



## ANONYMOUS ANALYTICS

Acquiring information through unconventional means

Operations Start Date: September 5, 2011

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### Chaoda Modern Agriculture

*11 Years of Deceit and Corporate Fraud*

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The Basics	
Ticker:	0682:HK
Associate:	Asian Citrus (0073:HK)
Market Cap:	HK\$8.5 Billion
Reported Net Cash:	RMB2.8 Billion
Float:	2.7 Billion

Consensus Estimates	
Recent Price:	HK\$2.50
Consensus Target:	HK\$6.31
Implied Return:	152.4%
Anonymous Estimates	
Anonymous Target:	<b>Delisting</b>
Expected Return:	<b>-100%</b>

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## Introduction

Recently, our representatives traveled to Hong Kong to meet with executives of Chaoda Modern Agriculture, one of China's largest agricultural companies. Chaoda places itself as a leader in farming and agricultural innovation. At the meeting, management showed us how fast the Company was growing. They told us how many production bases they operated. They told us about their involvement in the 2008 Beijing Olympics, about all the awards they had won. Phrases like 'state-level dragon head leading enterprise' and 'most valuable brand in China' were peppered throughout the meeting. We left with books, pamphlets, and CDs full of marketing material and notes.

But it wasn't their marketing material that caught our attention. It wasn't that this company was chosen as the official vegetable caterer to the 2008 Beijing Olympics. It wasn't that Chaoda had been ranked as one of the most valuable companies in China. It was their numbers, which were eye-popping. This once small company had managed to redefine the farming model, and in the process, grown to one of the biggest, most lucrative agricultural companies in the world – a company that Credit Suisse hailed as "revolutionary". We shook hands and left the meeting with the impression that Chaoda was either one of the greatest companies we had ever witnessed, or a large-scale fraud.



## Executive Summary

Chaoda Modern Agriculture is one of China's largest public agricultural companies. This report provides evidence that it is also one of the Hong Kong Exchange's largest, and longest running frauds.

Chaoda has an extensive history of deceiving investors and shareholders. Since its IPO, there have been several resignations by auditors, executives, and directors. We provide proof that management has consistently lied about the reasons behind these resignations. We further show that management has time after time misled investors about the Company's capital requirements. To this end, management has assured shareholders that the company was sufficiently capitalized, only to tap the capital markets – often within several weeks.

Rounds of financing are required because Chaoda is overstating its cash balance, exaggerating its revenue, and falsifying its financial statements. We show that reported revenue numbers make no sense and provide statistical proof as to the improbability of Chaoda's reported margins.

Much of the money that is raised is transferred out of the Company by management and third parties. These transfers are carried out under the cover of grossly inflated capex spending, and related party transactions. We provide proof that payments made to a 'major supplier' owned by the CEO are simply being transferred to a shell company with no business operations and de minimis assets.

Furthermore, we show that the CEO has used shareholder money to invest in risky projects without commensurate returns. One of these projects was a poorly operated orange plantation (Asian Citrus) that even Pepsi Co. found too risky. While this project robbed shareholders of high returns, they enriched the CEO through similar related party transactions.

Finally, we show that Chaoda is paying another fraudulent company to provide it with positive marketing exposure. In a bizarre twist worthy of a mystery novel, this saga involves Nobel laureates and some of the Western world's most renowned academics.

Theoretically, Chaoda may be worth HK\$0.60 per share (currently Hk\$2.50) derived from a blended NAV and DDM approach. However, based on the evidence in this report, as well as information we have decided not to release, we believe Chaoda may face delisting.



## Chaoda's Business Model

China has a highly fragmented farming industry. Whereas in the West a farmer owns and operates several hectares of farmland, in China a farmer generally cultivates one or two mu.<sup>1</sup> This fragmentation presents two problems for the Chinese farmer: lack of diversification to higher margin goods, and limited to no bargaining power.

Given the small area of land and limited horticultural know-how, Chinese farmers generally focus on cultivating what they know – usually rice. If farmers deviate from rice to higher margin produce, they risk the chance of a poor harvest. Since a farm's primary mandate is to feed the family, farmers avoid this risk by sticking to what they have traditionally grown.

If a farmer harvests enough produce to feed the family, the surplus is then sold to the market. Unfortunately, this process involves small quantities and several middlemen who each take their cut before the produce makes it to the retailers.

Chaoda's business model is based on consolidating the fragmented farmland, diversifying the products, and cutting out the middleman. First, the Company leases adjoining farmland from farmers and upgrades the infrastructure, adding irrigation systems and improving the soil. Then the farmers are hired back, trained, and paid a salary to grow a variety of vegetables on the new and improved land. In this way, the farmers are free to grow high margin produce while being assured income to support their families. The salaries are usually higher than what the farmers were making working for themselves which encourages them to co-operate with Chaoda.

After harvest, Chaoda uses its aggregate production muscle and its network of retail and wholesale contacts to sell the produce at a much higher price – often six times higher than what individual farmers get. In theory, that's how the model is supposed to work and can be very lucrative. So much so that it has been replicated by other companies, including China Green Holdings (904:HK), China Minzhong (MINZ:SP), and Le Gaga (GAGA:NSDQ). That's the good news. The bad news is that in practice the model is prone to fraud and corruption.

For example, since land is leased but never owned, it can be difficult, if not impossible to verify how big a production base the companies actually operate. Furthermore, given how fragmented the farmland is, it is not always practical for agricultural companies to negotiate with all the farmers. Instead, negotiations and agreements are often carried out with local government officials. These are two areas where the model is easily susceptible to fraud and corruption.

While our research indicates that there may be a select few legitimate companies in this space with good corporate governance practices, we do not believe Chaoda is part of this group. In reaching our conclusion, we have vetted thousands of documents, consulted other analysts,

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<sup>1</sup> A 'mu' is a standard unit of measurement in China, equal to approximately 1/15<sup>th</sup> of a hectare.



industry experts, and law offices spanning various jurisdictions and specialties. In addition to what is presented here, certain information has been brought to our attention which given its nature we have decided to withhold. However, based on all available information, we believe Chaoda is misleading investors and misrepresenting its operations. We will present evidence showing management has actively lied to investors, committed corporate fraud, and enriched itself at the expense of shareholders.



