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### NQ: Oops

NQ's July 3<sup>rd</sup> announcement vindicates short sellers, but was likely delayed in order to give China side insiders a chance to illegally dump stock. The announcement also puts lipstick on the state of NQ's doomed audit. Only hours before the long July 4<sup>th</sup> holiday weekend began, NQ announced that Ms. Ying Han, who was the chairwoman of its audit committee, had resigned from the board. NQ also announced that PwC Zhongtian ("PwC"), whose audit opinion was already more than two months late, had requested a broader audit scope. While both admissions are hugely vindicating for short sellers of NQ, we strongly suspect that:

- NQ deliberately held back both admissions so that NQ China insiders and their proxies could illegally dump more shares at existing shareholders' expense, and
- NQ is again misrepresenting the true state of its audit and relationship with PwC Zhongtian ("PwC"). NQ's prior statements and actions make clear that it has understood for some time that PwC will never issue an unqualified audit opinion for 2013. The language about PwC requesting a larger audit scope is a misrepresentation designed to keep the passengers on the sinking NQ ship (so that NQ insiders can keep the lifeboats for themselves).

We believe that by June 25<sup>th</sup> a) Ms. Han had already informed NQ she was resigning, and b) NQ had accepted that PwC will never issue an unqualified audit opinion. In delaying the day of reckoning by at least a week, NQ likely provided an opportunity for insiders to dump shares. We base our belief on the trading pattern that shows NQ stock dropping 5.3% on June 25<sup>th</sup> with no news, followed by consecutive declines of 4.5% and 4.7% on each of the next two trading days. Volume was substantially elevated during this period with the ADSes trading an average of 9.8 million shares per day, compared to 5.2 million shares per day on average prior to June 25, 2014.<sup>1</sup> The table below shows the drastic selling that began on June 25<sup>th</sup>.

Date	Close	Volume
6/23/14	7.19	5,102,300
6/24/14	7.04	3,259,200
6/25/14	6.67	5,267,700
6/26/14	6.37	9,033,800
6/27/14	6.07	15,312,900

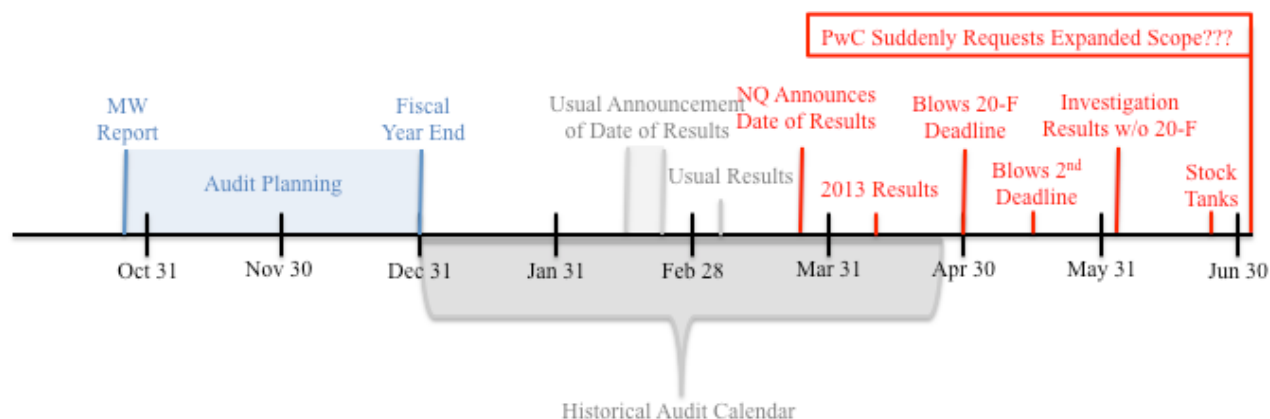
By delaying releasing this information, we believe NQ China side insiders were able to dump significant amounts of stock before NQ made the announcement.

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<sup>1</sup> 90-day average.

Ms. Han’s resignation lays bare the corrupt nature of the “independent” investigation NQ’s directors conducted. While NQ claims that Ms. Han resigned for “personal reasons”, it is obvious she resigned because of problems with NQ itself. To further illustrate that point, Ms. Han still chairs the audit committee of Wuxi PharmaTech (NYSE: WX). Just weeks earlier, Ms. Han was one of four directors whose investigation, we were told, “did not find evidence” that NQ is a fraud. The investigation did, however, find widespread evidence tampering. (We warned investors about the frequent corruption of these investigations in our December 19, 2013 open letter to NQ’s independent committee. In the letter, we cited eight other China companies whose shareholders suffered significant losses after purportedly independent committees exonerated their management friends of wrongdoing.)

It has been clear for some time that PwC will never issue an unqualified audit opinion. NQ’s statement that PwC has requested a broader audit scope is a misrepresentation. It simply does not hold water to say that PwC requested a broader audit scope when NQ’s 20-F was already 64 days past due. This timeline illustrates the events detailed below that support our conclusion.



