

Disclaimer:

Use of Muddy Waters LLC's research is at your own risk. You should do your own research and due diligence before making any investment decision with respect to securities covered herein. You should assume that as of the publication date of any report or letter, Muddy Waters, LLC (possibly along with or through our members, partners, affiliates, employees, and/or consultants) along with our clients and/or investors has a short position in all stocks (and/or options of the stock) covered herein, including without limitation EDU, and therefore stands to realize significant gains in the event that the price of stock declines. Following publication of any report or letter, we intend to continue transacting in the securities covered therein, and we may be long, short, or neutral at any time hereafter regardless of our initial recommendation. This is not an offer to sell or a solicitation of an offer to buy any security, nor shall any security be offered or sold to any person, in any jurisdiction in which such offer would be unlawful under the securities laws of such jurisdiction. Muddy Waters, LLC is not registered as an investment advisor. To the best of our ability and belief, all information contained herein is accurate and reliable, and has been obtained from public sources we believe to be accurate and reliable, and who are not insiders or connected persons of the stock covered herein or who may otherwise owe any fiduciary duty or duty of confidentiality to the issuer. However, such information is presented "as is," without warranty of any kind – whether express or implied. Muddy Waters, LLC makes no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information or with regard to the results to be obtained from its use. All expressions of opinion are subject to change without notice, and Muddy Waters, LLC does not undertake to update or supplement this report or any of the information contained herein.

This is copyrighted material and you agree not to distribute it in any way other than by emailing the link www.muddywatersresearch.com/research/. If you have obtained this research in any manner other than by download from the aforementioned link, you may not read this report without going to the aforementioned link and agreeing to the Terms of Service. You further agree that any dispute arising from your use of this report and / or the Muddy Waters Research website or viewing the material hereon shall be governed by the laws of the State of California, without regard to any conflict of law provisions. You knowingly and independently agree to submit to the personal and exclusive jurisdiction of the superior courts located within the State of California and waive your right to any other jurisdiction or applicable law, given that Muddy Waters, LLC has offices in California. The failure of Muddy Waters, LLC to exercise or enforce any right or provision of these Terms of Service shall not constitute a waiver of this right or provision. If any provision of these Terms of Service is found by a court of competent jurisdiction to be invalid, the parties nevertheless agree that the court should endeavor to give effect to the parties' intentions as reflected in the provision and rule that the other provisions of these Terms of Service remain in full force and effect, in particular as to this governing law and jurisdiction provision. You agree that regardless of any statute or law to the contrary, any claim or cause of action arising out of or related to use of this website or the material herein must be filed within one (1) year after such claim or cause of action arose or be forever barred.

Company:

New Oriental Education & Technology Group (NYSE: EDU)

Industry:

Education

Recommendation:

Strong Sell

Report Date:

July 18, 2012

Price:

\$14.62

Market Cap:

2.26 billion

Float:

117.1 million

Avg Volume:

1.14 million

- EDU has reported 392% revenue growth since going public.¹ The revenue growth has been built on store growth of 338% during this time.² EDU tells investors that its entire store network is company-owned, but this is a lie. As recently as last month, EDU president and CFO Louis Hsieh adamantly denied that EDU has any franchisees. This report shows Hsieh's statements are patently false – EDU has numerous franchisees. However, these franchisees are not a hidden bonus for investors. Rather, they are part of a substantial fraud in EDU's accounts.
- It is virtually certain that EDU uses the upfront franchise and other fees to inflate its cash balances in order to receive unqualified audit opinions from its auditor.
- EDU's Beijing operation (which is approximately 35% of EDU's reported revenue) has prepared financial statements for 2009 – 2011 are fraudulent. EDU has submitted these financial statements to its domestic regulator, the Civil Affairs Bureau ("CAB"). It is probable that EDU used these same financials in the preparation of its U.S. filings.
- EDU's corporate structure is far more problematic than just a weak VIE. The schools that conduct its operations are ultimately state property. We question how EDU can consolidate them.
- We believe that as a result of our exposure of these problems with EDU's reporting, EDU will restate historical results – likely significantly; and, that its auditor will resign.

Calculation based on RMB revenue, and excludes currency fluctuations.
 Store count number includes schools and learning centers; it excludes book stores.

Magna Cum Fraude

We rate EDU a Strong Sell because it is probable that EDU will have a significant restatement, and that its auditor will resign.

