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FAB Universal Failure to Disclose 100 Million RMB Debt Adds to Problems

November 18, 2013

Questions regarding the motives of the FAB Universal (FU) management team and the transparency of its Chinese operations first surfaced in back to back Seeking Alpha articles published on [September 26](#) and [October 1](#) discussing massive dilution headwinds on the horizon. The dilutive events that could ultimately result in 37.9 million shares hitting the market arose from the back door RTO transaction that FAB's Chinese subsidiary used to go public in [April 2012](#).

Next, after an over two year hiatus since Alfred Little (A*L) published his last report leading to the delisting of a ChineseHybrid, [SinoTech Energy](#), A*L broke his silence. On Thursday November 14, 2013, A*L put out a scathing report concluding that FAB Universal is a fraud. A*L's report went beyond capital structure issues and addressed FU's operations through intensive on-the-ground research. He found FAB guilty of rampant piracy, back-end deals with franchisees that guarantee returns, and of inflating its kiosk count by as much as 10 times. A*L's findings put into question 90% of FAB's kiosk revenues of \$26 million reported for the first nine months of 2013 (see page 28 of the [Q3 10-Q](#)). We had opened up an investigation into FU's operations several months ago and our initial attempt (or should we say inability) to locate FAB kiosks in Beijing leads us to believe A*L's claim that FAB has grossly exaggerated its kiosk count.

New Evidence of Deception Brought to GeoInvesting's Attention

On Friday, November 15th, 2013, a Seeking Alpha contributor, "Unemon1" [alerted](#) GeoInvesting to an undisclosed RMB 100 million (\$16.4 million) Chinese bond issuance by FAB. The implications of this development are significant, especially when one considers that FAB operates through Variable Interest Entities (VIEs) wherein U.S. investors have been found historically to have questionable legal claims to assets and cash flows.

Verification of FAB's undisclosed bond issuances is confirmed by three independent and authentic sources:

In April 2013, FAB issued RMB 100 million (\$16.4 million) of bonds to Chinese investors through one of its VIE subsidiaries, Beijing Fab Digital Entertainment Products Co., Ltd. ("FAB Digital"), and failed to disclose this debt in its U.S. filings. Page 37 of FAB's 2012 10-K clearly shows that FAB Digital is a subsidiary of FAB. (FAB's corporate structure diagram is presented later in this report). **This bond issuance should have been reflected in both FAB's [second](#) and [third quarter 2013 10Q](#) filings, but it was not.**

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For now let's take a look at how easy it is to prove FAB's bond offering.

- A public announcement regarding the bond offering was posted on August 2, 2013 on the official website of the Shenzhen Stock Exchange.
- Wind Info, China's leading financial data provider (the Chinese Bloomberg), disclosed information about the bond offering.
- An asset management report shows that a mutual fund sponsored by China's Daton Securities owns 20,000,000 RMB of the FU bonds.


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Independent Verification Number One

A [public announcement](#) posted on August 2, 2013 on the official website of the Shenzhen Stock Exchange clearly stated that 100 million RMB in bonds (collectively, the “12 FAB Bond”) had already been issued by FAB Digital (北京精彩无限音像有限公司). The announcement was dated August 1st 2013 (The 12 FAB Bonds were issued on April 25, 2013).

As shown in the screenshot below, the Shenzhen Stock Exchange announced under item 3 that:

“3. Beijing FAB Digital Entertainment Products Co., Ltd 2012 annual Small Medium Enterprise Private Placement Issuance of Bond, Ticker “118109”, the bond’s short name is “12 精彩债(12 FAB Bond).” The total size of the issuance is RMB 100,000,000 with a coupon rate of 11.00%. The bond matures in 3 years, with attached option for the issuer to adjust the coupon rate at the end of 2nd year and the option for the investors to redeem.”

