang

July 13, 2015

Appendix B: Shunshun Shareholder Registry

2015 Annual Report 2015年度报告								填报时间: 2016年5月17日 Report Date: May 17, 2016			
企业年度报告由企业填报, 企业对其年度报告的真实性、合法性负责											
基本信息 · 统一社会信用代码/注册号: 91110108327261376E · 企业通信地址: 北京市朝阳区工人体育场北路甲2号盈科中心A座2201 · 企业联系电话: 05915066 · 从业人数: 企业选择不公示 · 是否有网站或网店: 否 · 是否有投资信息或购买其他公司股权: 是				Company Name: Beijing Shunshun Bida Information Consulting Co., Ltd. · 企业名称: 北京顺顺必达信息咨询有限公司 · 邮政编码: 100000 · 企业电子邮箱: hezuo@shunshunbida.com · 企业经营状态: 开业 · 有限责任公司本年度是否发生股东股权转让: 是 · 是否有对外提供担保信息: 否							
网站或网店信息 暂无网站或网店信息											
Shareholders and Investment Information 股东及出资信息											
序号	股东	认缴出资额 (万元)	认缴出资时间	Form of Capital Subscription	Actual Capital Contributed (Rmb '0000)	Date of Actual Capital Contribution	Form of Actual Capital Contribution				
1	Beijing Xueersi Ed. Tech. Co., Ltd. 北京学而思教育科技有限公司	19.16	2024年12月30日	In kind 实物	0	2015年12月30日	In kind 实物				
2	张杨	70	2024年12月30日	货币	0	2015年12月30日	货币				
3	张都	6	2024年12月30日	货币	0	2015年12月30日	货币				
4	Beijing Xueersi Ed. Tech. Co., Ltd. 北京学而思教育科技有限公司	23.7	2024年12月30日	Cash 货币	23.7	2015年7月23日	Cash 货币				
5	上海峰瑞投资中心 (有限合伙)	20	2024年12月30日	货币	20	2015年11月3日	货币				

Appendix C: DFRL Share Transfer SAIC Record

2016 Annual Report
2016年度报告

8条修改记录
8 changes recorded

Report date: 2017-5-30
填报时间: 2017年5月30日

企业年报信息由该企业提供, 企业对其年报信息的真实性、合法性负责

The information in this report is provided by the company, the company is responsible for accuracy and legality of the reported information.

基本信息

Co. Registration No.:	Company name: Beijing Dongfangrenli Science & Commerce Co., Ltd.	
· 统一社会信用代码/注册号: 91110105700175135G	· 企业名称: 北京东方人力科贸发展有限公司	
· 企业通信地址: 北京市朝阳区工人体育场北路甲2号盈科中心B栋12层1201-1203单元	· 邮政编码: 100000	
· 企业联系电话: 010-65915866	· 企业电子邮箱: dgyx@shunshunliuxue.com	
· 从业人数: 企业选择不公示	· 其中女性从业人数: 企业选择不公示	
· 企业经营状态: 开业	· 企业控股情况: 企业选择不公示	
· 是否有投资信息或购买其他公司股权: 否	· 是否有网站或网店: 否	
· 是否有对外提供担保信息: 否	· 有限责任公司本年度是否发生股东股权转让: 否	
· 企业主营业务活动: 科技产品的技术开发、技术转让、技术培训; 经济信息咨询服务; 组织文化艺术交流活动(演出除外); 承办展览展示活动; 家居装饰; 劳务服务; 销售百货; 零售工艺美术品、机械电器设备、五金交电、化工产品、土产品、电子计算机及软件、建筑材料、汽车配件; 教育咨询; 会议服务; 翻译服务; 自费出国留学中介服务。		

网站或网店信息

暂无网站或网店信息

Shareholder Information:

股东及出资信息

序号	Shareholder 股东	Subscribed Capital ('0000 Rmb) 认缴出资额 (万元)	Date of Capital Subscription 认缴出资时间	Subscribed Capital Type 认缴出资方式	Paid-in Capital 实缴出资额 (万元)	Paid-in Capital Date 实缴出资时间	Paid-in Capital Type 实缴出资方式
1	北京顺顺必达信息咨询有限公司	103	2015年7月30日	货币	103	2015年12月16日	货币

Beijing Shunshun Bida Information Consulting Co., Ltd.
2016-7-30
Cash
Cash

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Appendix D: SAIC Financials / Credit Report Reconciliation

The DFRL credit report provides a more detailed breakdown of the balance sheet and statement of profit and loss. Note, the credit reports display the financials in thousands.