## Chaoda – A History Of Deceit

We lay the groundwork for our analysis by showing that Chaoda has a history of lying and misleading shareholders. Since its IPO, there have been several resignations by auditors, executives, and directors. Below is a summary of these events.

### December 15, 2000 – Chaoda goes public

### June 3, 2003 – PricewaterhouseCoopers resign as the firm’s auditor.

**The Event:** The resignation of PwC as early as 2003 is the first clear sign that there are issues with Chaoda’s operations and reported financial statements.

**Management’s Response:** In a released statement management claims the resignation of PwC was a result of fee disputes.<sup>2</sup>

**The Truth:** Auditors rarely resign as a result of fee disputes. There is sufficient competition among the Big Four and second tier audit firms to ensure they don’t nickel and dime clients. Moreover, auditors do not suddenly surprise companies with an auditing bill. The fee is agreed upon before the audit starts.

We are confident that the reason for PwC’s resignation had nothing to do with fees. We believe that PwC found discrepancies in Chaoda’s financial statements and concluded that the company was too risky to audit. To avoid public scrutiny, PwC and management agreed that the best way to resign was on the grounds of a fee dispute.

In fact, a paper released in 2005 by the Hong Kong Institute of Certified Public Accountants states the following:

*“The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) have raised concerns with the Hong Kong Institute of Certified Public Accountants concerning announcements made by listed issuers of the SEHK of the reasons for changes in auditors. In many cases, fee disputes are stated to be the reason for the change. **Concern has been expressed that certain auditors have been relying on purported fee disputes to disguise the real reasons for the change. As a result, potentially significant and fundamental matters about the listed issuer may not be disclosed to investors and creditors and the market is not therefore being kept fully informed. It is important that the situation concerning the change of auditors should be disclosed in full to avoid the possibility of the market being misled.**”<sup>3</sup>*

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<sup>2</sup> <http://www.chaoda.com.hk/pic/Announcement/2003/a030605.pdf>

<sup>3</sup> [http://app1.hkicpa.org.hk/professionaltechnical/whatsnew/docs/1\\_207A.pdf](http://app1.hkicpa.org.hk/professionaltechnical/whatsnew/docs/1_207A.pdf)



If as we believe, PwC used fee disputes to avoid bringing material issues to the attention of the board and shareholders, then PwC is complicit in the continuing fraud carried out by Chaoda.

### **September 1, 2003 – An independent director resigns**

**The Event:** Wong Kong Chi, an independent director resigns. When it rains, it pours, because this resignation comes three months after PwC's alleged fee dispute and in the middle of when Chaoda is normally preparing its year-end results.

**Management's Response:** We cannot find any statement by management regarding the reason for this resignation. However, a note was quietly slipped into the 2003 Annual Report.

**The Truth:** Wong is a fellow member of the Association of Chartered Certified Accountants, a member of the Hong Kong Institute of Certified Public Accountants and a career independent director. Wong has sat as an independent director on various boards, including his current position at Yip's Chemical.<sup>4</sup> We are curious what reason Mr. Wong had to resign from the board, especially at a time when the year-end financial information was being prepared. Chaoda's silence on the matter only adds to the mystery.

### **September 20, 2004 – An executive director resigns**

**The Event:** Chui Na Lai, co-founder of Chaoda, executive director, and wife of Mr. Kwok (CEO and Chairman of Chaoda) resigns.

**Management's Response:** In a released statement management claims the resignation is due to health reasons.<sup>5</sup>

**The Truth:** We note that in the weeks leading up to the resignation, Chui Na Lai's compensation increased substantially from ¥701,000<sup>6</sup> to ¥3,338,000. Additionally, she transferred her entire stake in Kailey Investment Ltd.<sup>7</sup> to Mr. Kwok,<sup>8</sup> effectively removing her direct interest and association with Chaoda. We don't know what to make of these events, but we find the resignation due to 'health issues' suspect given the transfer and extraordinary pay-off. Ms. Chui has since moved on to Le Gaga (a competitor) as the Vice Chairwoman.

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<sup>4</sup> <http://www.webb-site.com/dbpub/positions.asp?p=5414&hide=N>

<sup>5</sup> <http://202.66.146.82/listco/hk/chaoda/press/p040920.pdf>

<sup>6</sup> 2005 Annual Report, Pg. 56

<sup>7</sup> Kailey Investment Ltd. is a holding company by which Mr. Kwok holds ownership in Chaoda.

<sup>8</sup> 2004 Annual Report, Pg. 25





## **June 25, 2005 – Baker Tilly International appointed as co-auditor**

**The Event:** Baker Tilly Int. joins CCIF CPA Ltd. as joint auditor.

## **July 1, 2005 – An executive director resigns**

**The Event:** Chen Hang, an independent director resigns.

**Management’s Response:** In a press release Chaoda claims the resignation is “due to his pursuit of further study.”<sup>9</sup> It would seem that Mr. Hang is going back to university.

**The Truth:** Management’s purported excuse for the resignation is a lie. Our search indicates that shortly after resigning from the board, Mr. Hang went into private practice as an agricultural consultant. In 2008, he joined Le Gaga where he is currently Vice President of Operations.<sup>10</sup> No further study. No new degree.

## **September 1, 2005 – The CFO resigns**

**The Event:** Gordon Wang, the Chief Financial Officer of Chaoda resigns. Conveniently, this resignation comes in the middle of the annual report being prepared.

**Management’s Response:** In a press release, Chaoda claims the resignation is “due to personal reasons.”<sup>11</sup> This is a vague statement but invokes the image of personal or family problems.

**The Truth:** Mr. Wang’s personal problems seem to have cleared up rather quickly, because less than a month after resigning, he found a position as the CFO of Acorn International Inc, a little known company listed on the NYSE<sup>12</sup>. To be sure, this was not a positive career move given Acorn’s small size and relative obscurity. Accordingly, we believe Wang’s resignation had more to do with problems with Chaoda’s financial statements than problems at home. Wang has since moved back to a career in the agricultural sector by joining Le Gaga as an independent director.