**深圳证券交易所**
SHENZHEN STOCK EXCHANGE

Announcement regarding the matters related to the provision of transfer service for four privately issued debt securities of SMEs 2012, such as Chongqing City Liangpin Zhang Duck Food Co Ltd 2012

关于为重庆市梁平张鸭子食品有限公司2012年中小企业私募债券等四只私募债券提供转让服务有关事项的通知

日期: 2013-8-2 ← Date: August 2, 2013

各会员单位:


重庆市梁平张鸭子食品有限公司2012年中小企业私募债券、贵州森瑞管业有限公司2012年中小企业私募债券、北京精彩无限音像有限公司2012年中小企业私募债券和深圳市莲花山园林有限公司2013年中小企业私募债券定于2013年8月5日起在本所综合协议交易平台进行转让, 现将有关事项通知如下:
The following four bonds.....will begin transfer/trading on our exchange's comprehensive negotiation trading platform starting August 5th, 2013, the detailed matters are hereby announced as follows:

- 1、重庆市梁平张鸭子食品有限公司2012年中小企业私募债券证券代码“118103”, 证券简称“12张鸭子”, 发行总额3,000万元, 票面利率9.00%, 债券期限2年。
- 2、贵州森瑞管业有限公司2012年中小企业私募债券证券代码“118109”, 证券简称“12森瑞债”, 发行总额5,000万元, 票面利率10.00%, 债券期限2年。
- 3、北京精彩无限音像有限公司2012年中小企业私募债券证券代码“118089”, 证券简称“12精彩债”, 发行总额10,000万元, 票面利率11.00%, 债券期限3年, 附第2年末发行人上调票面利率选择权和投资者回售选择权。
- 4、莲花山园林有限公司2013年中小企业私募债券证券代码“118110”, 证券简称“13莲花山”, 发行总额28,000万元, 票面利率8.63%, 债券期限3年, 附第2年末发行人上调票面利率选择权和投资者回售选择权。

特此通知

3. 北京精彩无限音像有限公司 (Beijing FAB Digital Entertainment Products Co., Ltd) 2012 annual Small Medium Enterprise Private Placement Issuance of Bond, Ticker “118109”, the bond’s short name is “12精彩债(12 FAB Bond)”. The total size of the issuance is RMB 100,000,000 with a coupon rate of 11.00%. The bond matures in 3 years, with attached option for the issuer to adjust the coupon rate at the end of 2nd year and the option for the investors to redeem.

深圳证券交易所
二〇一三年八月一日

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[粤ICP备05012689 (建议使用IE6.0以上浏览器, 1024x768以上分辨率)]

FAB Universal Failure to Disclose 100 Million RMB Debt Adds to Problems

Independent Verification Number Two

[Wind Info](#), China's leading financial data provider (the Chinese Bloomberg), displays the following information regarding the 12 FAB Bond:

基本条款	Basic Term						
债券代码	Bond Number:	118089.SZ	118089.SZ	债券简称	Bond Name:	12精彩债	12 Jingcai Bond
债券类型	Bond Type:	私募债	Private Placement Bond	债券全称	Bond Full Name:	北京精彩无限音像有限公司2012年中小企业私募债券	
质押券代码	Pledge Bond Number:	--	--	折合标准券(元)	Converted to Standard Bond:	--	Beijing FAB Digital Entertainment Products Co., Ltd. 2012 Middle-small size Enterprise Bond
发行人	Issuer:	北京精彩无限音像有限公司 Beijing FAB Digital Entertainment Products Co., Ltd.					
起息日期	Interest Start Date:	2013-04-25	April 25, 2013	到期日期	Due Date:	2016-04-25	April 25, 2016
剩余期限(年)	Remaining term (Year):	2.44(加权: 2.44)	2.44	期限(年)	Term:	3.00(2+1)	3 years (2+1)
内含特殊条款	Special term:	回售,调整票面利率	Buy back, adjust par interest	下一行权日	Next Exercise Date:	2015-04-25	April 25, 2015
条款说明	Note:	回售:附第2年末发行人上调票面利率选择权和投资者回售选择权; 调整票面利率:附第2年末发行人上调票面利率选择权和投资者回售选择权					
当前余额(亿元)	Current Balance:	1.0000	100 million	发行规模(亿元)	Issued Amount:	1.0000	100 million
利率类型	Interest Type:	累进利率	accumulated interest	息票品种	Interest Type:	附息	with interest
票面利率(当期)	Face Interest (current)	11.0000	11%	利率说明	Interest Note:	20130425-20150424,票面利率:11%;20150425-20160424,票面利率:11%+上调基点,利息税率:20%	
付息频率	Interest payment frequency:	每年付息1次	annually	距下一付息日(天)	days to next Interest Date:	160	160
付息日说明	Interest Payment Date:	每年4月25日付息,节假日顺延 April 25, next working day if it is a holiday					
面值(元)	Par value:	100.0000	100	发行价格(元)	Issurance Price:	100.0000	Issured price: 100
最新信用评级	Current rating:	--	--	评级机构	Rating Agency:	--	--
增信方式	--	--	--	担保人	Guarantee:	--	--
增信情况	--	--	--	--	--	--	--
上市日期	listed Date:	2013-08-05	August 5, 2013	摘牌日期	Due Date:	2016-04-24	April 24, 2016
交易市场	Trading Market	118089.SZ(深圳)	118089.SZ (Shenzhen)	--	--	--	--