年度		2015-12-31		2016-12-31
年报类型		年报		年报
报表类型		个别		个别
来源渠道		政府		政府
是否审计		无法确认		无法确认
资产表 (千元)	Assets (thousands of RMB)	2015	Change 变化率 (%)	2016
货币资金	Cash	9,047	69.43	15,328
预付账款	Pre-paid expenses	2,188	3,092.50	69,852
其他应收款	Other receivables	1,386	3,893.87	55,355
存货	Inventory	-	-	0
流动资产合计	Liquid Assets	12,621	1,013.50	140,535
长期应收款	L/T receivables	-	-	3,324
固定资产	Fixed assets	109	41.28	154
长期待摊费用	L/T prepayments	-	-	35
非流动资产合计	Non-current assets	109	3,122.94	3,513
资产合计	Total assets	12,730	1,031.56	144,048

DFRL Assets: The total assets as at 12/31/2016 match the changed total of Rmb 144,048,170

负债表 (千元)	Liabilities (thousands of RMB)	2015	变化率 (%)	2016
应付账款	Payables	1,429	-97.27	39
预收账款	Prepayments received	11,175	1,686.46	199,637
应付职工薪酬	Staff salaries payable	1,759	93.12	3,397
应交税费	Tax payable	229	289.96	893
其他应付款	Other payables	8,355	-88.07	997
流动负债合计	Current liabilities	22,947	793.20	204,963
非流动负债合计	Non-current liabilities	0	-	0
负债合计	Total liabilities	22,947	793.20	204,963
股本 (实收资本)	Share capital (received capital)	1,030	0	1,030
资本公积	Capital reserve	63	0	63

企业财务报告				
盈余公积	Surplus reserve	152	0	152
未分配利润	Undistributed profits	-11,462	-442.31	-62,160
股东权益 (或所有者权益) 合计	Shareholders' equity (or equity holders beneficial interest) Total	-10,217	-496.21	-60,915
负债和股东权益 (或所有者权益) 合计	Liabilities and shareholders' equity (or Total interests) Total	12,730	1,031.56	144,048

DFRL Liabilities: The total liabilities as at 12/31/2016 match the changed total of Rmb 204,963,310

In 2016, DFRL's liabilities were substantially all (97.4%) composed of pre-payments or advances from customers; or as stated in TAL's financials, deferred revenues.

损益表 (千元)	Profit & Loss (thousands of RMB)	2015	变化率 (%)	2016
营业收入	Sales Revenue	289	8,868.51	25,919
减: 营业成本	Less: Selling Expenses	1,467	3,194.07	48,324
营业税金及附加	Sales Taxes and Fees	1	9,300.00	94
营业毛利	Operating Margin	-1,179	-1,808.31	-22,499
减: 营业费用	Less: Operating Expenses	6,011	4.81	6,300
管理费用	Management Expenses	3,892	508.89	23,698
财务费用	Financial Expenses	33	1,903.03	661
营业利润	Operating Profit	-11,115	-378.25	-53,158
营业外收入	Non-operating Income	1	1,100.00	12
减: 营业外支出	Non-operating Expenses	1	100.00	2
利润总额	Pre-tax Profit	-11,115	-378.16	-53,148
减: 所得税	Less: Income Tax	0	-	0
净利润	Net Income	-11,115	-378.16	-53,148

DFRL P&L: Revenue, Pre-tax Profit, Net Income match at 25,918,577; -53,147,794; and -53,147,794.

Appendix E: Shunshun / DFRL CY2015 - CY2017 SAIC Financials

SAIC Financial Reports for Shunshun and DFRL CY2015~2017 (RMB)									
	DFRL			Shunshun			Total		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
Assets	12.73	144.05	142.54	76.10	113.64	78.19	88.83	257.68	220.73
		1032%	n/a		49%	n/a		190%	n/a
Liabilities	22.95	204.96	309.37	44.09	98.62	96.95	67.04	303.58	406.32
		793%	51%		124%	n/a		353%	34%
Equity	(10.22)	(60.92)	(166.84)	32.01	15.02	(18.76)	21.79	(45.89)	(185.60)
		496%	174%		n/a	n/a		n/a	n/a
Rev	0.29	25.92	53.45	1.89	17.04	23.02	2.18	42.96	76.47
		8878%	106%		801%	35%		1872%	78%
- Main business	0.29	25.92	53.45	1.79	16.41	23.02	2.08	42.33	76.47
		88.78	1.06		8.17	0.40		19.36	0.81
Pre tax income	(11.12)	(53.15)	(107.73)	(36.79)	(45.31)	(33.78)	(47.91)	(98.46)	(141.51)
		378%	103%		23%	n/a		106%	44%
Net income	(11.12)	(53.15)	(107.73)	(36.79)	(45.31)	(33.78)	(47.91)	(98.46)	(141.51)
		378%	103%		23%	n/a		106%	44%
Tax payment	0.01	1.16	1.80	12.34	0.57	0.00	12.35	1.73	1.80
		12750%	55%		-95%	n/a		n/a	4%

