

2018

GMT
RESEARCH

GMT RESEARCH

THE ACCOUNTING PEOPLE

WHO WE ARE

ACCOUNTING RESEARCH



- An accounting research firm focused on Asia and regulated by Hong Kong's Securities and Futures Commission
- Developing proprietary methodologies to detect financial anomalies, or traits similar to past shenanigans
- Offer clients:
 - actionable investment ideas
 - latest developments in corporate fraud
 - risk minimisation by highlighting companies engaged in questionable accounting
 - idea generation through ability to scan for companies with specific accounting traits
 - ability to check any company globally for unusual financial anomalies or traits in line with past shenanigans
 - bespoke research based on our A&G Screen
- Three product lines...

1. WRITTEN RESEARCH

AROUND 30
REPORTS A
YEAR

- Publish around 30 accounting based reports a year across three broad categories:
 - **In-depth thematic:** Pick a specific theme, such as how to spot companies boosting profits through Acquisition Accounting, explain the accounting behind it, and then highlight companies with similar traits
 - **High conviction single stock ideas:** Highlight companies where the accounting masks the economic reality, possibly through window dressing, profit manipulation or by faking sales
 - **In-brief research:** Shorter pieces on more topical issues such as stocks targeted by short-sellers or companies which have inexplicably defaulted
- A negative recommendation bias given our focus on accounting issues but constructive investment advice
- Attempt to engage management prior to publishing and based on publicly available information



2. A&G SCREEN

DEVELOPING PROPRIETARY MODELS

- Developed an Accounting & Governance (A&G) Screen which scrutinises every line item within financial statements for anomalies
 - Methodology uses a percentile scoring system for each financial ratio relative to a relevant industry peer group
 - Drawn from 16,000 companies globally and five years' worth of data
- Developed modules within the Screen which flag up specific accounting shenanigans, such as Acquisition Accounting or Fake Cash Flows
- Available to our clients in the form of a Bloomberg-enabled excel spreadsheet which can check any company globally for any financial year that Bloomberg has data
- Provide additional screens that help investors search for companies with specific accounting traits



3. CLIENT INTERACTION

OUR UNIQUE PROPRIETARY MODEL

- We offer a limited bespoke research product where we provide a written interpretation of the output of our Accounting & Governance Screen
- Process a “reasonable” number of requests
- Available for conference calls and meetings on written reports and other matters (e.g. general accounting questions)
- Crisis management on companies recently targeted by a short-seller



WHO WE ARE...

EXPERIENCED WRITERS

Gillem Tulloch has been a financial analyst since 1994 and has been based in Asia since 1995, with spells in Singapore, Thailand, Korea and most recently Hong Kong. Over his career, Gillem has covered sectors ranging from telecoms to printing to electronics. He has achieved top industry rankings in regional polls like Asiamoney and Institutional Investor, and has appeared on Bloomberg and Business Week. Gillem has worked in research and strategy for several large sell-side institutions, including Cazenove, Nomura and CLSA, and founded the independent research company Forensic Asia before moving on to establish GMT Research.

Nigel Stevenson worked for eight years in investment banking at Dresdner Kleinwort Wasserstein in London, primarily advising on equity offerings and M&A transactions, both in the UK and internationally. He subsequently spent seven years as an equity research analyst at Veritas Asset Management, where he was a member of the global equities team, primarily focusing on the industrials sector. Nigel is a graduate of Cambridge University and a qualified barrister. He has a Masters in Finance from London Business School, awarded with distinction, and is a CFA charterholder.



WHO WE ARE...

EXPERIENCED WRITERS

Mark Webb is a research analyst and chartered accountant. He has been based in Asia for 21 years, writing research on transport, logistic and industrial conglomerate companies since 1997. Mark has worked for HSBC in equity research in Hong Kong and Singapore, and at PricewaterhouseCoopers in London and Hong Kong.

We also have highly experienced guest writers contribute on occasion.

