GRAVITY

RESEARCH

Reiterating Strong Sell Rating on Montage Technology Group Ltd. (NASDAQ:MONT)

Date: February 13, 2014
Price: $15.99/Share
Market Capitalization: $444mm

Legal Disclaimer

Introduction

In this report, we refute MONT's lie that Shanghai Montage Microelectronics Technology Company Ltd.[1, 2] ("SMMT") has not been affiliated with MONT since 2009. **We produce new conclusive evidence showing that SMMT has been owned/controlled by MONT and related parties even during the time period after SMMT acquired LQW and in 2013—well after MONT began recognizing significant revenue from LQW.** We also expand on the half-truths provided in Montage Technology Group Ltd. ("MONT") Management's responses to our initiating coverage report to give investors the full story on MONT and its relationships with SMMT and LQW.

We are more convinced than ever that MONT is a fraud. **Since our initiating coverage report (the "Report") was published seven days ago, neither sell-side analysts nor MONT has contested any of the 20 facts underpinning our thesis other than claiming that SMMT is an unrelated party (which we will show is a lie).** See pp. 5-6 of the Report or pp. 10-11 of this report where we have repeated the 20 primary facts underpinning our thesis for the benefit of readers. **We remain confident that our thesis and evidence are both 100% correct, and urge any institutions holding MONT stock or sell-side analysts covering the company to reach out to us through e-mail at info@gravityresearchgroup.com with any questions on MONT or our research. We will address all serious inquiries and keep any contact confidential.**

Instead of directly disputing any of the points we made in the Report, in its February 10, 2014 response, MONT provided a series of lies and half-truths to distract investors from the serious allegations covered in the Report.[3] To reiterate, we do not believe that MONT is merely siphoning off shareholder money to related parties through under-the-table deals—**we are confident that MONT is dramatically overstating its revenue and margins**. The vast majority of MONT's purported revenue comes from set-top box chips, which are commoditized. Yet MONT is claiming to earn profit margins that are roughly 50% higher than the market leader within the Chinese STB system-on-a-chip space. See below for the table comparing the two companies, reproduced from the Report:

ALi Corporation	2008	2009	2010	2011	2012
Revenue (TWD 000s)	$3,210,500	$4,723,351	$4,159,147	$3,683,182	$5,122,588
Cost of sales (TWD 000s)	$2,075,430	$2,520,109	$2,114,481	$2,019,866	$2,802,371
Gross profit (TWD 000s)	$1,135,070	$2,203,242	$2,044,666	$1,663,316	$2,320,217
Gross margin	35.4%	46.6%	49.2%	45.2%	45.3%
Net margin	7.1%	20.8%	23.3%	18.2%	15.6%

MONT	2010	2011	2012	1st 6M 2013	1st 9M 2013
Revenue ($000s)	$29,078	$50,338	$78,245	$45,932	$75,448
Cost of sales ($000s)	$21,248	$22,840	$31,736	$16,589	$27,496
Gross profit ($000s)	$7,830	$27,498	$46,509	$28,803	$47,952
Gross margin	26.9%	54.6%	59.4%	62.7%	63.6%
Net margin	-28.5%	15.8%	24.5%	20.7%	24.1%

Further, MONT has provided no explanation to investors regarding the phenomenal improvement in revenue and margins that took place between 2010 and 2011. The reported revenue increased by 73% yet the reported cost of sales only increased by 7.5%, driving gross margins up over 100%. **We could not find any recent example of another fabless semiconductor company that saw its gross margins more than double year-over-year.** MONT has not explained what

[1] Also referred to as Shanghai Lanqi Micro-Electronics Technology Company Ltd., "SLMT"

[2] SMMT constituted 50% of MONT's revenue in FY 2012 and 71% of MONT's reported revenue in the 1st 9M of 2013

[3] http://ir.montage-tech.com/releasedetail.cfm?ReleaseID=824394

happened. What we do know, however, is that October 2011 was when LQW was incorporated and became a "distributor" for MONT. Sales declined at all disclosed distributors except for LQW between 2011 and 2012, and MONT also reported sales declines for the majority of distributors in 1st 9M 2013 as well, while simultaneously reporting 179% revenue growth at LQW. We are curious as to how MONT Management would try to explain these conflicting changes, given that MONT's S-1 states that its distribution agreements grant each distributor a specific territory or customer base, **meaning that LQW could not have taken business from other distributors**:

> "We typically enter into distribution agreements with our distributors, with each distributor covering a defined customer base and/or geographic area."