Units: Rmb millions

Source: SAIC financials & credit reports

SAIC Financial Reports for Shunshun and DFRL CY2015~2017 (USD)									
	DFRL			Shunshun			Total		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
Assets	2.02	21.60	21.19	12.06	17.04	11.63	14.07	38.64	32.82
		971%	n/a		41%	n/a		175%	n/a
Liabilities	3.64	30.74	46.00	6.99	14.79	14.41	10.62	45.52	60.41
		745%	50%		112%	n/a		329%	33%
Equity	(1.62)	(9.13)	(24.81)	5.07	2.25	(2.79)	3.45	(6.88)	(27.60)
		464%	172%		n/a	n/a		n/a	n/a
Rev	0.05	3.89	7.95	0.30	2.55	3.42	0.35	6.44	11.37
		8397%	104%		753%	34%		1766%	76%
- Main business	0.05	3.89	7.95	0.28	2.46	3.42	0.33	6.35	11.37
		83.97	1.04		7.68	0.39		18.27	0.79
Pre tax income	(1.76)	(7.97)	(16.02)	(5.83)	(6.79)	(5.02)	(7.59)	(14.76)	(21.04)
		353%	101%		17%	n/a		95%	43%
Net income	(1.76)	(7.97)	(16.02)	(5.83)	(6.79)	(5.02)	(7.59)	(14.76)	(21.04)
		353%	101%		17%	n/a		95%	43%
Tax payment	0.00	0.17	0.27	1.96	0.09	0.00	1.96	0.26	0.27
		12062%	54%		n/a	n/a		n/a	3%

Units: US\$ millions

Source: SAIC financials & credit reports

FX rates: CY2015: 6.31, CY2016: 6.67, CY2017: 6.73

Appendix F: GZ XRS EdTech SAIC Financials

Guangzhou XRS EdTech Co. Ltd 2015-2017 Financials						
Balance Sheet	<u>CY2015</u>		<u>CY2016</u>		<u>CY2017</u>	
	RMB	USD	RMB	USD	RMB	USD
Currency						
Cash	52.1	8.3	46.7	7.0	49.0	7.3
Prepaid	3.7	0.6	3.0	0.4	6.5	1.0
Other receivables	3.6	0.6	6.4	1.0	3.3	0.5
Other			0.2	0.0	0.1	0.0
Total current assets	59.4	9.4	56.3	8.4	58.9	8.8
Long term equity investment	1.0	0.2	1.0	0.1	1.4	0.2
Fixed assets	2.8	0.4	1.8	0.3	1.8	0.3
Construction in process	1.4	0.2				
Long term deferred exp	3.8	0.6	4.4	0.7	3.2	0.5
Total assets	68.4	10.8	63.5	9.5	65.3	9.7
Accounts payable	1.5	0.2	0.8	0.1	7.4	1.1
Advances from customer	30.9	4.9	42.1	6.3	36.8	5.5
Payroll	2.7	0.4	2.5	0.4	2.7	0.4
Other payables	25.2	4.0	5.6	0.8	3.1	0.5
Tax payables	0.2	0.0	0.7	0.1	0.6	0.1
Total current liabilities	60.5	9.6	51.7	7.8	50.6	7.5
Capital	1.0	0.2	1.0	0.1	1.0	0.1
Surplus	1.0	0.2	1.0	0.1	1.0	0.1
Retained earnings	5.9	0.9	9.7	1.5	12.7	1.9
Total equity	7.9	1.2	11.7	1.7	14.7	2.2
Total equity and liabilities	68.4	10.8	63.4	9.5	65.3	9.7
Total shareholders equity	0.0	0.0	0.1	0.0	0.0	0.0
Income Statement						
	<u>2015</u>		<u>2016</u>		<u>2017</u>	
Currency	RMB	USD	RMB	USD	RMB	USD
Sales	66.7	10.6	44.9	6.7	65.8	9.8
Cost	33.8	5.4	15.0	2.2	34.5	5.1
sales tax etc.	2.2	0.3	0.7	0.1	0.3	0.0
Gross margin	30.7	4.9	29.2	4.4	31.0	4.6
Sales exp	17.6	2.8	16.8	2.5	18.0	2.7
G&A exp	13.6	2.2	9.6	1.4	9.2	1.4
Financial costs	-1.6	-0.3	-1.8	-0.3	-0.1	0.0
Operating profit	1.1	0.2	4.6	0.7	4.0	0.6
Other income			0.1	0.0	0.2	0.0
Other exp					0.3	0.0
Pre tax income	1.1	0.2	4.7	0.7	3.8	0.6
Income tax			0.8	0.1	1.0	0.1
Net income	1.1	0.2	3.9	0.6	2.9	0.4

