

Independent Investment Research Focused on Public Company Interactions with the SEC.

#### Disclosed SEC Investigation(s) Confirmed as On-going

**Watch List Status:** Not on Watch List of Companies with Undisclosed SEC Investigations

#### Inadequate Disclosures Make It Impossible to Assess this Material and Newly-Disclosed Risk

**Quick Take:** in our opinion, HF Foods Group is a troubled company. In addition to a wide array of internal controls problems, the company recently disclosed a formal SEC investigation that our research suggests has a tail back to at least April 2020. Details on the investigation are scant, making it impossible for investors to assess this material and newly disclosed risk. We are left to wonder: 1) Why did the company wait so long to disclose; and, 2) What changed that made management realize it had to? Remember, the act of disclosure itself is enough to tell you management thinks the exposure is serious.

**What's Been Disclosed:** in his 10-Q filed on November 9, 2020, HF Foods first disclosed a formal SEC investigation. Relative to this investigation, the company said the following "The document request relates to a range of matters including, but not limited to, the matters identified in the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit."

We also note that HF Foods has been dealing with a wide array of internal controls problems that remain unresolved as of the 10-Q filed in November 2020.

The following is from the initial disclosure made of the formal SEC investigation of HF Foods. More in-depth detail on the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit appear later in this report.

The United States Securities and Exchange Commission ("SEC") has initiated a formal, non-public investigation of the Company, and the SEC issued a request for a variety of documents and other information. The document request relates to a range of matters including, but not limited to, the matters identified in the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit. We are cooperating with the SEC in its investigation.

Prior to receiving the document request from the SEC, the Company's board of directors appointed a special committee of independent directors to investigate the matters identified in the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit.

The SEC and independent committee investigations are in process and no conclusions have been reached.

**Updates / Developments of Note:** There are none at this time. This is a relatively recent disclosure of a formal SEC investigation.

**From the Probes Reporter Database:** We filed our first Freedom of Information Act (FOIA) request with the SEC on this company in **Apr-2020**. Recent FOIA responses are NOT consistent with recent company disclosures; that is, they show first signs of SEC enforcement proceedings as early as Apr-2020, with confirmation as recently as of 17-Sep-2020. The company waited until Nov-2020 to make its first disclosure of an SEC investigation.

24-Apr-2020	FOIA Response	SEC denies access to records over concern their release, "could reasonably be expected to interfere with enforcement activities."
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31-Aug-2020	FOIA Response	SEC denies access to records over concern their release, "could reasonably be expected to interfere with enforcement activities."
17-Sep-2020	Appeal Response	<b>Existence of on-going SEC enforcement proceedings officially confirmed on appeal</b> ; Access to records remains blocked.

Clients are invited to contact us anytime, in total confidence, to discuss the data, documents, and/or risks we identify here.

**Disclosure Insight®**

*This section offers analysis and opinion regarding the exposure(s) we identify in this report.*

The timing of SEC responses to us suggests that **HF Foods Group management may have known about an SEC probe since at least Apr-2020.**

**How to Proceed from Here:** Remember, public companies can provide investors with far more substantive detail and updates on SEC investigative activity than most do. Public companies can – if they choose – disclose greater detail on such things as:

- First contact with the SEC.
- Records / testimony requested.
- Time period [now] covered by the investigation.
- Areas it is [now] focused on.
- Whether the investigation has expanded.
- Whether the investigation is formal.
- Involvement by other agencies.
- Company personnel asked to give testimony.
- Subpoenas (there can be many over time).
- Who got subpoenas / what they sought?
- Last contact with the SEC on the investigation(s).

Let’s now look at a few of these –

- **First contact with the SEC.** The company does not say when it first had contact with the SEC. We know from experience that SEC investigations rarely start out as formal. That alone suggests this investigation began prior to it becoming formal. Our own research supports this. In a FOIA response dated 24 April 2020, we got our first indication of undisclosed SEC investigative activity at HF foods.

- **Areas it is [now] focused on.** The company also provides the scantest of detail regarding what this exposure is about. So be careful. You sure can bury a lot of bad things in a disclosure that says an SEC “document request relates to a range of matters including but not limited to...”
- **At this point, there’s no update on what’s occurred with that internal investigation.** HF Foods says, “the Company's board of directors appointed a special committee of independent directors to investigate the matters identified in the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit.”

The company did not say its internal investigation would also examine matters related to what is now a formal SEC investigation. Why?

Finally, keep in mind that a public company can be involved in more than one SEC investigation at a time. As such, we routinely recommend asking a company if there are any investigations beyond what is disclosed or reported in media stories – or even in our research.

Clients are invited to contact us anytime, in total confidence, to discuss how to better assess the risks we identify here.

– John P. Gavin, CFA

**Additional research history with select disclosure excerpts appear below.**

## Documents Acquired Under the Freedom of Information Act

### Documents from the Probes Reporter Document Library –

At this time, we have no investigative records in our library from closed SEC investigations of this company.