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<sup>9</sup> <http://www.hkexnews.hk/listedco/listconews/sehk/20050630/LTN20050630159.pdf>

<sup>10</sup> <http://people.forbes.com/profile/hang-chen/149020>

<sup>11</sup> <http://www.hkexnews.hk/listedco/listconews/sehk/20050817/LTN20050817118.pdf>

<sup>12</sup> <http://people.forbes.com/profile/gordon-xiaogang-wang/1011>



## **December 29, 2006 – Corporate Secretary resigns**

**The Event:** Susanna Ching Che Man, Chaoda's Corporate Secretary resigns.

**Management's Response:** We can find no explanation for the departure.

**The Truth:** We don't know why Ms. Ching resigned, but she currently works for the Government of Hong Kong on the Administrative Appeals Board.<sup>13</sup>

## **June 21, 2007 – Both auditors resign**

**The Event:** Baker Tilly Int. and CCIF CPA Ltd. both resign as co-auditors.

**Management's Response:** In a released statement management once again claims the resignation of both its auditors is the result of fee disputes.

**The Truth:** Let us suspend belief for a minute and take this claim seriously. We challenge management to answer the following:

Back in 2003 when it was announced that PwC was resigning as the Company's auditor, Chaoda lost approximately HK\$200 million in market value in two days. Having previously gone through this experience, how much could the auditor fees have been to justify the billions of dollars of shareholder value that was wiped out following this resignations?

Either this is one of the most reckless management teams we have witnessed or Chaoda is a fraud and misstating the scope of its business.

*"Hello, I'm Leonard Nimoy. The following tale is true. And by 'true' I mean false. It's all lies. But they're entertaining lies. And in the end, isn't that the real truth? The answer is no."*

-The Simpsons

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<sup>13</sup> [http://www.admwing.gov.hk/eng/links/aab\\_mem.htm](http://www.admwing.gov.hk/eng/links/aab_mem.htm)



## Misleading Shareholders On Financing Needs

One of our sources states that “at a conference with Chaoda in the first half of 2010, management discussed their lofty 3-year expansion plans. When asked how they proposed to finance the rapid growth, we were assured the Company had more than enough operating cash flow and cash on hand to meet any capex requirements.”

On August 17, 2010, shortly after that conference, the Company raised US\$356M through a combination of stocks, options, and notes. Unbelievably, on April 27, 2011, the Company proposed a further round of financing.

While the second proposal was withdrawn less than a week later citing ‘market conditions’, we find that management has consistently misled investors regarding Chaoda’s capital requirements. Time after time, management claimed the company was sufficiently capitalized, only to tap the capital markets shortly afterwards. Three examples follow:

### Example 1

**What Was Said:** From an October 22, 2008 South China Morning Post article titled “Chaoda Eyes Additional Farmland”:

*“Chairman Kwok Ho said Chaoda would use internal resources to fund the expansion of 100,000 mu amid the global financial crisis. It currently has 494,800 mu of vegetable land, tea gardens and fruit orchards. One mu is one-fifteenth of a hectare.*

*‘It’s impossible to raise funds right now, so our plan is mapped out in accordance with our own ability,’ Mr Kwok said.*

*The Fujian-based company had enough cash to redeem its convertible bonds, worth 1.37 billion yuan, due in May 2009, he said. At the end of June, Chaoda had cash and equivalents of 1.28 billion yuan, down from 1.67 billion yuan a year earlier.*

*‘I am a very conservative man,’ said Mr. Kwok. ‘We have adequate financial resources for the bonds redemption.’”*

**What Was Done:** Four months later, Chaoda netted ¥341 million through a gypsy swap. Right before the announcement, two executive directors, Kuang Qiao and Ip Chi Ming sold their entire holding of 3.2M shares and 0.7M shares, respectively.<sup>14</sup>

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[http://sdinotice.hkex.com.hk/di/NSNotice3AList.aspx?sa2=nd&sid=10102200&corp=Chaoda+Modern+Agriculture+\(Holdings\)+Ltd.&corpndisp=%u8d85%u5927%u73fe%u4ee3%u8fb2%u696d\(%u63a7%u80a1\)%u6709%u9650%](http://sdinotice.hkex.com.hk/di/NSNotice3AList.aspx?sa2=nd&sid=10102200&corp=Chaoda+Modern+Agriculture+(Holdings)+Ltd.&corpndisp=%u8d85%u5927%u73fe%u4ee3%u8fb2%u696d(%u63a7%u80a1)%u6709%u9650%)



## Example 2

**What Was Said:** During the 2008/2009 interim conference call in March 2009, Mr. Kwok stated, “we are confident that with internal resources we will be able to repay the CB as well as the high-yield bond and maintain a proper growth rate.”<sup>15</sup>

**What Was Done:** In June 2009, the Company raised ¥1.5 billion through a share placement. Two weeks before the announcement, Ip Chi Ming dumped 80,000 of his 90,000 shares.<sup>16</sup>

## Example 3

**What Was Said:** During the 2009/2010 interim conference call in March 2010, the CFO (Andy Chan) explained that even after retiring the high yield bonds, there was enough cash on hand and funds from operations to internally finance any growth activities. This position was reaffirmed to one of our contacts as late as June, 2010.

**What Was Done:** Two months later, Chaoda raised ¥2.4 billion through a combination of bonds, shares, and options. The Company also tried to raise another ¥1.3 billion in April, 2011, but failed citing ‘market conditions’.

We find the sudden nature of these capital raises bizarre given Chaoda’s growth model. Management states that it takes approximately 6 to 12 months from consideration and planning to actually leasing farm land. During this period, a team examines the climate, water source, and land to ensure cultivation is economic and viable. Once the lease is signed, Chaoda has to wait for the farmers to harvest what they have already grown. This step can take another 12 to 18 months before Chaoda begins cultivating the land. The entire process is slow and takes approximately two to two and a half years. Accordingly, management would know far in advance of its financial position and capital requirements.