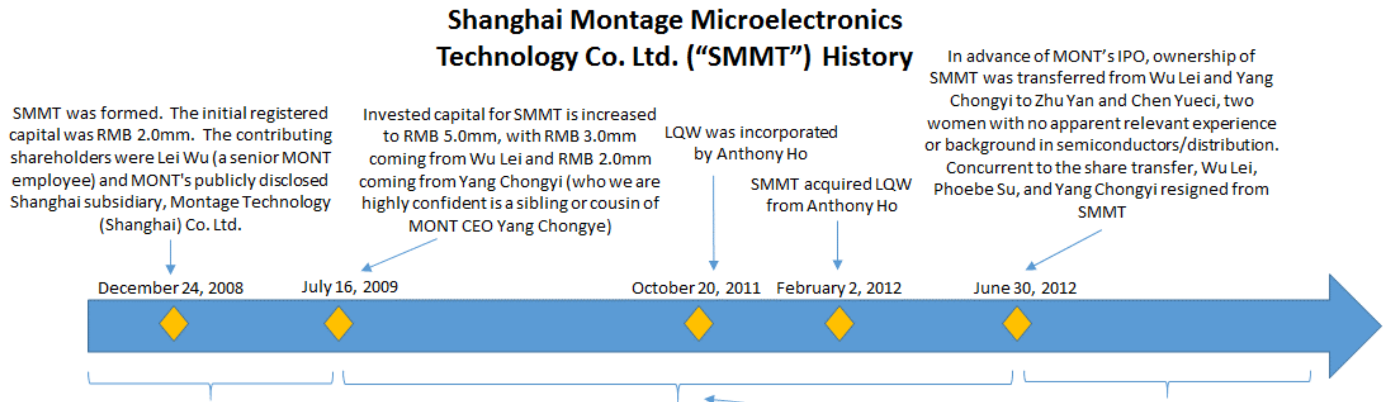
We believe that 2011 is the year Management effectively turned MONT into a fraud.

As we established in our initiating coverage report, LQW is owned by SMMT—it was acquired by SMMT a mere four months after incorporating. MONT has not denied this; it has simply claimed that SMMT is not affiliated with MONT despite acknowledging that SMMT was formed by MONT and a senior MONT employee. We have obtained corporate filings for SMMT showing the **following new facts**:

1) **At the date that SMMT acquired LQW, SMMT was owned by senior MONT employee Wu Lei and an individual that we believe is almost certainly a sibling or cousin of MONT CEO Howard Yang.** In its response to our initiating coverage report, MONT made the following statement:

    > "On July 3, 2009, Montage Technology (Shanghai) transferred its equity interest in SLMT, which was documented in the Industrial and Commercial Bureau of Shanghai Xuhui District and is a matter of public record."

    This is true— however, the **interest in question was transferred from Montage Technology (Shanghai) to Yang Chongyi (杨崇颐), who we believe is almost certainly a sibling or cousin of MONT CEO Yang Chonghe (Howard Yang, 杨崇和)**. It is tradition in China for families to use a "generational" character as the first character of the name of children within a specific generation. These "generational" characters vary from family to family and from generation to generation. In this case, the generational character is "Chong" (崇). Howard Yang's Chinese name is Yang Chonghe, sharing the same surname and "generational" character as Yang Chongyi. **The probability of an individual with such a similar name happening into such a position without being related to Howard Yang is slim to none.** Wu Lei (a senior MONT employee) retained 60% ownership of SMMT and Yang Chongyi retained 40% ownership of SMMT until June 30, 2012. **This included the period during which LQW was incorporated, acquired by SMMT, and purportedly doing business with MONT.** It was not until June 30, 2012 (well after the acquisition of LQW) that Wu Lei and Yang Chongyi disposed of ownership of LQW. Below is a timeline for the events surrounding SMMT:



Shareholder Structure #1

SMMT Shareholder Structure from December 24, 2008 to July 16, 2009

Shareholder	Contributed Capital	% Ownership
Wu Lei (吴雷)	RMB 1.8mm	90.0%
Montage Technology (Shanghai) Co. Ltd.	RMB 0.2mm	10.0%