- PwC would have planned for and requested an expanded audit scope months ago, rather than bringing it up recently. We published our initial report on October 24, 2013, which was more than two months before PwC began the audit. Were we to have published our initial report when PwC was already well into the audit, it would be understandable if PwC subsequently requested an increased scope and had to delay the audit opinion. However, we released our initial report at a point that gave PwC ample time to adjust its audit plan and procedures before it began the audit. If PwC wanted to expand the scope of the audit, that request would have been made a long time ago.
- It was clear by mid-February that the audit was troubled. In prior years, NQ announced its date of Q4 earnings release in mid-February.<sup>2</sup> In both prior years, the Q4 earnings release date was March 6<sup>th</sup>. NQ’s 2013 results would be a very different matter though. The company did not announce the date of release until March 25<sup>th</sup>, more than one month later than normal. This year’s announcement of the date of release appeared to be a reaction to a research report, rather than a well-planned announcement made with PwC’s blessing. Only hours before NQ’s announcement, J Capital Research published a report titled “Time to Quit” that highlighted NQ’s failure to provide a date of earnings release as

<sup>2</sup> February 16, 2012 and February 20, 2013.

an indication that something was going awry. Ultimately, NQ released its Q4 earnings on April 10, 2014. NQ's failure to announce a date of earnings release until it was challenged by the J Capital report shows it did not have PwC's buy-in to announce results because the audit was troubled.

- NQ's June 4<sup>th</sup> release of the investigation results shows that by early June, NQ felt strongly it would not ultimately receive an unqualified audit opinion. NQ had stated on April 10<sup>th</sup>, and reiterated on April 30<sup>th</sup>, that it was going to release the final results of the independent committee's investigation in the 20-F. However, NQ ultimately did not wait until the 20-F to release the results. On June 4<sup>th</sup>, NQ issued a press release touting the final results of the investigation. This change of plan was a clear indicator that NQ felt strongly that it would not receive an unqualified audit opinion. (The positive release also pushed the stock up 30.9% on the day, likely giving insiders another opportunity to dump stock.)

This latest deception is just another in a string of misrepresentations about the state of NQ's audit.

- By releasing Q4 results and hosting a conference call, NQ was sending a strong signal that an unqualified audit opinion was fait accompli. It is highly unusual for a company to release its full year results when there is even a reasonable doubt about whether it will receive an unqualified opinion.
- On the April 10th call, Mr. Khan twice stated that he expected NQ to file its 20-F on or by April 30th. To quote Mr. Khan "...based on the current [audit] schedule, the fully integrated schedule that all the parties that are associated with the process are working from, we're planning on – we're currently planning on meeting the statutory deadline for the 20F which is April 30."
- After NQ missed the second filing deadline of May 15<sup>th</sup>, Matt Mathison privately reassured investors that the audit opinion was "on the goal line", and that PwC merely needed to perform some more compliance procedures.

### *What Now?*

We believe NQ's misleading statement that PwC wants to expand the scope of the audit, and that the board is reviewing the request, is merely to create a pretext for NQ to change auditors. In other words, NQ has likely already decided to fire PwC, or PwC has already informed NQ it is resigning. It is highly unlikely that another affiliate of a Big Four (or BDO for that matter) would touch NQ with a 10-foot pole. While the long-term game for NQ is to avoid becoming another tombstone in the graveyard of China frauds, we expect that insiders will continue to make more acquisitions in order to drain the company of value.

At these stock price levels, we would not be surprised to see the consideration mix for acquisitions go toward cash, given that there should be real cash in the company from the October 2013 convertible bond offering. At the same time, NQ will likely issue more bullish press releases about "partnerships" with big names (and no disclosed economics), report more terrific but fake financials, and enter into more (likely corrupt) partial sales of subsidiaries that

make NQ's market cap seem enticingly small. If NQ does manage to pump its stock price up again, we then expect more share issuances and illegal insider sales.

We base these assumptions on NQ's past reptilian pumping behavior, two recent examples of which are below.

- On April 30<sup>th</sup>, when it missed the 20-F filing deadline, NQ issued an uber-bullish press release that touted unofficial "no evidence found" results of the independent committee investigation, which pushed the stock up by 10.8% on the day to \$12.36 (which is 2.7x NQ's closing price this past Friday of \$4.58).
- On May 30<sup>th</sup>, when the 20-F was one month overdue, NQ had the temerity to increase Q1 guidance and issue Q2 revenue YoY growth guidance of over 100%. On the same day, it also announced (an almost certainly corrupt) sale of a minority interest in FL Mobile that gave the subsidiary an implied valuation equal to NQ's market capitalization. NQ did not even acknowledge its past due 20-F in either release. These announcements pushed the stock up 11.8% to \$7.59.