Independent Verification Number Three

A mutual fund sponsored by China's Daton Securities named "Daton Three Stone No. 2 Aggregate Asset Management Plan" reported holding 20,000,000 RMB of the 12 FAB Bond, according to its [2013 2nd Quarter Asset Management Report](#) dated July 20, 2013, as shown below:

2. Top five bond holding by market value

Bond Name → 2、按市值占净值比例大小排序的前五名债券明细

End of Period Market Value (RMB)

序号	债券名称	期末市值(元)	占资产净值比例
1	12 姜国资	30,954,000.00	6.58%
2	09 东华债	25,184,794.99	5.35%
3	12 精彩债 12 FAB Bond	20,000,000.00	4.25%
4	12 申环 01	16,178,016.44	3.44%
5	10 泰豪债	10,170,000.00	2.16%

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FAB completely failed to disclose this debt in its financials filed with the SEC.

Below is a screenshot of FAB's consolidated balance sheet taken directly from FAB's [Q3 10-Q](#) filed on November 14, 2013:

FAB UNIVERSAL CORP AND SUBSIDIARIES UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS		
	September 30, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash	\$ 43,575,330	\$ 19,671,937
Accounts receivable, net	10,264,310 [1]	6,927,045 [1]
Advances to suppliers, net	81,500	154,770
Inventory	6,552,797	5,207,008
Deferred tax assets, current	2,537,494	1,771,799
Other current assets	293,724	979,021
Total current assets	<u>63,305,155</u>	<u>34,711,580</u>
Property, and equipment, net	16,482,771	16,720,637
Goodwill	61,538,155	60,652,957
Intangible assets, net	24,730,658	27,875,748
Deferred tax assets, non-current	5,237,776	3,346,166
Long-term deposits	39,476,943	24,488,131
Total assets	<u>\$ 210,771,458</u>	<u>\$ 167,795,219</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank loans	\$ 1,797,849	\$ 2,072,619
Accounts payable	7,451,436	6,471,270
Accrued expenses	2,932,105	3,077,785
Deferred revenue, current	13,094,805	8,250,402
Taxes payable	2,804,354	1,603,821
Due to related parties	122,184	41,341
Other payable	1,956,728	1,910,378
Total current liabilities	<u>30,159,461</u>	<u>23,427,616</u>
Long-term deposits from customers	2,359,053	2,474,604
Deferred revenue, non-current	24,978,957	7,923,450
Long-term payables	-	39,204
Total liabilities	<u>57,497,471</u>	<u>33,864,874</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred Stock	- [2]	- [2]
Common stock	20,806 [3]	20,469 [4]
Additional paid-in capital	207,716,509	206,786,139

A simple review of each of FAB's liabilities shows no sign of the \$16.4 million FAB Digital debt.

