

# Muddy Waters Joins Short Sellers Pounding Away at GSX

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- ▶ At least four detractors say GSX Techedu has overstated sales
- ▶ Chen says GSX is misunderstood; many analysts have buy rating

To some short sellers, GSX Techedu Inc. is an “almost completely empty box,” with numbers that are too good to be true. To many analysts -- including those at Credit Suisse Group AG, which led the company’s initial public offering -- the Chinese online education firm remains a buy, and detractors just don’t understand the business model.

GSX is an after-school tutoring platform whose American depositary receipts began trading last June and had more than quadrupled earlier this year, boosting the fortune of billionaire chairman and founder Larry Chen.

Then, in late February, Grizzly Research started questioning GSX’s results. Citron Research followed in April, accusing the company of overstating revenue by as much as 70%. In early May, Scorpio VC concluded the financial data “is not up to the test.” Muddy Waters joined the fray last week, claiming at least 70% of the firm’s users are robots and calling it a massive loss-making business. The ADRs have tumbled 34% from their Feb. 24 peak.

Chen, 48, shot back on social media.

“Muddy Waters did some homework for the report,” he wrote last week in a post on Weibo, China’s version of Twitter. “It’s just a pity that they didn’t understand the business model of our online live large class.”

## Outperforming Peers

At GSX, an instructor uses a web platform to teach several hundred students with the help of tutors -- a format that’s increasingly appealing in a world with fewer social interactions. Muddy Waters’ misunderstanding may be because it didn’t try its live courses, or it did and ignored part of the process, a GSX spokeswoman wrote in an email.



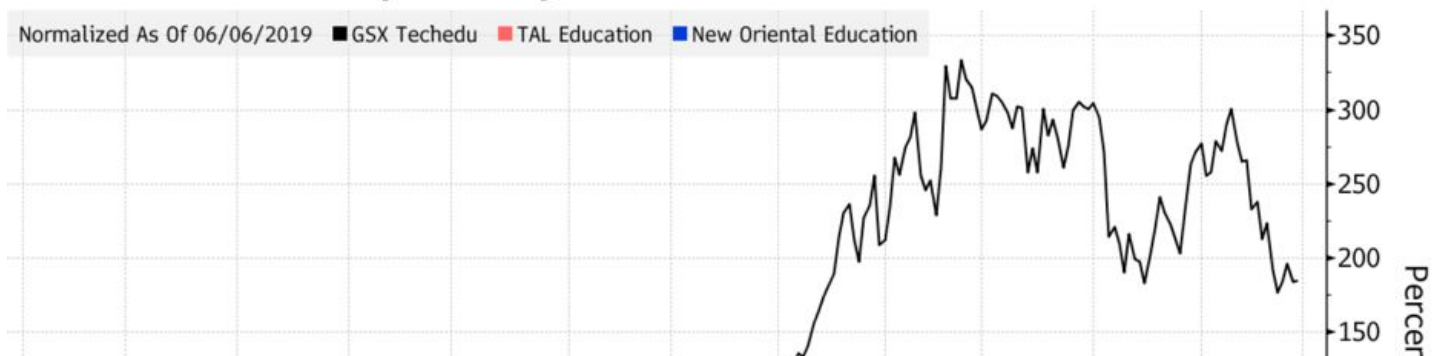
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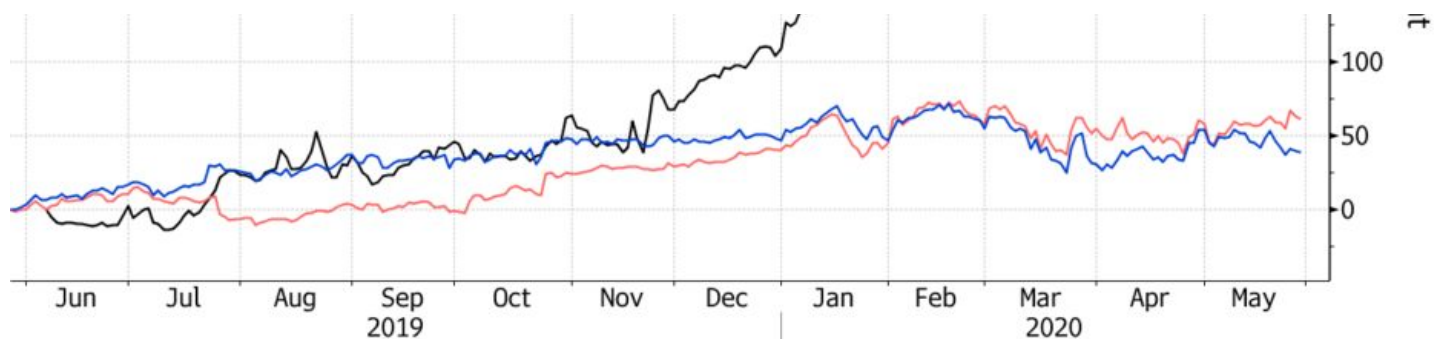
**A Rare Port Ellen from 1979**