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[u516c%u53f8&sd=01%2f04%2f2003&ed=12%2f11%2f2010&sa1=cl&scsd=16%2f11%2f2000&sced=16%2f11%2f2010&sc=0682&src=MAIN&lang=ZH&pg=2](http://www.chaoda.com.hk/pic/420110a.mp3)

<sup>15</sup> <http://www.chaoda.com.hk/pic/420110a.mp3>

<sup>16</sup>

[http://sdinotice.hkex.com.hk/di/NSNotice3AList.aspx?sa2=nd&sid=10102200&corp=Chaoda+Modern+Agriculture+\(Holdings\)+Ltd.&corpndisp=%u8d85%u5927%u73fe%u4ee3%u8fb2%u696d\(%u63a7%u80a1\)%u6709%u9650%u516c%u53f8&sd=01%2f04%2f2003&ed=12%2f11%2f2010&sa1=cl&scsd=16%2f11%2f2000&sced=16%2f11%2f2010&sc=0682&src=MAIN&lang=ZH&pg=1](http://sdinotice.hkex.com.hk/di/NSNotice3AList.aspx?sa2=nd&sid=10102200&corp=Chaoda+Modern+Agriculture+(Holdings)+Ltd.&corpndisp=%u8d85%u5927%u73fe%u4ee3%u8fb2%u696d(%u63a7%u80a1)%u6709%u9650%u516c%u53f8&sd=01%2f04%2f2003&ed=12%2f11%2f2010&sa1=cl&scsd=16%2f11%2f2000&sced=16%2f11%2f2010&sc=0682&src=MAIN&lang=ZH&pg=1)



## Falsifying Financial Statements

Adding to our concerns of management's opaque financing activities are the Company's reported cash balances. We are confident management is inflating the amount of cash the Company has as well as falsifying Chaoda's financial statements.

### Cash Balance – Don't Bank on it.

Exhibit1 shows the amounts Chaoda has raised through the years, the financing method, and the stated net cash balance just prior to the raise.

#### Exhibit 1

Reporting Period	Reported Net Cash (¥)	Date of Funding	Net Raise (¥ Equivalent)	Type	Discount/Rate
2011 H1	2,835M	April 27, 2011	1,300M	Proposed Notes*	n/a
2010 H2	2,029M	August 17, 2010	2,421M	Bonds, Shares	11.6%
2009 H1	398M	June 18, 2009	1,517M	Share Placement	12.9%
2009 H1	398M	February 19, 2009	341M	Gypsy Swap	11.0%
2006 H1	(360M)	May 3, 2006	1,172M	CB	16.0%
2005 H1	611M	February 7, 2005	1,530M	Senior Notes	n/a
2004 H1	359M	June 14, 2004	1,020M	Proposed Bonds*	n/a
2004 H1	359M	January 15, 2004	595M	Gypsy Swap	5.7%

Source: Company statements, CapitalIQ

The most glaring red flags pertain to the financing activities on August 17, 2010, and April 27, 2011. On August 17, 2010 Chaoda raised ¥2.4 billion through a combination of bonds and shares in a high interest environment. This raise is alarming given the ¥2 billion net cash position the company claimed. Adding to this is that Chaoda tried but failed to raise another ¥1.3 billion several months later. This time, the Company claimed nearly ¥3 billion in net cash on its balance sheets. If the reported numbers were correct, Chaoda should have easily been able to finance its expansion using cash on hand and cash flow from operations without any need to tap the capital markets.<sup>17</sup>

Fueling the mystery and our conviction that Chaoda is falsifying its financial statements are the events surrounding the first canceled bond offering in 2004. In June 2004, management canceled bond offerings as a result of 'market conditions'. This offering was meant to raise ¥1 billion. To put this sum in perspective, it was approximately equal to Chaoda's 2004FY net income.

<sup>17</sup> Chaoda spends approximately RMB3 billion in capex and draws similar amounts from operating cash flow.



Management offered the following statement relating to the cancelation of the bond placement:

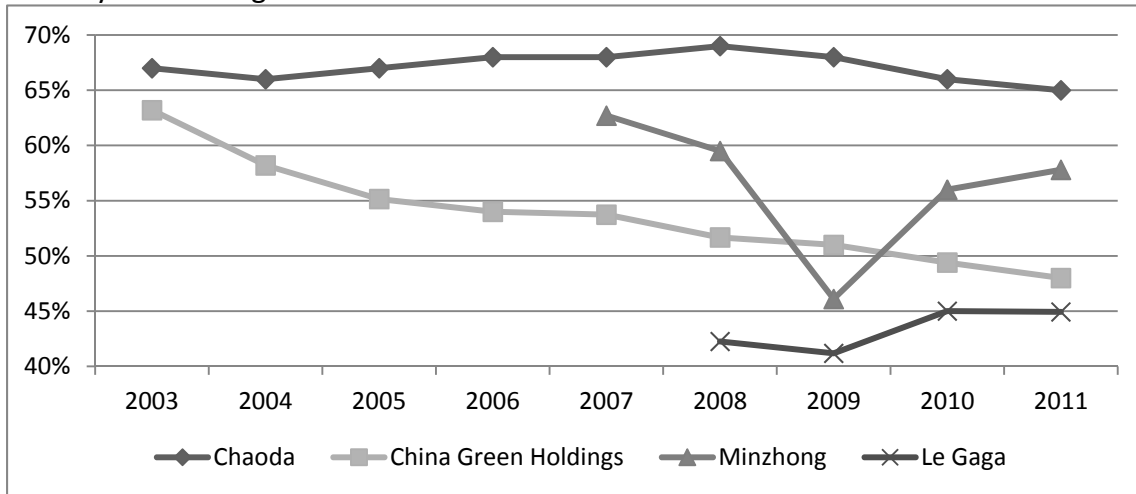
*“It was stated in the Announcement that the Company intends to use the net proceeds arising from the Proposed Bond Issue to finance the expansion of the agricultural production bases of the Company and its subsidiaries and for general corporate purposes. Based on the current cash reserve of the Group, it is the view of the board of Directors that the Company’s decision not to proceed with the Proposed Bond Issue **will not have any impact on the operation and business of the Group.**”<sup>18</sup>*

We do not understand how failure to raise capital of this magnitude would not affect business. Generally, when companies are not able to secure this amount of financing, it cripples growth. Not Chaoda. Despite not being able to raise the capital in 2004, the Company reported revenue growth of 38% in 2007, the year that investment spending in 2004 would have been realized<sup>19</sup>. Coincidentally, this is the largest growth rate that Chaoda has ever recorded in its history as a public company. How this miracle was achieved while locked out of the capital markets is beyond logic.