### Regarding the Current Warning –

If we alert you to the existence of an undisclosed SEC investigation – or any response from the SEC – that means we filed a Freedom of Information Act (FOIA) request on the company in question and have a response, in black-and-white on government letterhead, that supports our statement.

As can be seen in the table above, at least once in the past the SEC cited the "law enforcement exemption" of the FOIA as basis to deny the public's access to the detailed records we sought on this company. As a matter of law, the SEC is acknowledging some sort of investigative activity with this response.

We filed an appeal with the SEC's Office of the General Counsel to challenge that response. In response to our latest appeal(s), the date(s) of which is/are also shown in the table above, the SEC stated, "We have confirmed with staff that releasing the withheld information could reasonably be expected to interfere with on-going enforcement proceedings."

*Editor's Note: When the SEC denies access to records on closed SEC investigations, they are frequently blocking internal SEC documents known as "Opening and Closing Reports, including 'Case Closing Recommendation,' 'Matter Under Inquiry Summary,' 'Investigation Summary,' and/or similar documents and/or reports." A Case Closing Report is merely the cover page for a report called a Case Closing Recommendation. A Case Closing Recommendation is the SEC's report that tells you why an investigation was opened, what work was done, and the conclusions reached. To date, the SEC almost always refuses to release its Case Closing Recommendations and similar documents, a practice for which we remain sharply critical of the agency.*

## Notable Events and Disclosures

A search of this company's filings for the two years prior to initial disclosure of an SEC investigation in November 2020, found no clear disclosure of SEC investigative activity.

These are long and detailed disclosure excerpts. First disclosure of the SEC investigation is **highlighted** at the bottom.

### From the HFFG Foods Group, Inc. 10-Q filed on 09-Nov-2020:

#### Changes in Internal Control Over Financial Reporting

As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2019, management concluded that our internal control over financial reporting was ineffective due to material weaknesses and control deficiencies in our internal control over financial reporting. The material weaknesses identified includes: (1) the Company has limited in-house accounting personnel with sufficient U.S. GAAP and SEC reporting experiences, especially related to complex transactions and new accounting pronouncements; and (2) the Company lacks sufficient IT resources to maintain effective IT General Controls, including missing certain entity level controls in IT management, lack of segregation of duties in IT functions, proper review of the operation of application systems, and measures to protect data security and maintain business sustainability. Control deficiencies are related to the lack of proper documentation to evidence the management review of various business processes. In order to address and resolve the foregoing material weakness, during the quarter ended September 30, 2020, we continued to improve on our U.S. GAAP and SEC reporting

knowledge relating to complex transactions and added additional resources both in terms of systems and manpower to improve our internal control over financial reporting.

The measures we have implemented are subject to continued management review supported by confirmation and testing, as well as audit committee oversight. Management remains committed to the implementation of remediation efforts to address these weaknesses. Although we will continue to implement measures to remedy our internal control deficiencies, there can be no assurance that our efforts will be successful or avoid potential future material weaknesses. In addition, until remediation steps have been completed and/or operated for a sufficient period of time, and subsequent evaluation of their effectiveness is completed, the weaknesses identified and described above will continue to exist.

#### Item 1. Legal Proceedings.

A labor and employment lawsuit was filed by a former employee against FUSO, alleging it failed to provide proper meal and rest breaks, as well as other related violations. FUSO believes there is no merit to the case and vigorously defending against all the allegations. Therefore, the Company did not accrue any loss contingency for these matters on its consolidated financial statements as of September 30, 2020 and December 31, 2019.

On March 29, 2020, plaintiff Jesus Mendoza (“Mendoza”) filed a putative shareholder securities class action lawsuit (the Class Action Lawsuit”) in the United States District Court for the Central District of California against the Company and certain of its present and former officers (collectively, the “Class Action Defendants”) for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 styled Mendoza v. HF Foods Group Inc., et al., Civil Action No. 2:20-CV-2929-ODW-JPR (C.D. Cal.).

On April 30, 2020, plaintiff Walter Ponce-Sanchez (“Ponce-Sanchez”) filed a substantially similar putative shareholder securities class action lawsuit (the “Ponce-Sanchez Lawsuit”) in the United States District Court for the Central District of California against the same defendants named in the Class Action Lawsuit (collectively, the “Ponce-Sanchez Defendants” and with the Class Action Defendants, the “Defendants”) styled Ponce-Sanchez v. HF Foods Group Inc., et al., Civil Action No. 2:20-CV-3967-ODW-JPR (C.D. Cal.). The Ponce-Sanchez Lawsuit has now been consolidated with the Class Action Lawsuit and both cases will proceed under the Class Action Lawsuit docket. The complaints both allege that the Defendants made materially false and (or) misleading statements that caused losses to investors. Additionally, the complaints both allege that the Defendants failed to disclose in public statements that the Company engaged in certain related party transactions, that insiders and related parties were enriching themselves by misusing shareholder funds, and that the Company masked the true number of free-floating shares. Neither complaint quantifies any alleged damages, but, in addition to attorneys’ fees and costs, they seek to recover damages on behalf of themselves and other persons who purchased or otherwise acquired Company stock during the putative class period from August 23, 2018 through March 23, 2020 at allegedly inflated prices and purportedly suffered financial harm as a result. On October 13, 2020, the Court appointed Yun F. Yee as lead plaintiff and approved Mr. Yee’s counsel as lead counsel in the Class Action Lawsuit. On October 28, 2020, the Court entered a scheduling order setting December 4, 2020 as the deadline for lead plaintiff to file the Consolidated Amended Complaint and setting a schedule for Defendants’ anticipated motion to dismiss. The Class Action Lawsuit does not quantify any alleged damages. The Company disputes these allegations and intends to defend the consolidated actions vigorously.