Lisa Mangkornkarn: COO

Christopher Guinness: Asian Sales

Brian Kern and **Matthew Barker**: US Sales



A&G SCREEN

SUMMARY (PAGES 1)

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Insert BBG ticker

Defaults to latest period, but can check any period

Checks auditor, incorporation and currency of financials

Summary of traditional mathematical models for quality of profit and leverage

Summary of our own models

Anything worth further investigation is highlighted in red.

Short Name	China Hongqiao	Description:	China Hongqiao Group Ltd. manufactures aluminum products. The Company's aluminum products consist of molten aluminum alloy, aluminum alloy ingots and aluminum busbars.	Relevant
GICS Ind Name	Metals & Mining			IN-BRIEF
GICS Industry	151,040			HIDDEN
Cntry of Dom	CN			
Most Recent Balance Sheet Period	2017 Y			Short-Se
Ticker	1378 HK			By Emer
Latest Period	Y			Summary
Current Fiscal Year	2017			- Profit r
Well known auditor:	Shinewing Cp			- Financi
Numbe of auditors in past Syrs:	3	Shinewing Cp. Ernst & YOUN. Deloitte Tou.		- Genera
Country of incorporation:	Country of incorporation (Cayman Islands) is different from domicile (China).			- Shenar
Country of financials:	Currency of financials (Yuan Renminbi) is same as country of risk (China).			= Accou
Profit Manipulation		Latest financials complete		
<u>Profit Manipulation: Beneish M-Score (See App 1)</u>		Beneish M-Score of -2.4 in Y/FY17 suggests no profit manipulation.		
<u>Cooking the Books: Montier's C-Score (App 2)</u>		A C-Score of 2/6 slightly better than average but watch out for: Rising OCA. High asset growth.		
Financial Position				
<u>Strength of Financial Position: Piotroski F-Score (App 3)</u>		An F-Score of 7/9 suggests financials are improving.		
<u>Risk of Default: Altman Z-Score (App 4)</u>		An Altman Z-Score of 5.34 is in the Safe Zone: Financially sound.		
Accounting Shenanigans				
<u>Acquisition Accounting (App 5)</u>	Global screen	Possible earnings manipulation through acquisition accounting in FY16 owing to material acquisi		
<u>Window Dressing (App 6)</u>		No evidence of window dressing.		
<u>Fake Cash Fraud: Overly profitable (App 7)</u>	Global screen	Scores 0/4 in Y/FY17. 64% of companies score similarly and just 2.4% of frauds. Rest easy. Trigg		
<u>Excess Capital Raising (App 8)</u>	Global screen	Net flows over 5yrs at 11% of Sales are in the 93%ile and unusually high suggesting too much ex		
<u>Debt Reconciliation (App 9)</u>	Global screen	No material unreconcilable changes in debt in the last 5 years.		
Other Financial Items				
<u>Number of Red Flags (Out of a possible 75)</u>		Triggers 10 red flags in the last financial period which is normal.		
<u>Cash Balance</u>		Cash & STI of CNY21.9bn is within normal range.		
<u>Restricted Cash</u>		Restricted Cash of CNY1.3bn is within normal range.		
<u>Receivables</u>		Receivables of CNY14.1bn are equal to 13% of Sales which is in within normal range.		
<u>Doubtful Debts</u>		Delinquency at 0% of total receivables are within normal range.		
<u>Payables</u>		Large Payables of CNY32.9bn equal to 28% of Sales are in the 92%ile relative to peers, can be a s		
<u>Inventory</u>		Inventories of CNY15.6bn are equal to 17% of Sales which is within normal range.		
<u>Profit Manipulation: Gross Working Capital</u>		No evidence of profit/cash flow manipulation through working capital.		
<u>Cash Extraction Fraud: Prepaid Expenses</u>		Prepaid Expenses of CNY12.4bn are large relative to sales (13.2%) and inventory (79.3%), raising		
<u>Capitalisation of Expenses</u>		Capitalised expenses relative to pre-tax profits (0%) are within normal range.		
<u>Affiliate Investments</u>		Investments in Associates of CNY1.3bn are equal to 2% of equity and 4% of OP, within normal ra		
<u>Auditing Costs</u>		Auditing expenses of 0.5bp of sales are unusually low in the 4%ile relative to peers, suggesting a		
<u>Deferred Tax Assets</u>		Deferred Tax Assets have increased by 1.3ppts relative to sales over the past year which can be		
<u>Deferred Tax Liabilities</u>		Deferred Tax Liabilities/Sales of 2% are within normal range.		
<u>Debt to Equity</u>		Debt to Equity ratio of 20% is within normal range.		