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Despite their recent swoon, the ADRs are still up 37% this year through Wednesday, outperforming peers New Oriental Education & Technology Group Inc. and TAL Education Group. That has helped add almost \$830 million to Chen’s fortune, now worth \$3.2 billion, according to the Bloomberg Billionaires Index.

## Outperforming Peers GSX's ADRs are still up for the year





Source: Bloomberg

The spotlight on Chinese companies listed in the U.S. intensified in early April with an accounting scandal at Luckin Coffee Inc., which several short sellers noted in presenting their arguments against GSX.

In its report, Muddy Waters said Chen pledged at least \$318 million of ADRs to banks, putting investors at risk if the margin lenders were to sell the securities. Chen said in April he pledged 5.1 million ADRs -- currently worth about \$152 million -- to Credit Suisse for a \$50 million loan facility, and the GSX spokeswoman said he hadn't made additional pledges since then.

"No other senior management has pledged any shares, as far as the company is aware," she added.

A Hong Kong-based spokeswoman at Credit Suisse declined to comment. The Swiss bank, which helped several other Chinese companies go public in the U.S., posted a fivefold jump in loan-loss provisions at its Asia-Pacific unit, primarily because of a default by Luckin's founder, Lu Zhengyao. People familiar with the matter have said it is now reviewing how it lends to billionaire clients at the international wealth-management division.

Each time Muddy Waters exposed alleged wrongdoing at a Chinese company, the usual response is that the short seller doesn't understand the business, Chief Executive Officer Carson Block wrote in an email, maintaining GSX is deceiving investors.


GSX's response: "Muddy Waters is bluffing."

## Teen Teacher

Born in a poor village in northern China, Chen's father helped him enroll in a tuition-free vocational training school for teachers. He later obtained a master's degree and doctorate in economics from Renmin University of China, and completed a general manager program at Harvard Business School in 2005, a company filing shows.

Chen started his career as a middle school teacher at age 17, according to GSX's website. He joined New Oriental Education in 1999, eventually becoming executive president before leaving to start GSX in 2014. The Beijing-based provider of online K-12 courses reported 2.1 billion yuan (\$294 million) in revenue last year, a fivefold increase from 2018, with 2.7 million enrollments and students in more than 190 countries.

Most Wall Street analysts tracked by Bloomberg remain bullish on GSX, with 12 of them recommending that investors buy the ADRs, compared with one sell rating. Terry Weng of Blue Lotus Capital is among the optimists, saying short sellers misunderstand the online big-class business. GSX has higher penetration than peers in low-tier Chinese cities, with better product differentiation and market channels. He estimates the market share of the online large-class, after-school tutoring industry will reach 20% in five years, up from 3.5% now, and generate 200 billion yuan in revenue.

Meanwhile, Nasdaq Inc. is looking into IPO rules that would make it harder for some Chinese companies to go public on the exchange. Since the Luckin scandal, billionaire Zhang Bangxin's TAL disclosed that an employee had wrongly inflated sales, and more short sellers have targeted  stocks from the Asian nation trading in the U.S.

In his Weibo post last week, Chen said he is "surprised and confused" about short sellers' attitude. "Don't they care about their conscience and reputation?"

"Weakness and ignorance are not barriers to survival, but arrogance is," Chen added, quoting the novel "Death's End" by Chinese author Liu Cixin.

(Updates with Credit Suisse lending review in 11th paragraph, Chen's fortune and stock moves throughout)

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## In this article

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GSX  
**GSX TECHEDU-ADR**  
36.97 USD ▲ +4.36 +13.37%

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CSGN  
**CREDIT SWISS-REG**  
9.22 CHF ▲ +0.46 +5.20%

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1480439D  
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EDU  
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