Shareholder Structure #2

SMMT Shareholder Structure from July 16, 2009 to July 16, 2012

Shareholder	Contributed Capital	% Ownership
Wu Lei (吴雷)	RMB 3.0mm	60.0%
Yang Chongyi (杨崇颐)	RMB 2.0mm	40.0%

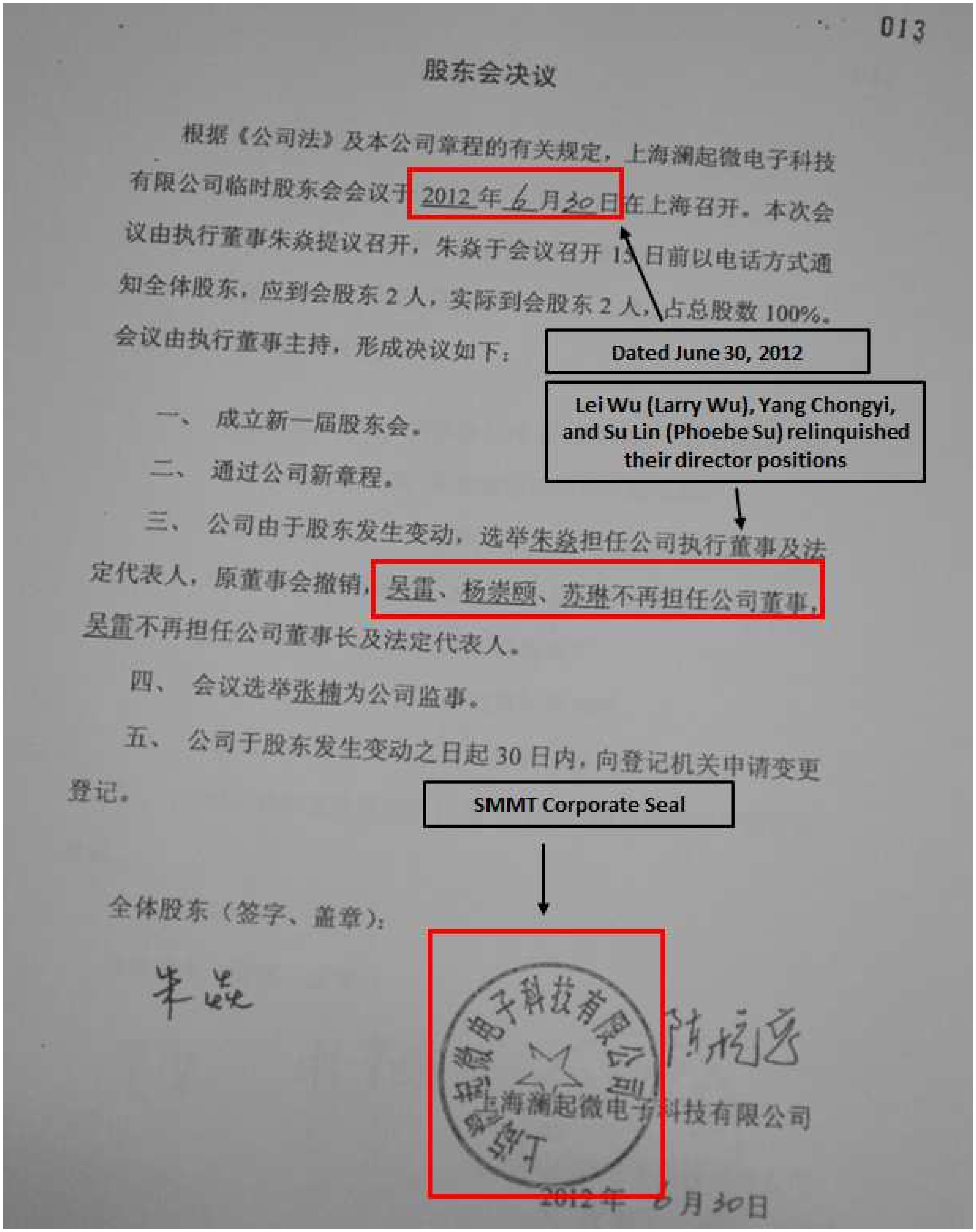
Shareholder Structure #3

SMMT Shareholder Structure from June 30, 2012 to Present

Shareholder	Contributed Capital	% Ownership
Zhu Yan (朱焱)	RMB 3.0mm	60.0%
Chen Yueci (陳悦慈)	RMB 2.0mm	40.0%