### !\$#@ing Margins – How Do They Work?™

#### Exhibit 2

Industry Gross Margins



Source: Company reports

<sup>18</sup> <http://www.hkexnews.hk/listedco/listconews/sehk/20040720/LTN20040720084.pdf>

<sup>19</sup> Investments made in 2004 would have been realized in 2007 as we explained on the bottom of page 10 re: Chaoda’s growth model.



Management's miracles are not limited to neck-breaking growth in lieu of financing. They also present themselves in Chaoda's gross margins. Exhibit 2 shows Chaoda's margins relative to peers. What immediately sticks out is how high and consistent these numbers are. Over the last decade, Chaoda has managed to maintain its margins within a 4% range. Numbers so high and so unflinching are virtual unheard of in the commodities business and mostly exist in the Land of Make Believe.

To demonstrate just how improbable these numbers are, we ran the numbers through statistical modeling software to compare the margin parameters between Chaoda and China Green, an industry peer. The results are presented below.

### Exhibit 3 Statistical Modeling Output

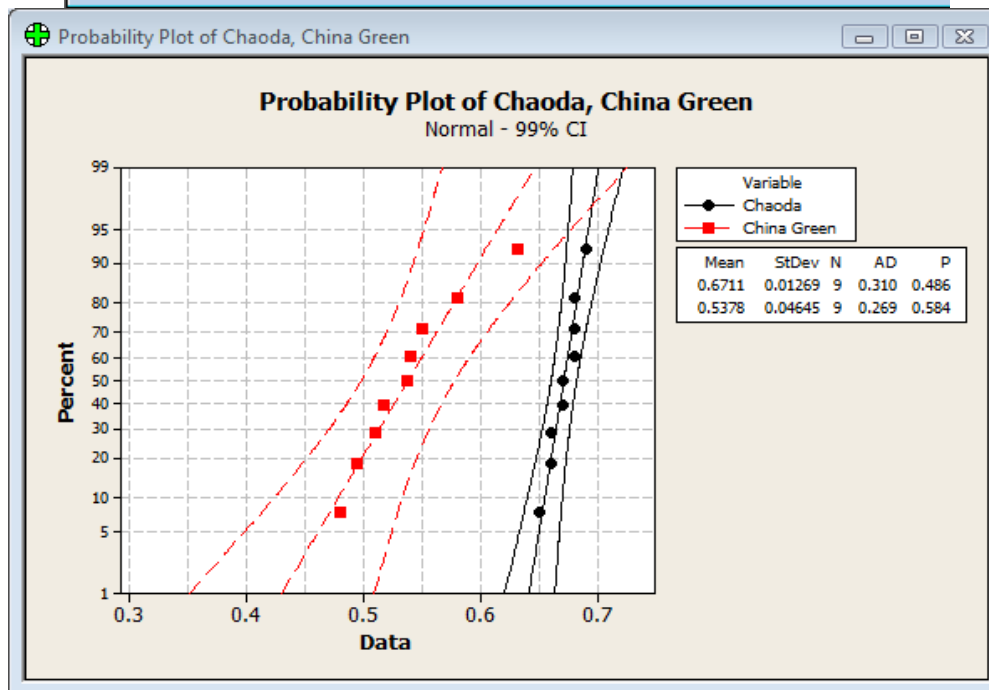
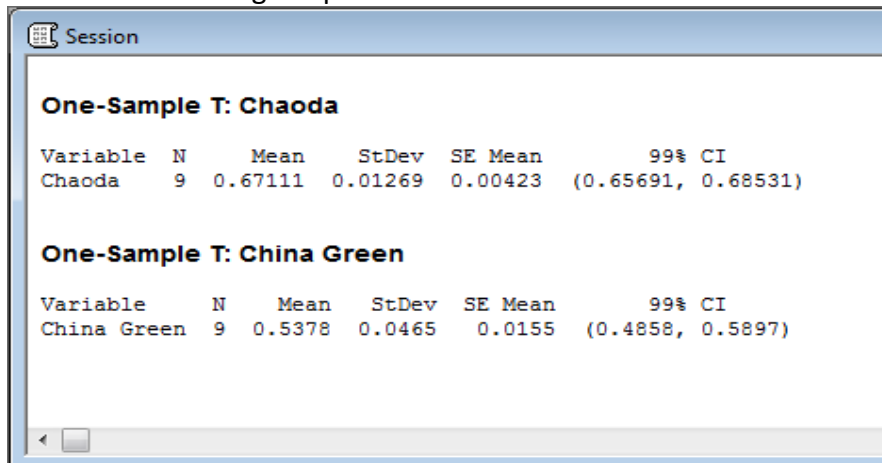




Exhibit 3 shows the standard deviation of Chaoda's gross margins is approximately 1.3%, compared to 4.7% for China Green. Based on these parameters, Chaoda will report gross margins within a 65.7% - 68.5% range 99% of the time. **THIS RANGE SPANS A MERE 3.2%.**

As a point of reference, China Green's 99% confidence interval is a much more reasonable 48.6% - 59.0%. This range spans Chaoda's three fold. Save for the largest multinational conglomerates, Chaoda's reported margins are not just unlikely for a vegetable producer, they are unlikely for any company, in any industry. These numbers are even more improbable when you consider the Company's long operating history. It appears that Chaoda is unaffected by supply, demand, droughts, quality issues, bad harvest seasons, or any form of natural disaster.

Based on the preceding analysis, we are confident that Chaoda's cash balances, reported revenue and audited financial statements are inflated and completely inaccurate. We urge investors not to rely on this information.

*"Apparently nothing affects Chaoda. If these guys started farming in Japan, the country would never experience another earthquake or tsunami again."*

-Associate analyst





## Billions Raised...

From the time of its IPO, Chaoda has raised over ¥7.3 billion (~US\$1.1B) through a combination of stocks, options, bond issues, and more disturbingly, gypsy swaps. The numerous rounds of financing have been expensive and highly dilutive, nearly tripling the number of shares outstanding over the last ten years.