Units: Rmb millions and USD millions

Source: credit reports

FX rate: CY2015: 6.31, CY2016: 6.67, CY2017 6.73

Appendix G: Changing Edu Entity SAIC Financials

Changing Edu's Guangzhou Businesses (RMB)									
Financial Reports									
Balance Sheet	Guangzhou Shujia			Guangzhou Qingqing			GZ Zhidian		
	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Cash	2.2	0.7		0.4	0.0				
Accounts receivable		0.3							
Other receivables	4.4	71.1		4.1	21.7	20.2			
Other		0.5				0.0			
Total current assets	6.6	72.6		4.5	21.7	20.2			
Goodwill									
Longterm equity investment				1.0	1.0	1.0			
Construction in process		3.0							
Long term deferred exp	1.5	0.3		0.2	0.1	0.0			
Intangible				0.3	0.2	0.1			
Total assets	8.1	75.9		6.0	23.0	21.4		28.2	
Advances from customer	12.6	31.8							
Payroll									
Other payables	3.4	45.1		28.8	45.9	44.5			
Tax payables	0.5	0.2		(0.0)					
Total current liabilities	16.5	77.1		28.7	45.9	44.5		2.0	
Capital	0.2	0.2		1.0	1.0	1.0			
Retained equity	(10.0)	(1.5)		(23.7)	(23.9)	(24.1)			
Total equity	(9.8)	(1.3)		(22.7)	(22.9)	(23.1)		26.2	
Total equity and liabilities	6.8	75.8		6.0	23.0	21.4		28.2	
Income Statement	Guangzhou Shujia			Guangzhou Qingqing			GZ Zhidian		
	<u>2015</u>	<u>2016</u>		<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Sales	5.8	70.7		22.2	0.2	0.0		0.7	
Cost	11.9	51.6							
Sales tax etc		0.3		0.1					
Gross margin	(6.1)	18.8		22.1	0.2				
Sales exp	1.6	2.9		33.2	3.2				
G&A exp	2.3	6.8		5.6	3.0	(0.4)			
Operating profit	(9.9)	9.1		(16.7)	(6.0)	0.4			
Pre tax income	(9.9)	9.1		(16.7)	(6.0)	0.4		(14.0)	
Income tax		0.2							
Net income	(9.9)	8.9		(16.7)	(6.0)	0.4		(14.0)	

Unit: Rmb millions

Sources: SAIC financials and credit reports

Changing Edu's Guangzhou Businesses (USD)									
Financial Reports 2015-2017									
Balance Sheet	Guangzhou Shujia			Guangzhou Qingqing			GZ Zhidian		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
Cash	0.3	0.1		0.1	0.0				
Accounts receivable		0.0							
Other receivables	0.7	10.7		0.6	3.3	3.0			
Other		0.5				0.0			
Total current assets	1.0	11.3		0.7	3.3	3.0			
Goodwill									
Longterm equity investment				0.2	0.1	0.1			
Construction in process		0.4							
Long term deferred exp	0.2	0.0		0.0	0.0	0.0			
Intangible				0.0	0.0				
Total assets	1.3	11.8		1.0	3.5	0.1		4.2	
Advances from customer	2.0	4.8							
Payroll									
Other payables	0.5	6.8		4.6	6.9	6.6			
Tax payables	0.1	0.0		(0.0)					
Total current liabilities	2.6	11.6		4.6	6.9	6.6		0.3	
Capital	0.0	0.0		0.2	0.1	0.1			
Retained equity	(1.6)	(0.2)		(23.7)	(3.6)	(3.6)			
Total equity	(1.5)	(0.2)		(23.5)	(3.4)	(3.4)		3.9	
Total equity and liabilities	1.1	11.4		(19.0)	3.5	3.2		4.2	
Income Statement	Guangzhou Shujia			Guangzhou Qingqing			GZ Zhidian		
	2015	2016		2015	2016	2017	2015	2016	2017
Sales	0.9	10.6		3.5	0.0	0.0		0.1	
Cost	1.9	7.7							
Sales tax etc		0.0		0.0					
Gross margin	(1.0)	2.8		3.5	0.0				
Sales exp	0.2	0.4		5.3	0.5				
G&A exp	0.4	1.0		5.6	0.4	(0.1)			
Operating profit	(1.6)	1.4		(7.4)	(0.9)	0.1			
Pre tax income	(1.6)	1.4		(7.4)	(0.9)	0.0		(2.1)	
Income tax		0.0							
Net income	(1.6)	1.3		(7.4)	(0.9)	0.0		(2.1)	

Unit: USD millions

Sources: SAIC financials and credit reports

FX rates: CY2015: 6.31, CY2016: 6.67, CY2017: 6.73