Note: Figure not drawn to scale

2) **SMMT's corporate filings show that Wu Lei (engineering director at MONT), Yang Chongyi (almost certainly a sibling or cousin of MONT CEO Yang Chonghe), and Phoebe Su (VP of Finance and Administration at MONT) were directors of SMMT until June 30, 2012—well after SMMT acquired LQW and after MONT reported generating significant revenue from LQW.** See below:



013

股东会决议

根据《公司法》及本公司章程的有关规定，上海澜起微电子科技有限公司临时股东会会议于2012年6月30日在上海召开。本次会议由执行董事朱焱提议召开，朱焱于会议召开15日前以电话方式通知全体股东，应到会股东2人，实际到会股东2人，占总股数100%。会议由执行董事主持，形成决议如下：

一、成立新一届股东会。

二、通过公司新章程。

三、公司由于股东发生变动，选举朱焱担任公司执行董事及法定代表人，原董事会撤销，吴雷、杨崇颐、苏琳不再担任公司董事，吴雷不再担任公司董事长及法定代表人。

四、会议选举张楠为公司监事。

五、公司于股东发生变动之日起30日内，向登记机关申请变更登记。

全体股东（签字、盖章）：

朱焱

上海澜起微电子科技有限公司

2012年6月30日

3) **We have obtained Shanghai filings for SMMT showing that, as of 2013, even after the transfer of SMMT ownership to Zhu Yan and Chen Yueci, the e-mail address provided as a contact with SMMT's 2012 tax filings (filed in calendar year 2013) belonged to a MONT employee—yangyang.gao@montage-tech.com**. See below for the relevant excerpt from SMMT's 2012 Shanghai tax filings:

SMMT tax ID number

SMMT bank account number

MONT E-mail Address

企业相关信息

国家税务登记机关	上海市国家税务局	税务登记证号	31010468400129X
地方税务登记机关	上海市地方税务局	税务登记证号	31010468400129X
开户银行(基本户)	交通银行上海市漕河泾支行	开户银行帐号	310066632018170084354
组织机构代码	68400129X	从业人员	18 人
企业电子邮箱	yangyang.gao@montage-tech.com	企业网站	

4) **The phone number for SMMT listed in its current Shanghai corporate registration information belongs to MONT. Dialing the number, (+86 (21) 5169-6833), takes the caller directly to MONT's IVR system.**

These facts build on top of the twenty primary points included in the original Report, which we have also included on pp. 10-11 of this report.

<u>Dissecting MONT's Response</u>

In this section, we will go through each statement made by MONT in response to our report and show why each of the points made by MONT are either meaningless or incorrect. We begin with MONT's February 7, 2014 initial response to our report.

MONT February 7, 2014 Press Release:

> "The company believes that the allegations and accusations in the report lack merit and contain numerous errors of fact, misleading speculation and misinterpretation of events."

Gravity Response: We have yet to see MONT provide evidence identify a single error or refute a single point from our report.

MONT February 7, 2014 Press Release:

> "Montage also disclaims any suggestion that LQW Technology Company, an independent distributor of semiconductor products to the end customers of Montage and other technology companies, is an affiliate of Montage."

Gravity Response: This is a lie. MONT has conveniently ignored the statement within our report that LQW is owned by SMMT because we have provided conclusive evidence to that effect. As we showed within the prior section of this report, there is overwhelming evidence that SMMT is still effectively functioning as a subsidiary of MONT. Even without such knowledge, investors have to admit that the relationship makes no sense. Investors should be asking the following questions:

1) If LQW were genuinely an independent distributor, then why would ownership of LQW be transferred to SMMT within four months of incorporating? Why would Anthony Ho agree to that if LQW was supposed to be his personal venture?
2) Why was ownership of SMMT transferred to two women with no apparent relevant experience in 2012?
3) How did LQW obtain "other technology companies" as customers without a website? Additionally, the agreement between LQW and MONT states:

> "Party B [LQW] shall neither act as a distributor for products, nor produce or sell products, which are identical to or similar to the Product defined herein in any territory during the term of this Agreement."

If this is the case, then what other products is LQW distributing?

And perhaps most importantly:

4) **Why is one of the directors for LQW providing a false residential address on LQW corporate filings that actually belongs to the VP of Finance at MONT?**[4] Is she really able to function as a director of LQW in Hong Kong from her actual village residence in Anhui? She lives in a village— as in, her actual residential address does not include a street address because there are no street addresses in her village. See pp. 13-15 of the Report for more details.