So where is the money going?

We have reason to believe that Mr. Kwok, select members of management, and third-parties are transferring money out of Chaoda through inflated capital expenditures, and related party transactions. Evidence follows.

## ...Billions Missing

### Inflated Capital Spending

From inception to Fiscal 2010, Chaoda has spent over ¥9 billion (US\$1.4B) on capital expenditures. This figure includes irrigation systems, greenhouses, processing centers, office buildings, and machinery. To that date, the company claims a production base of 664,225 mu. This translates to capex spending of approximately ¥13,700 per mu.

As a point of reference, Exhibit 4 shows similar metrics for Chaoda's closest comparables.

### Exhibit 4

#### Industry Capex Spending

	Production Base (mu)	Cumulative CapEx (¥' 000)	Capex per Mu	Greenhouse coverage
Chaoda	664,225	9,103,150	13,705	7%
Minzhong	27,981	238,372	8,519	10%
China Green	92,700	1,074,402	11,590	12%
Ex-Chaoda average	-	-	10,055	-

Source: Company reports



On comparison, Chaoda spends 37% more than the average of its peers on capex while following a very similar growth strategy. Chaoda's reported numbers are highly suspect given the extremely competitive landscape of China's agricultural industry. These numbers makes even less sense when you consider that (i) a greater portion of Chaoda's cost base is historic, and (ii) the Company is twice the size of its peers. We are surprised that a company that boasts it is so big that it can even get concessions from Wal-Mart<sup>20</sup> supposedly pays so much more per mu.

If we use the average figure of ¥10,055 as a reference point, the amount of total capex spending needed to establish and maintain Chaoda's production bases should have at **most cost** ¥6.7 billion (~US\$1B).

We say 'at most' because we are giving the benefit of the doubt to Chaoda. Even ignoring points (i) and (ii) above, this number is still questionably high. We note that China Green and Minzhong both have higher greenhouse coverage than Chaoda. Greenhouses can triple the yield of open fields, and produce higher quality products. However, the costs associated with establishing them are generally four times higher than open fields. Greenhouse coverage for China Green and Minzhong stand at 12% and 10% respectively, as opposed to only 7% for Chaoda<sup>21</sup>. This is why even our ¥6.7 billion estimate is likely too generous.

Based on this comparison, **there is an ¥2.3 billion (~US\$350M) unexplained black hole on Chaoda's balance sheet.** We believe this amount (and likely much more) has been siphoned out of the Company by certain managers and third-parties under the guise of capital spending.

Even at present, Chaoda's costs seem to be unjustifiably high. In a recent call to Chaoda, our representatives were told that management expects capex spending to be 28,000 per mu. Calls to peers gave us a range of 13,000 to 20,000 per mu.

We suspect management has made it a policy to grossly inflate capex costs as a cover to transfer money out of Chaoda.

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<sup>20</sup> 2004 Corporate presentation, slide 28

<sup>21</sup> <http://wenku.baidu.com/view/54665ec2d5bbfd0a795673a7.html>

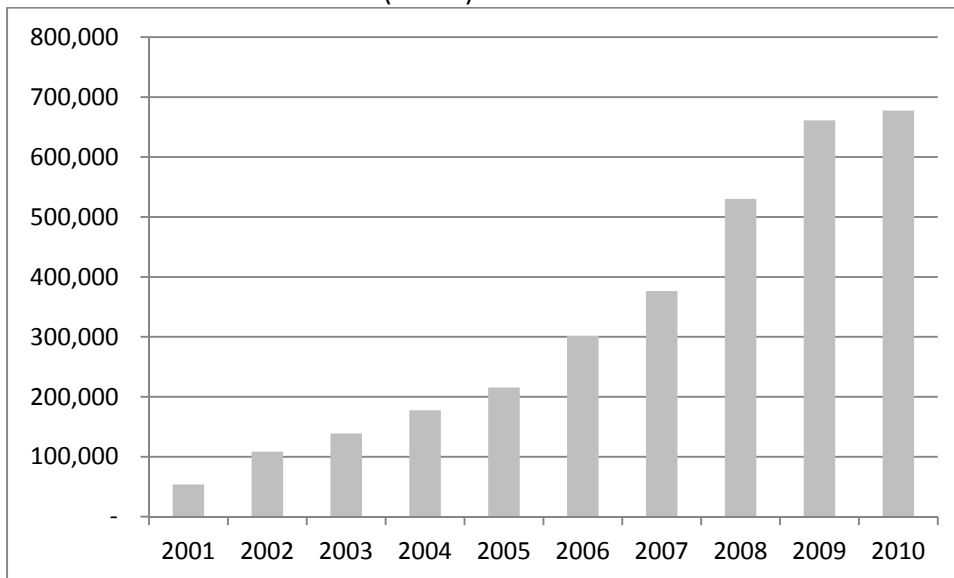


## Related Party Transactions

Perhaps more egregious than the inflated capex spending, are Chaoda's related party transactions. The largest raw input cost in farming is fertilizer, equating to approximately 10% of revenue. Despite their smaller size, most companies in the industry contract between 10 to 20 fertilizer suppliers to ensure competition and quality. Chaoda contracts only one – Fujian Chaoda Agricultural Produce Trading Company Limited ("Fujian Fertilizer" to avoid confusion). Fujian Fertilizer is an organic fertilizer company that is majority owned by none other than Mr. Kwok through a holding company.

Chaoda states that the reason for this exclusive agreement is to ensure a stable supply of quality fertilizer. As evidenced in the proceeding pages, we are confident that the CEO is using these contracts to transfer money out of Chaoda.

**Exhibit 5**  
Value of Fertilizer Contracts (¥'000)



Source: Company reports

Exhibit 5 shows that since 2001, approximately ¥3.2 billion (~US\$500M) worth of fertilizer has been purchased from Fujian Fertilizer. While this much money has been paid, we don't know how much fertilizer has actually exchanged hands. This is because the terms of the agreement as stated in Chaoda's annual reports are not only opaque, but completely absurd.