By failing to disclose this debt, FAB violated many SEC rules including:

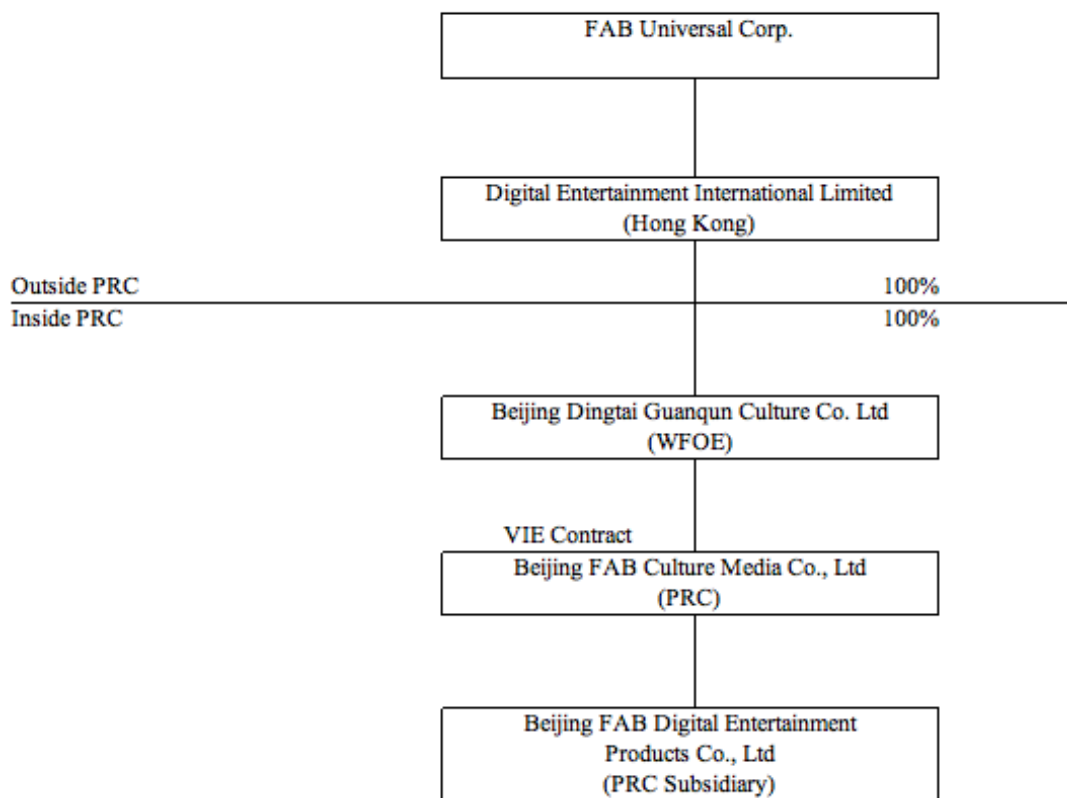
- *Section 17(a) of the Securities Act for making untrue statements of material fact and engaging in engaging in transactions that deceived purchasers of FAB common stock.*
- *Section 13(a) and 10(b) of the Exchange Act for filing inaccurate quarterly reports and failing to disclose indebtedness.*
- *Section 13(b) of the Exchange Act for failure to keep accurate books and records.*
- *Section 13(b)(5) and Rule 13b2-2 of the Exchange Act for knowingly falsifying books and records and making materially false and misleading statements.*
- *SOX Section 302 for principal officers falsely certifying the integrity of financial reports.*

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- *SOX Section 906 for falsely certifying that financial reports were accurate and reflected the true financial condition of the issuer.*

FAB's SEC Filings Confirm that Fab Digital Entertainment Products Co., Ltd. is indeed the FAB Digital that issued the 12 FAB Bonds

As shown in the following organizational chart copied from FAB's 2012 10-K, FAB conducts its operation in China through a series of contracts (VIE agreements) that allowed them to consolidate the operations of its two main Variable Interest Entities (VIEs), Beijing FAB Culture Media Co., Ltd ("FAB Media") and its wholly owned subsidiary, Beijing FAB Digital Entertainment Products Co., Ltd. ("FAB Digital").



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According to page 49 of the 2012 10-K shown below, FAB Digital was incorporated in September 2003 with registered capital of 1 million RMB.

“ ...