- EDU has reported 392% revenue growth since going public.¹ The revenue growth has been built on store growth of 338% during this time.² EDU tells investors that its entire store network is company-owned, but this is a lie. As recently as last month, EDU president and CFO Louis Hsieh adamantly denied that EDU has any franchisees. This report shows Hsieh's statements are patently false – EDU has numerous franchisees. However, these franchisees are not a hidden bonus for investors. Rather, they are part of a substantial fraud in EDU's accounts.
- It is virtually certain that EDU uses the upfront franchise and other fees to inflate its cash balances in order to receive unqualified audit opinions from its auditor.
- EDU's Beijing operation (which is approximately 35% of EDU's reported revenue) has prepared financial statements for 2009 – 2011 are fraudulent. EDU has submitted these financial statements to its domestic regulator, the Civil Affairs Bureau ("CAB"). It is probable that EDU used these same financials in the preparation of its U.S. filings.
- EDU's corporate structure is far more problematic than just a weak VIE. The schools that conduct its operations are ultimately state property. We question how EDU can consolidate them.
- We believe that as a result of our exposure of these problems with EDU's reporting, EDU will restate historical results – likely significantly; and, that its auditor will resign.

Franchising: The CFO Doth Protest Too Much, Methinks³

"A lie ain't a side of a story. It's just a lie."
- The Wire, season 5 episode 8⁴

In the following excerpt of a June 2012 conversation, EDU president and CFO Louis Hsieh is either lying or demonstrating that he is being lied to. As we show in this report, it is indisputable that EDU has an extensive franchising operation. It is virtually certain that EDU has been consolidating the financials of its franchisees into its own financials.

We encourage investors to listen to the recording of this conversation at
<http://www.muddywatersresearch.com/watch-the-video-edu>.

Q: "Do you franchise any of your stores?"

Hsieh: "No. No. Our biggest asset, the reason our moat is so large is cause of our brand name. We will protect that. [inaudible] We own everything."

Q: "So the four hundred and thirty learning centers..."

Hsieh: "We own all of them."

¹ Calculation based on RMB revenue, and excludes currency fluctuations.

² Store count number includes schools and learning centers; it excludes book stores.

³ Props to Shakespeare for the original line in Hamlet Act III, Scene II "The lady doth protest too much, methinks."

⁴ <http://en.wikipedia.org/wiki/Clarifications>

Q: "How many? I'm sorry."

Hsieh: "It's six hundred and fifty."

Q: "Learning centers and schools? It's a mix?"

Hsieh: "Yeah. Over six hundred. About six hundred and fifty. We own everything."

Q: "A hundred percent fully-owned?"

Hsieh: "Yes."

Q: "I see. And do you have any arrangements, in terms of, you know, capital, capex, or cost sharing, or profit sharing, or any type of cooperation?"

Hsieh: "No."

Q: "With others?"

Hsieh: "Nope. All ours. We've grown completely organically. We owe nobody."

Q: "Purely organic, a hundred percent owned by New Oriental?"

Hsieh: "Correct. Absolutely correct. That's how we control the quality."

Introduction

New Oriental Education & Technology Group Inc. ("EDU") is lying to shareholders about its store growth and financial performance. As is typical of many of the frauds we have witnessed in China, how EDU actually conducts its business differs materially from what it tells investors. Inside China, EDU has an extensive and long-standing franchising operation. We know this because we have listened to discussions between EDU and a potential franchisee. Outside China, EDU's president / CFO Louis Hsieh vehemently denies the existence of any franchising or financial sharing arrangements whatsoever.

We have evidence that EDU's franchising operation covers dozens of cities, including its original Tier 1 markets, and that the franchising includes both POP Kids and traditional format stores. However, EDU has never disclosed any information related to franchising. It is virtually certain that EDU uses the front-end weighted franchise fees it receives to game its cash balance confirmation during its audit. It is also virtually certain that EDU consolidates its franchisees' results as though they were EDU's own. This has a number of other implications for numbers reported since going public in September 2006, including:

- 37.0% revenue CAGR built on 29.1% store count CAGR from FY2006 to FY2011.
- Capital expenditures since going public of approximately \$104 million.
- 19.5% enrollment CAGR.
- 41.0% teacher and 39.8% non-teacher employee count CAGRs.