Highlights recent GMT Research reports

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A&G RATIOS (PAGES 2 & 3)

Chosen ratios. Hyperlinked to explanations on our website. Can easily incorporate more upon request.

Chosen peer group. Set to our default but can over-ride and choose between GICS industry, Country or Global.

Ratios of the chosen company for FY, -1FY and -3FY, and change over 1 and 3 years
Defaults to latest financial period (in this case S1/FY16) but can over-ride.

Bell curve of relevant peer group

Number of peers

Percentile scoring system with red flags highlighted and commentary

Ratios	Global/Sector/ Country	China Hongqiao Ratios			Ratio Change		Peer Group Comparison Ratios				Percentiles and Red Flags			Red Flag C
		Y/FY17	Y/FY16	Y/FY14	-1yr Chg	-3yr Chg	20th %ile	50th %ile	80th %ile	No of Peers	Y/FY17	-1yr Chg	-3yr Chg	
Balance Sheet: Assets														
											(0-100%)	(+/-50%)	(+/-50%)	
Av Cash & Equiv./Sales (%)	GICS Industry	18.6	17.4	19.5	+1.3	-0.8	2.8	9.6	25.9	644	71%	-17%	+9%	
Unrestricted Cash/COGS (%)	GICS Industry	28.0	27.2	28.7	+0.7	-0.7	2.8	9.9	31.2	563	77%	-1%	-1%	
ST Investments/Sales FY (%)	GICS Industry	0.0	0.0	0.0	+0.0	+0.0	0.1	1.0	7.7	255	na	na	na	
Av. Trade & Notes Rec/Sales (%)	GICS Industry	13.0	15.2	6.9	-2.2	+6.0	4.4	11.0	19.6	621	59%	-39%	+35%	Risen over
Delinquent AR/AR (%)	Global	0.0	0.0	0.0	+0.0	+0.0	0.9	5.9	22.7	1,912	na	na	na	
Av. Inventory/Sales (%)	GICS Industry	16.7	27.9	30.9	-11.2	-14.2	11.1	17.8	28.5	649	45%	-46%	-46%	
Inventory Days	GICS Industry	76	114	145	-38	-69	49	77	126	558	49%	-46%	-47%	
Finished Goods/Inventory (%)	GICS Industry	8	9	1	-0.6	+6.7	16	32	50	691	8%	-8%	+22%	
Av. Other ST Assets/Sales (%)	GICS Industry	10.6	8.3	4.4	+2.3	+6.1	1.9	4.5	10.5	647	80%	+31%	+33%	Av. Other S
PPE/Sales (%)	GICS Industry	95.1	131.4	135.0	-36.3	-39.9	25.9	54.9	120.5	626	72%	-46%	-45%	Fallen over
Affiliate Inv/Equity (%)	Global	2.5	2.1	na	+0.4	na	0.5	3.0	13.1	7,896	46%	+23%	na	
LT Inv & Rec/Sales (%)	GICS Industry	0.2	0.0	0.0	+0.2	+0.2	0.2	1.4	6.4	463	17%	+18%	+7%	

A&G SCREEN

MATHEMATICAL MODELS (PAGES 3 - 5)



- Detailed breakdown of traditional mathematical models (Beneish, Montier, Altman and Piotroski), linked into full explanations on our website.
- Incorporates our own models highlighting potential Acquisition Accounting, Window Dressing, etc.