FAB Media was incorporated as a private enterprise in the PRC in April 2008 with a registered capital of RMB 1 million. FAB Media is primarily engaged in operating and providing proprietary multimedia kiosks for music downloads, information exchange and advertising.

FAB Digital was incorporated as a private enterprise in the PRC in September 2003 with a registered capital of 1 million Renminbi (“RMB”) and is a wholly owned subsidiary of FAB Media. FAB Digital specializes in the distribution of entertainment and audio visual products through its two flagship stores in Beijing as well as its online stores. Beijing Jingl-vtong Travel and Science Technology Co., Ltd. (“JLTST”), which is fully owned by FAB Digital, was incorporated in the PRC in November 2010 with a registered capital of RMB 1 million.

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...”

FAB disclosed in its Definitive Proxy Statement filed on 6/15/12 (link [here](#) and excerpted below), that the legal representative of FAB Digital is Mr. Jiliang Ma, who is also a 40% owner of FAB Media. Mr. Ma was also the authorized signing representative of FAB Digital on FAB Universal’s various publicly disclosed VIE agreements that enabled FAB’s consolidation of FAB Media and FAB Digital.

“ ...

IN WITNESS HEREOF, the following Parties have caused this Shareholders’ Voting Rights Proxy Agreement to be executed as of the date and in the place first here above mentioned.

WangGang (Signature):

Ma Jiliang (Signature):

ZhangHongcheng(Signature):

Beijing FAB Digital Entertainment Products Co., Ltd. (Company Chop)

Signed by:

Name: Ma Jiliang

Position: Authorized Representative

...”

The Chinese name of FAB Digital is 北京精彩无限音像有限公司 , which we confirmed using the Beijing Enterprise Credit Website operated by Beijing Government’s State Administration of Industry and Commerce (“SAIC”)(link [here](#) and [here](#)). As shown in the screenshots below, FAB Digital (北京精彩无限音像有限公司) was founded on September 3, 2003 with 1 million RMB registered capital and with Jiliang Ma serving as its legal representative. FAB Digital’s business scope of “distribution and rental of audio, visual and other media products” described in SAIC records matches FAB Digital’s business description in FAB’s 10-K.

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The screenshot shows the '北京市企业信用信息网' (Beijing Enterprise Credit Information Website). The main header includes the site name and a search bar. Below the header, there are navigation links and a sidebar with '信用信息快速查询' (Quick Credit Information Search) and '信用动态' (Credit Dynamic). The main content area displays '企业信息' (Enterprise Information) for '北京精彩无限音像有限公司' (Beijing Fab Digital Entertainment Products Co Ltd).

Registration No.: 110101006106764	Enterprise Type: Limited Liability Company
注册号: 110101006106764	企业类型: 有限责任公司(自然人投资或控股)
主体名称: 北京精彩无限音像有限公司	Entity Name: Beijing Fab Digital Entertainment Products Co Ltd
法定代表人/负责人: 马继良 Legal Rep: Jiliang Ma	行政区划: 东城区
成立日期: 2003-09-03 Date established: 2003-09-03	注册资本: 100 万 Registered Capital: 1 million RMB
经营期限自: 2003-09-03	经营期限至: 2021-09-02
登记机关: 东城分局	企业状态: 开业
地址/住所: 北京市东城区王府井大街301号B4层4-04	
销售、出租音像制品 (有效期至2019年12月7日); 零售国内外版图书、报纸、期刊、电子出版物 (有效期至2015年12月31日); 利用互联网经营音像制品、艺术	

Conclusion

In contrast to A*L's allegations, FAB's very obvious failure to disclose \$16.4 million in debt should take very little time for securities regulators and FAB's auditor (Friedman LLP) to confirm. In fact, this should take Friedman, CEO Chris Spencer, CFO John Busshaus, the NYSE, SEC, or even Jim Rodgers all of 20 minutes or at most one day, being generous, to confirm this.

FAB indicated on Friday November 15, 2013 that they would respond to the A*L report in short order. At this point FAB's U.S. management should proactively halt their own stock to protect investors and commence an independent investigation to carefully check these very serious allegations.