We do not believe LQW actually distributes anything, and MONT Management has not given any evidence to the contrary.

MONT February 10, 2014 Press Release:

> "As evident in Montage's filings with the U.S. Securities and Exchange Commission, revenue from sales through distributors is recognized on a "sell-through" basis, meaning revenue is recognized when delivery is made to Montage's more than 160 end customers worldwide. However, Gravity Research's report ignores this fact and appears to attempt to mislead the reader to incorrectly believe that Montage has a "sell-in" sales model, in which revenue is recognized when sold to the distributor, rather than when actually distributed to an end-customer. This sell-through approach applies to both the company's set-top box manufacturer customers and our memory module manufacturer customers."

Gravity Response: This is completely irrelevant. When we say that we believe LQW is a shell company, we are also saying that we do not believe the end customers LQW supposedly sells to exist. Based on the preponderance of evidence we collected, we believe the bulk of MONT's revenue is fabricated regardless of whether revenue is recognized via sell-through or sell-in.

MONT February 10, 2014 Press Release:

> "To provide additional confirmation of the company's solid financial performance, we have summarized Montage's bank cash balances from the first quarter of 2012 to the third quarter of 2013 in the following table. We have also provided the supporting quarterly bank statements online on the company web site, http://ir.montage-tech.com/releasedetail.cfm?ReleaseID=824337. We plan to make the fourth quarter 2013 cash balance and bank statement available shortly following the filing of the company's Form 10K for 2013. The

[4] See pp. 13-15 of the Report

fourth quarter and year-end financial results are currently scheduled to be reported on February 20, 2014, subject to the anticipated completion of our quarterly and annual review procedures."

Gravity Response: This is completely meaningless. It is well-known that bribing bank officials to help fake balances in China is extremely easy (either by falsifying the documents or by temporarily borrowing fake balances for the purposes of showing auditors/investors), and would have been a prerequisite for MONT's IPO anyways. Part of the responsibility of auditors is verifying claimed cash balances, which means that **every single Chinese fraud that ever filed an audited statement with investors also faked its bank balance. We are also curious about the millions in fixed deposits MONT purportedly purchased from E-bank in 2012 for which "no supporting [documentation] is available" (see MONT's bank account documents posted under the press releases section of its website).**

MONT February 10, 2014 Press Release:

> "LQW Technology Company Ltd. is not an affiliate of Montage or its subsidiaries. Mr. Anthony Ho is a seasoned industry veteran with more than 30 years of experience in semiconductor sales and distribution. Mr. Ho was previously Director of Business Development at ASCOMM HK Ltd from July 2003 to February 2006. When Montage first began shipping product in 2005, ASCOMM HK Ltd. was one of our primary distributors, and Mr. Ho the lead account manager. Based on this prior working history, Mr. Ho agreed to form LQW to distribute Montage products."

Gravity Response: This story should make even the most naïve investors skeptical: MONT decided to recruit a **salesman** from a prior distributor to start a brand-new **logistics** company to distribute MONT products after no business contact with him for more than five and a half years. Within a little over a year, this new entity is handling 50% of MONT's revenue. Within two years, the entity is handling over 70% of MONT's revenue.

Further, in this response, MONT ignores the key points we made in the Report regarding LQW and SMMT. Namely:

1) LQW's corporate filings show that one of the directors for LQW provided a false residential address that actually belongs to the VP of Finance at MONT
2) It would make no sense for LQW to be acquired by SMMT if LQW were genuinely an independent entity and MONT Management has yet to explain why this happened.
3) Ownership of LQW was transferred to SMMT less than four months after LQW incorporated
4) The shareholders of SMMT at the time of the LQW acquisition and through June 2012 were a senior MONT employee and an individual we believe to be a relative of MONT CEO Howard Yang. SMMT listed two senior MONT employees and the relative of Howard Yang as directors
5) One of the current owners of SMMT is an employee of MONT President Stephen Tai's parents
6) We tried to visit the purported office of SMMT (Room 303-30, Building 33, 680 Guiping Rd., Shanghai). Room 303-30 does not exist and SMMT had no office anywhere on the floor or in the building
7) LQW's registered "office" is actually nothing more than a small warehouse room that we estimate to be between 1,000 and 1,500 square feet. We visited the registered address of LQW on a recent weekday afternoon, where we found LQW's door padlocked and did not see any employees. A security guard working at the building during the day said that LQW had moved into its room a few months ago, but that he had never seen anyone from LQW entering or exiting the premises

MONT February 10, 2014 Press Release:

"1. Montage has contracted with LQW and conducts business with LQW because they are able to offer attractive business terms to Montage such as non-refundable advanced payments for product inventory."