Appendix 1: Beneish M-Score	Calculation	Result	Index Calculation
Days Sales in Receivables Index	$+(0.92 \times 1.39)$	1.28	$(\text{Net Receivables}_t / \text{Sales}_t) / (\text{Net Receivables}_{t-1} / \text{Sales}_{t-1})$
Gross Margin Index	$+(0.528 \times 1.20)$	0.63	$[(\text{Sales}_{t-1} - \text{COGS}_{t-1}) / \text{Sales}_{t-1}] / [(\text{Sales}_t - \text{COGS}_t) / \text{Sales}_t]$
Asset Quality Index	$+(0.404 \times 0.90)$	0.36	$[1 - (\text{Current Assets}_t + \text{PP\&E}_t + \text{Securities}_t) / \text{Total Assets}_t] / [1 - ((\text{Current Assets}_{t-1} + \text{PP\&E}_{t-1} + \text{Securities}_{t-1}) / \text{Total Assets}_{t-1})]$
Sales Growth Index	$+(0.892 \times 1.14)$	1.02	$\text{Sales}_t / \text{Sales}_{t-1}$
Depreciation Index	$+(0.115 \times 1.00)$	0.12	$(\text{Depreciation}_{t-1} / (\text{PP\&E}_{t-1} + \text{Depreciation}_{t-1})) / (\text{Depreciation}_t / (\text{PP\&E}_t + \text{Depreciation}_t))$
SG&A Index	$-(0.172 \times 1.06)$	-0.18	$(\text{SG\&A Expense}_t / \text{Sales}_t) / (\text{SG\&A Expense}_{t-1} / \text{Sales}_{t-1})$
Total Accruals to Total Assets	$-(4.679 \times 0.03)$	-0.14	$(\text{Income from Continuing Operations}_t - \text{Cash Flows from Operations}_t) / \text{Total Assets}_t$
Leverage Index	$-(0.327 \times 1.06)$	-0.35	$[(\text{Current Liabilities}_t + \text{Total Long Term Debt}_t) / \text{Total Assets}_t] / [(\text{Current Liabilities}_{t-1} + \text{Total Long Term Debt}_{t-1}) / \text{Total Assets}_{t-1}]$
Beneish M-Score for S1/FY16	$-4.84 =$	-2.10	Beneish M-Score of -2.1 in S1/FY16 suggests possible profit manipulation triggered by deteriorating receivable days in previous year: -1.67

- Traditional models designed for developed markets, not Asia, but get analysts to think about important issues.

Comments
Receivables of 62 days have increased by 17.6 days YoY
12m Trailing Gross Margin of 22% has deteriorated by 4.3% YoY
Other LT Assets/Total Assets of 2.5% has fallen by 0.3% YoY
12m Trailing Sales have risen 14% YoY
12m Trailing Depreciation/Sales of 5.8% has fallen by 0% YoY
12m Trailing SG&A/Sales of 2.2% have risen by 0.1% YoY
Total Accruals (Net Profit less CFO)/Total Assets are 0% YoY
LT Debt + Current Liabilities / Total Assets of 67% have risen by 3.6% YoY
An M-Score of >-2.22 signals that the company is likely to be a manipulator

RESEARCH DELIVERY

MULTIPLE PLATFORMS



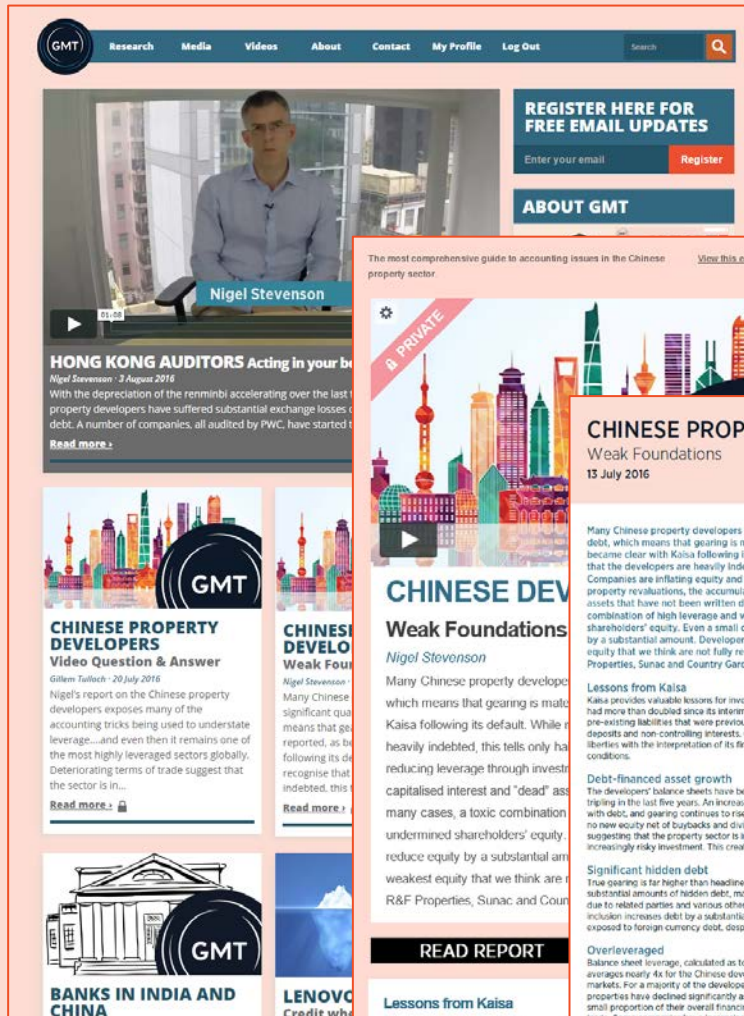
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Bespoke Research:

Red Flags Consulting writes independent, confidential, in-depth company-specific bespoke research tailored to individual client needs. Clients are primarily institutional fund managers and equity research analysts. The service aims to provide idea and lead generation, and/or hypothesis opinion as well as professional back up to clients' own research.

Typical research objectives are to identify accounting, liquidity and/or corporate governance red flags in the annual or interim filings of medium to large cap stock exchange listed companies. Only publicly available information is used in this integrity assessment. The forensic analysis utilizes experience from the characteristics of known problematic vs high quality companies.

Its founder, **John Besant-Jones**, began his career as an equity analyst in 1989 and since then has worked in this role on both the buy and sell side for companies such as Barclays Bank, ABN and Credit Suisse. Prior to setting up Red Flags Consulting LLC, John also worked as a research assistant to the Chinese professor of accounting department head at the Chinese University of Hong Kong, researching financial irregularities among US listed Chinese companies.

John holds a Bachelors degree in Civil & Structural Engineering and a Masters degree in Finance & Investment from the United Kingdom, an MBA specializing in Chinese business from the Chinese University of Hong Kong, and post graduate certificates in both US GAAP accounting and Oil & Gas accounting from the USA. He has also served as a member of the continuing education committee on the Hong Kong Society of Financial Analysts (HKSFA), which is the CFA branch of Hong Kong.

STRATEGIC PARTNERSHIPS

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Corporate Investigations:

Schmittzehe & Partners is a boutique Asia-focused management consultancy which provides strategic consultancy, expert analysis and in-depth due diligence investigations.

Originally founded as a China-focused consultancy in 2005, the firm has grown to now cover the broader Asia region, while maintaining its recognized Greater China expertise.

In terms of investment research, Schmittzehe & Partners is specialised in methodical, bespoke investigative primary research leveraging on-the-ground strategy and M&A consulting expertise to help clients gain a deeper, clearer understanding of companies and the context within which they operate.

Its founder, **Benjamin Schmittzehe**, has almost 25 years of cross-border experience between Asia and the rest of the world. He is specialised in Strategy, Investment and Implementation and advises clients across a wide range of sectors with particularly deep expertise in the TMT (Technology/Media/Telecom), Consumer Goods and Services, Life Sciences and Engineering Products sectors. Prior to consulting, Benjamin worked in Corporate Development and General Management roles for Microsoft, Pfizer and the Swire Group, where he began working in China in 1991. He was the first non-Chinese representative for the Swire Group in China in the Group's 150+ year history there. Benjamin has lived in China, Indonesia, Singapore as well as in Europe, and speaks Chinese (Mandarin and Cantonese), Bahasa Indonesia, French, German, as well as English. He was educated at Oxford University (BA Hons, Chinese; MA Oxon.) and INSEAD (MBA). When at Oxford, he was awarded a Chinese government scholarship, and a college academic prize.

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