From the 2010 Annual Report:

*“The 2009 Agreement enabled the Group to obtain a stable and reliable supply of organic fertilizers. The price of the organic fertilizers supplied under the 2009 Agreement was agreed between the parties at the time when a purchase order was placed and it would not exceed the ex-factory price (net of delivery costs) at which the same type of organic fertilizers was supplied by Fujian Chaoda Trading (Fujian Fertilizer) to independent third parties when the purchase order was placed by Fuzhou Chaoda.”*

We had to do a double take when we read this statement. To make the nature of these contracts perfectly clear: Chaoda does not pay market price for its fertilizer. In fact, if our reading of the agreement is correct, Chaoda has no say in the pricing. It is Mr. Kwok’s fertilizer company that sets the price based on what it can sell to other entities. This type of “pay what we say” pricing mechanism is unheard of and ripe for manipulation.

As an example, a shell entity can easily be set up to buy a notional amount of fertilizer from Fujian Fertilizer at far above market. Fujian Fertilizer can then turn and supply Chaoda based on those elevated prices. Given the nature of these contracts, it is impossible to know with any degree of confidence how much fertilizer is actually changing hands.

Management was dodgy in discussing the pricing mechanism but has previously stated that Chaoda purchases fertilizer for approximately ¥1,500 per metric tonne (MT). Again, we have no confidence in this number, but quotes from other agricultural companies and suppliers gave us an average range of ¥700 to ¥1,300 for very high quality organic fertilizer, shipping included. Even if management’s figure is to be believed, then at minimum Chaoda has to date overpaid by at least ¥500 million (~US\$77M) for its fertilizer purchases - and almost certainly much more, as we show next.



## Fujian Chaoda Agricultural Produce Trading Company: The Most Lucrative Company That Never Existed

Fujian Fertilizer, a company majority owned by Mr. Kwok is the exclusive manufacturer and supplier of fertilizer to Chaoda. Mr. Kwok is also a major supplier to Asian Citrus, an associate company we discuss on page 22. If these claims were true, Fujian Fertilizer would be one of the biggest organic fertilizer companies not only in China, but globally. It is neither.

We have proof that Fujian Chaoda Agricultural Produce Trading Company is nothing more than a shell company used to transfer money from Chaoda. Our sources have acquired Fujian Fertilizer's SAIC documents, complete with official seal.<sup>22</sup> These documents show the company has no business operations and its assets consist almost entirely of account and other receivables. Exhibit 6 shows a translated version of the condensed 2009 financial statements.

### Exhibit 6

2009 Income Statement (in Yuan)	
Main Business Income	-
Main Business Cost	-
Management Expense	176,955
Financial Expense	(77)
Profit	(176,878)
Net Income	(176,878)
2009 Balance Sheet (in Yuan)	
Accounts Receivable	1,552,471
Other Accounts Receivable	247,372,204
Inventory	477,284
Total Current Assets	249,502,649
Total Fixed Assets	11,559
Total Assets	249,514,408
Accounts Payable	251,031
Other Payables	249,064,304
Total Current Liabilities	249,469,429
Total Liabilities	249,469,429
Paid-In Capital	3,000,000
Total Liabilities and Equity	249,514,408

<sup>22</sup> Businesses operating in China must provide annual financial statements to the State Administration for Industry and Commerce (SAIC).



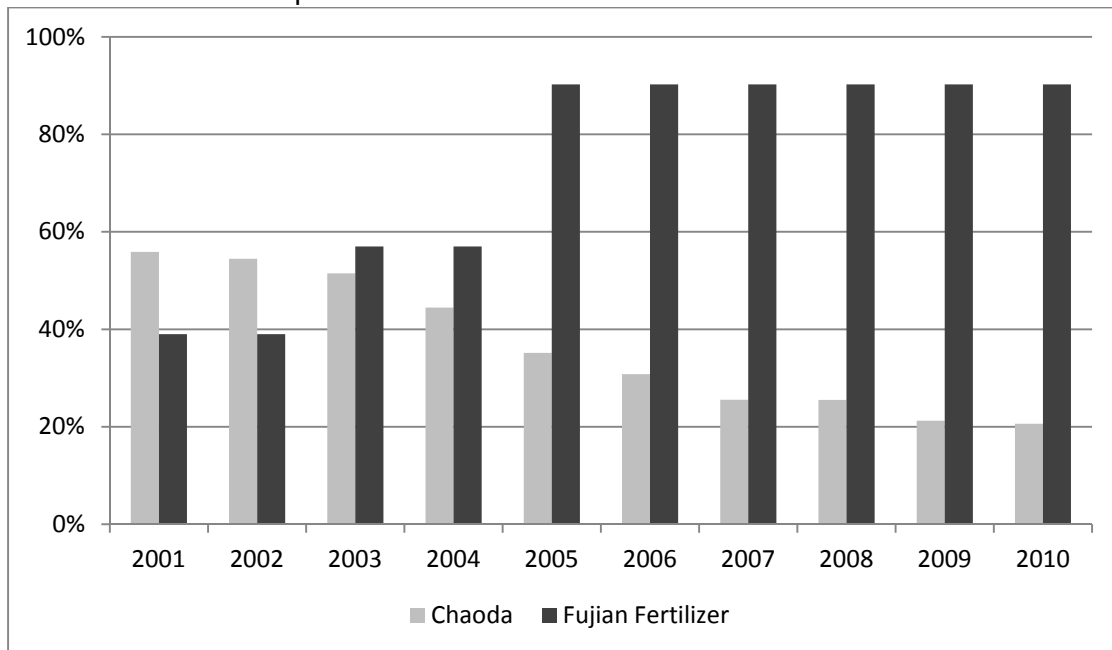
Far from being a major player in organic fertilizer, Fujian Fertilizer only has ¥477,284 (~US\$72K) worth of obsolete inventory on hand. How this company supplies the numbers Chaoda claims is beyond us. Whatever amount of fertilizer is being supplied to Chaoda is likely through local animal farms with Mr. Kwok only acting as an intermediary. Of course, the irony here is that the Chaoda model was built on the premise that intermediaries are an unnecessary cost and add little value to the supply chain.