Gravity Response: This statement completely contradicts MONT's financial statements, which show that as of the latest period for which MONT has filed financials, LQW made up 79% of MONT's accounts receivable. This is how MONT described the relationship with LQW (emphasis added):

"**Under our contract with LQW Technology Company Limited**, or LQW, which has been a distributor for our products since October 2011 and was our largest distributor in 2012 and the nine months ended September 30, 2013, **we are entitled to bill only a portion of the total sale price at the time of shipment (deferred revenue), with the remainder billed upon sale by LQW to the end customer**."

MONT February 10, 2014 Press Release:

"2. Since Montage already directly supports our set-top box end customers with additional software and engineering capabilities, LQW is a good fit to support Montage's logistics requirements."

Gravity Response: Really? So LQW is only handling logistics and they are still the best choice? It wouldn't make more sense to use an established logistics/shipping company as opposed to a brand-new start-up run by a salesman operating out of a tiny warehouse room? Come on.

MONT February 10, 2014 Press Release:

"On July 3, 2009, Montage Technology (Shanghai) transferred its equity interest in SLMT, which was documented in the Industrial and Commercial Bureau of Shanghai Xuhui District and is a matter of public record. A legal opinion was issued by Commerce & Finance Law Offices (a Chinese law firm as only a Chinese law firm can issue Chinese legal opinions in China) confirming that SLMT's 100% ownership was actually and beneficially owned by a third party subsequent to July 3, 2009.

Montage Technology (Shanghai) has not held an ownership interest in SLMT since July 3, 2009, at which time SLMT was no longer an affiliate of Montage Technology (Shanghai). When Gravity Research was working on their story, we believe they must have seen this record but chose to ignore it to mislead the reader."

Gravity Response: We absolutely were aware of the record and explicitly pointed out the change in ownership in the Report—see p. 3 of the initiating coverage report. We have again pointed it out in this report as well—see p. 3. Notice that MONT is careful to only state that Montage Technology (Shanghai) did not have an ownership stake. This is because the ownership was changed in 2009 to Wu Lei (a senior MONT employee) and Yang Chongyi, who we believe is a relative of MONT CEO Howard Yang for the reasons previously discussed. They, along with MONT VP of Finance Phoebe Su, were all directors of SMMT at the time it acquired LQW. MONT Management is again avoiding the real issues here.

__Concluding Thoughts on MONT's Responses__

The weakness and misdirection present in MONT's responses are a recurring pattern among fraudulent companies. **MONT's response avoided all the major points in our report.** No sell side analyst or the company provided any evidence contradicting the overwhelming evidence we provided. Every allegation in the report is true, and they can be independently verified by anyone using the resources we provided in the appendices to the report posted on our website. We present again our core summary of facts for your review:

1) According to MONT, LQW comprised 50% of MONT's 2012 purported revenue ($39.1mm) and 71% of MONT's purported revenue in the first 9M of 2013 ($53.6mm)[5]

2) In 2010, before MONT began to use LQW as a distributor, MONT reported 26.9% gross margins and -28.5% net margins. In 2011, after adding on LQW as a distributor, MONT reported 73% revenue growth, gross margins that were twice as high as 2010 and net margins of positive 15.8%

3) LQW was incorporated in October 2011, the exact same month MONT claims to have started doing business with it.

4) LQW was established by a former senior employee of the CEO of MONT

5) LQW is currently 100% owned by Shanghai Montage Microelectronics Technology Company Limited ("SMMT") and was acquired by SMMT within 4 months of incorporating

6) LQW's registered "office" is actually nothing more than a small warehouse room that we estimate to be between 1,000 and 1,500 square feet. We visited the registered address of LQW on a recent weekday afternoon, where we found LQW's door padlocked and did not see any employees. See the *Introduction* section of this report for photographs. A security guard working at the building during the day said that LQW had moved into its room a few months ago, but that he had never seen anyone from LQW entering or exiting the premises.