On June 15, 2020, Mendoza filed a shareholder derivative lawsuit on behalf of the Company as a nominal defendant (the “Mendoza Derivative Lawsuit”) in the United States District Court for the Central District of California against certain of the Company’s present and former directors and officers (collectively, the “Mendoza Derivative Defendants”) styled Mendoza v. Zhou Min Ni, et al., Civil Action No. 2:20-CV-5300-ODW-JPR (C.D. Cal.). The complaint in the Mendoza Derivative Lawsuit is based largely on the same allegations as set forth in the Class Action Lawsuit discussed above and alleges violations of Sections 10(b), 14(a), and 20(a) of the Securities Exchange Act of 1934, breach of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. The Mendoza Derivative Lawsuit does not quantify any alleged damages, but, in addition to attorneys’ fees and costs, Mendoza seeks to recover damages on behalf of the Company for purported financial harm and to have the court order changes in the Company’s

corporate governance. The Mendoza Derivative Defendants and the Company dispute these allegations and intend to defend the Mendoza Derivative Lawsuit vigorously. On July 8, 2020, the Court ordered that all proceedings in the Mendoza Derivative Lawsuit be stayed until such time as the Court has finally resolved the Mendoza Defendants' anticipated motion to dismiss the Class Action Lawsuit.

At this stage, the Company is unable to determine whether a future loss will be incurred due to the consolidated Class Action Lawsuit or the Mendoza Derivative Lawsuit, or estimate a range of loss, if any; accordingly, no amounts have been accrued in the Company's financial statements as of September 30, 2020.

On August 21, 2020, Plaintiff Jim Bishop filed a putative shareholder derivative lawsuit (the "Bishop Lawsuit") in the United States District Court for the District of Delaware against certain of the Company's present and former directors and officers, as well as the Company (collectively, the "Bishop Defendants") styled Jim Bishop v. Zhou Min Ni, et al., Civil Action No. 1:20-cv-01103-RGA (D. Del.). The Bishop Lawsuit complaint alleges claims that are virtually the same as those alleged in the Mendoza II Lawsuit. The Bishop Lawsuit does not quantify any alleged damages. But in addition to attorneys' fees and costs, Mr. Bishop seeks to recover damages on behalf of the Company for purported financial harm and to have the Court order changes to the Company's corporate governance. The Bishop Defendants will seek to have the Bishop Lawsuit stayed until such time as the Court has finally resolved the Mendoza Defendants' anticipated motion to dismiss the securities class action claims in the consolidated Mendoza Lawsuit.

The Bishop Defendants and the Company dispute and intend to defend vigorously the allegations in the Bishop Lawsuit, assuming it proceeds. On October 20, 2020, Mr. Bishop and the Bishop Defendants filed a Joint Stipulation to Stay Litigation with the Court. In response, the Court entered a docket order on October 21, 2020, indicating that the Bishop Lawsuit could have been brought in the Central District of California where the Mendoza Derivative Lawsuit is pending already, and directing that any party opposing a transfer of the case to the Central District of California should submit a brief in support of that position by November 4, 2020. The Court further directed that the Bishop Defendants do not need to respond to the complaint until the transfer issue is resolved. This case remains in early procedural posture.

At this stage, the Company is unable to determine whether a future loss will be incurred due to the Bishop Lawsuit or estimate a range of loss, if any; accordingly, no amounts have been accrued in the Company's financial statements as of September 30, 2020.

**The United States Securities and Exchange Commission ("SEC") has initiated a formal, non-public investigation** of the Company, and the SEC issued a request for a variety of documents and other information. The document request relates to a range of matters including, but not limited to, the matters identified in the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit. We are cooperating with the SEC in its investigation.

Prior to receiving the document request from the SEC, the Company's board of directors appointed a special committee of independent directors to investigate the matters identified in the Ponce-Sanchez Lawsuit and the Mendoza Derivative Lawsuit.

The SEC and independent committee investigations are in process and no conclusions have been reached.

**[Emphasis added by Probes Reporter to highlight first disclosure of SEC investigation]**

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**Notes:** The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security.

New SEC investigative activity could theoretically begin or end after the date covered by the latest information in this report, which would not be reflected here. The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced above. Companies with undisclosed SEC investigations are maintained on our Watch List of companies with undisclosed SEC investigations.

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