

November 3, 2020

Attention: Jay Clayton, Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Letter #7 Re: Ongoing Coverup of GSX Techedu's Criminal Fraud

To Mr. Jay Clayton,

There has been extensive evidence collection and analysis of the GSX fraud (see: DeloitteFraud.com & Bit.ly/GSXFraud) to date. We now embark upon a new part of the story: **The Cover-Up.**

- On September 2, 2020, GSX Techedu (NYSE: GSX) held its Q2 earnings call in which they predicted full-year profitability, noted their customer conversion rate as being industry best, and discussed how they spent an *additional* \$200M in Q2 marketing to turbocharge Q3's growth.
- Only a few weeks after the end of Q2, GSX pulled a sudden 180 for the first time as a company by guiding analysts for a lower Q3. Now they claim that "sales & marketing expenses to increase 512% YoY" and lament having "record low conversion rates."

During GSX's Q2 earnings conference call, their senior leadership – Chairman and CEO, Larry Chen and Chief Financial Officer, Nan Shen – painted a picture for shareholders of a highly successful, profitable quarter; yet in just four weeks prior to its completion, GSX now describes their worst results ever. What changed?

GSX must account for missing cash by creating fictitious expenses as investigators come closer to unearthing massive fraud. Therefore, they must cover up their dwindling cash balances.

The auditors of GSX, both Deloitte and an independent auditor GSX hired for their internal investigation [GSX refuses to disclose the auditor beyond saying it is a Big 4 firm], have a responsibility to ensure these payments are real, to understand who was paid and confirm GSX did not transact to or pay related or affiliated parties.

On September 2, 2020, GSX's executive management repeat to shareholders that they expect profitability for the whole year:

- “We plan to execute a profitable growth strategy for the whole year”
- “We target full-year profitability”
- “Target profitable growth for the whole year”
- “We firmly believe that we will achieve our full-year revenue target”

The Q2 earnings call, which is normally in August, was delayed to September. According to their Investor Relations team it was to “*provide a comprehensive picture to investors after the summer semester approaches to an end.*” During the call, CEO Chen and CFO Shen, continuously reiterate their unwavering confidence in their summer numbers.

GSX repeats they expect summer numbers to be on track:

- “Last but not least, this summer, Genshuixue and Gaotu Ketang both delivered solid results.”
- “So, we still see we did a very good job on our summer campaign.”
- “The main goal for the summer was to -- is to recruit more students in the fourth semester, and we do expect a big jump in the fall semester concurrent students.”

GSX went from expecting a Q3 profit to a **loss** of **RMB 900 million**. To recap:

- In Q2 they claim to have earned RMB 1,650 million and were profitable
- In Q3 they are expecting RMB 1,936 million, but an RMB 900 million loss

But if GSX was on track through September 2, as GSX executives maintained, it means that ~70% of the quarter had already transpired, yet GSX made **no mention** on their earnings call that exploding costs would threaten profitability.

As evidenced in this letter, on September 2, 2020, GSX executives were extremely confident of a profit, yet four weeks later they claim they spent an additional RMB 900 million. Even more puzzling is that marketing for Summer classes was **already over** by September 2. It’s not conceivable that GSX, which had supposedly been profitable for 8 consecutive quarters, and which expected to be profitable for a 9th quarter, realized only in the final 4 weeks of the 13 week quarter that they spent an additional RMB 900 million without realizing it. That amount is equal to 46% of quarterly earnings! Even more unrealistic, is that GSX purposefully waited until the end of the Summer to report Q2 earnings and provide Q3 guidance.

The only explanation for GSX not mentioning a loss of RMB 900 million is that senior leadership needed to explain missing cash in a hurry. Any spending for their summer promotions would have happened before September 2nd.

In addition, throughout the call, GSX proudly declared their conversion and cost of acquisition (CAC) to be the industry’s best.

GSX reiterates their purportedly incredible conversion rates:

- “We still enjoy – our ROI level is still leading the whole industry.”
- “For our existing students, basically, the customer acquisition cost is zero.”
- “We can still maintain relatively high conversion rate. That gives us a lower customer acquisition cost and a high ROI.”
- “We will make efforts to prioritize investments in high ROI traffic acquisition channels.”
- “We are laser-focused on deploying our customer acquisition resources based on ROI.”
- “Still able to record an acceleration in paid course enrollments, which really speaks to the remarkable conversion, competitive and operational efficiency of our team.”

GSX is now *pretending* their marketing budget expanded greatly in Q3, yet they pre-funded its marketing and had fewer classes to promote this Summer.

GSX Q3 marketing should not have increased:

- “We strategically front-loaded investments of more than \$200 million in the traffic acquisition for the promotional courses recruitment for the third quarter, which generated no gross billings in the second quarter.”
- “This summer vacation is relatively shortened because the delay of Gaokao and Zhongkao. So, we have reduced one round of the classes.”
- “Paid course enrollments that we attracted in the second quarter laid a solid foundation for net revenue growth in the third and fourth quarters, which can be seen in our deferred revenues, which is nearly to 2 billion.”

Independent sources show that GSX’s marketing budget did not increase over the summer. Below is the WeChat search index with GSX’s two companies being the yellow and blue. It’s clear they are a fraction of their competitors. This graph also shows that in the last week searches for Genshuixue decreased 21% and for Gaotu decreased 10%.



GSX reaffirmed stable operating profit margin:

- “But overall, GP margin will be stable with 1% or 2% fluctuation.”
- “We will still generate operating leverage from our R&D and G&A expenses with our net revenue continue to expand.”

GSX has employed Capex Fraud previously to hide cash:

- Companies that report fake profits have a fake cash problem in that they need excuses for not having the cash in their accounts implied by their reported profits
- Frauds often address the fake cash problem by fraudulently inflating the amounts they report paying for asset purchases
- GSX reported an inflated purchase price (Capex fraud) with respect to its commercial building purchase, and in reality paid a substantially lower price for the real estate than reported to investors
- GSX claims they paid RMB 333.8 million for three buildings, but Grizzly Research proves in their [February 2020 report](#) the real amount was only RMB 75 million

GSX's CEO Larry Chen and CFO Shan Nan are hoping to play their auditors and the US SEC for fools by fabricating wholly fictitious invoices and expenses in an ill-fated attempt to cover-up previously reported "profits" and "cash flow" and account for their mounting cash losses. We implore the SEC, Deloitte, and their undisclosed independent auditor to follow the trail of these "invoices." We are confident that "revenues" and profitability were significantly overstated and that the companies charging GSX have no other clients, have not performed any services, and/or are related entities owned by GSX or its insiders.

Yours truly,

Joseph White