7) LQW uses the exact same small law office (C.K. Mok & Co.) as all three of MONT's Hong Kong subsidiaries (Montage Semiconductor Hong Kong Company Ltd., Montage Technology Hong Kong Co. Ltd., and Montage Technology Co. Ltd). We were unable to find any company-owned website for C.K. Mok & Co., and online sources indicate that it is a very small practice (<10 lawyers). We find this highly unlikely to be a mere coincidence given that there are hundreds of law offices doing business in Hong Kong

8) After LQW was acquired by SMMT, Zhu Dexiu (諸德秀) was appointed as a director of LQW. The address in the Hong Kong filing for LQW shows that Zhu Dexiu's residential address is Room 2103, Block 2, No. 88 Si Nan Road, Shanghai. However, that is not Zhu Dexiu's actual address-- that is the address of Phoebe Su, the VP of Finance and Administration at MONT! According to her passport and registration record, Zhu Dexiu doesn't even live in Shanghai; she lives in a village in Hefei! We believe Zhu Dexiu is being used as a front for MONT

9) SMMT was formed as a joint venture between MONT and a senior employee at MONT (Wu Lei/Larry Wu/吴雷). 90% of the registered capital for SMMT came from Larry Wu (who is a senior employee and shareholder of MONT), and 10% of the registered capital came from MONT's Montage Technology (Shanghai) Co. Ltd. subsidiary

10) Larry Wu was also appointed as legal representative, executive director, and general manager of SMMT

11) Larry Wu is still currently listed as the contact person for SMMT on multiple websites[6,7,8,9]

12) The phone number posted online for SMMT (+86 021-51696833) is the same as the phone number posted for MONT. We called it to see what would happen—it goes directly to MONT's interactive voice response system!

---

[5] See p. 17 of MONT S-1 filed on 1/17/2014
[6] http://www.xizhi.com/COMDwQBUQQLCQE2JYY/
[7] http://www.11467.com/shanghai/co/1031408.htm
[8] http://dianzi.b2bname.com/u48076520
[9] http://7780165.czvv.com

13) The original address of SMMT is listed as Room 402, 4th floor, Building 32, 680 Guiping Road. This is across the hall from an address of MONT (Building 32, Room 406-A, 680 Guiping Road, Xuhui District, Shanghai). Later, SMMT's registered address changed to Room 303-30, Block 33, 680 Guiping Road, Shanghai—this is nearly the same as another address purportedly held by MONT (Room 303-27, Building 33, 680 Guiping Road, Shanghai)

14) As of today (February 6, 2014), the registered address of SMMT is Room 303-30, Building 33, 680 Guiping Rd., Shanghai. We tried to visit the purported office. Room 303-30 does not exist and SMMT had no office anywhere on the floor or in the building. See *Introduction* for relevant pictures

15) The Vice President of Finance and Administration at MONT (Su Lin/Phoebe Su/苏琳), was appointed as the initial auditor of SMMT

16) In every job posting we came across for MONT where MONT listed its subsidiaries, MONT lists SMMT as one of its subsidiaries. It is listed alongside the other Shanghai subsidiaries—so there is no question of simply miswriting the names

17) According to a recent filing, ownership of SMMT was transferred to Zhu Yan (朱焱, received 60% ownership) and Chen Yueci (陳悅慈, received 40% ownership). We believe this was done to make it more difficult for investors to link MONT with LQW in advance of the MONT IPO

18) The current legal representative of SMMT is listed as Zhu Yan

19) Zhu Yan is also the legal representative of Yunduan Technology (Shanghai) Co. Ltd. ("Yunduan"), which is owned by Yunduan Media Company Ltd (a Hong Kong entity), which is controlled by the parents of Stephen Tai (President of MONT). A website listing contact information for Yunduan[10] shows that Yunduan's address is the exact same address (down to the room letter) that previously belonged to MONT

20) During a recorded phone call with Zhu Yan on January 15, 2014, she claimed that she was not in the office and would not be working for the next few weeks since she was not feeling well and Chinese New Year (which was weeks away at the time of the call) was coming up. During the call, we inquired about obtaining price quotes for set-top box chips (MONT's bread and butter), and Zhu Yan appeared to be uncomfortable and claimed that she was not selling such products. She stated that she only had a small relationship with MONT (a strange comment for the legal representative and 60% owner of the parent company of LQW, MONT's largest distributor), and insisted that we continue future correspondence through text messages rather than calls. We believe that Zhu Yan is a front for MONT

[10] http://14376576.czvv.com