Supporting our hypothesis is the fact that Fujian Fertilizer reports **net fixed assets of ¥11,559 (~US\$1,750)**. Either this company can manufacture, process, package and ship hundreds of thousands of MT of fertilizer using US\$2,000 worth of equipment, or it's a shell company feeding the CEO's pockets. We'll let investors decide.

As an added kicker, shareholders will likely appreciate that over the last decade, as Mr. Kwok was dumping his stake in Chaoda, he was buying out his partners in Fujian Fertilizer. Clearly, Mr. Kwok knows where the money is going.

### Exhibit 7

Mr. Kwok's Ownership Stake



Source: Company reports



## Asian Citrus – Muddying The Waters With Citron

If misleading investors and transferring funds out of Chaoda weren't enough, here we provide evidence that management is ignoring its fiduciary duty by investing in projects that benefit executives at the expense of shareholders.

In July, 2001, Chaoda paid HK\$101 million (~US\$13M) for a 49% stake in Newasia ("Asian Citrus" 902:HK), an owner and operator of orange tree plantations. Management justified the purchase as follows:

*"The acquisition of a 49 per cent. shareholding in Newasia also offers the Company an **investment opportunity** with growth and profitability potential in a **modern orange farm** in the Guangxi region, PRC, and to expand its farmland."*<sup>23</sup>

### Modern Orange Farm – Really?

In 2001, Asian Citrus was anything but a 'modern orange farm'. The company consisted of a single plantation (Hepu Plantation) that was neglected and only had young orange trees (the yields provided by young orange trees are uninspiring).

In fact, Hepu Plantation was originally owned by Tropicana. In 1998, Pepsi Co. acquired Tropicana from Seagram for US\$3.3 billion. The following year, Pepsi Co. sent a team to Hepu Plantation to analyze the property. The team concluded that the operations required additional investments which were not economically viable and that the project was too risky. Accordingly, they abandoned the operation and handed the plantation over to the Hepu government for free. As late as 2000, the Hepu government was looking for investors to develop, manage, and operate the plantation.<sup>24</sup> Modern orange farm? We don't think so.

Furthermore, upon acquisition, Chaoda had to write down ¥162 million (US\$23M) or over 50% of its share of net assets. We find it hard to believe such a 'modern orange farm' would incur so much negative goodwill.

### Attractive Investment Opportunity – Compared To What?

We question management's claim that Asian Citrus provided an attractive investment opportunity. The graph below shows an ROE comparison between Chaoda and Asian Citrus.

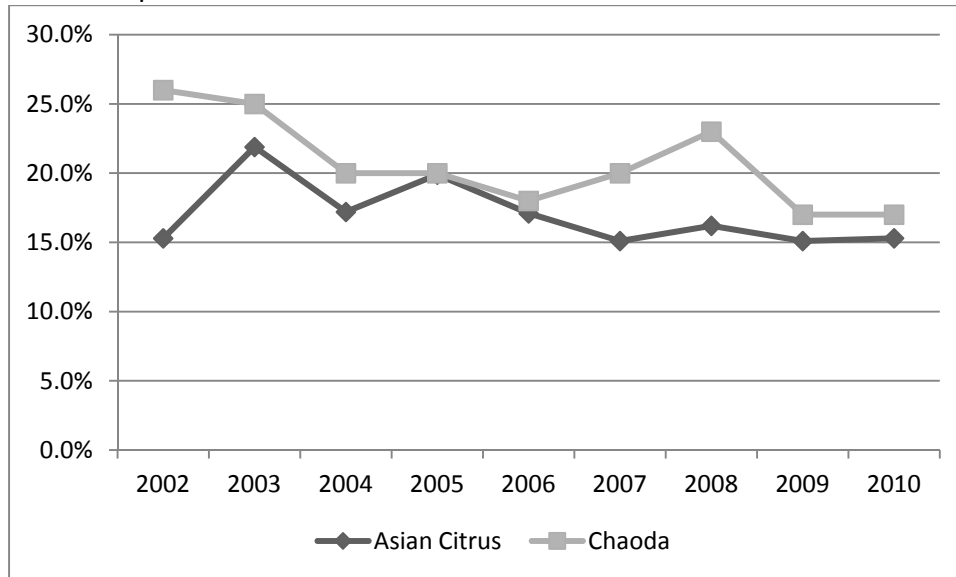
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<sup>23</sup> <http://www.hkexnews.hk/listedco/listconews/sehk/20010727/LTN20010727074.doc>

<sup>24</sup> <http://www.hkexnews.hk/listedco/listconews/sehk/20091123/LTN20091123014.pdf>



### Exhibit 8 ROE Comparison



Source: Company reports. Asian Citrus' 2002 and 2003 figures have been revised upwards to reflect Chaoda's investment net of negative goodwill.

Chaoda's return on equity has trumped Asian Citrus' by leaps and bounds since the acquisition. If management was looking for an attractive investment opportunity, why did they not invest the funds in Chaoda? Why did management instead invest in a company that even Pepsi Co. considered too risky? Given Chaoda's numerous rounds of financing, there clearly were lucrative internal investment opportunities available. It's hard to believe that management had shareholders' best interests in mind when they acquired the stake in Asian Citrus. So if shareholders didn't benefit from this acquisition, who did?

### Related Party Transactions, Part II

The 49% stake gave Chaoda significant influence over Asian Citrus. This influence was cemented when Ip Chi Ming, one of Chaoda's executive directors was appointed Vice President of Asian Citrus. If that name rings a bell it is because as we mentioned on pages 10 and 11, he was the same director who on more than one occasion dumped his shares of Chaoda ahead of material news releases. Instead of being reprimanded and possibly facing charges of insider trading, he continues to act as the Vice President of Asian Citrus.

Predictably, Mr. Kwok has used this influence to position his fertilizer company as one of the main suppliers to Asian Citrus. Over the last 9 years, Asian Citrus has bought ¥238 million (US\$37M) worth of fertilizer from another of Mr. Kwok's fertilizer companies. We note that these lucrative contracts have the same questionable pricing mechanism that was entered into with Chaoda, as per page 19.

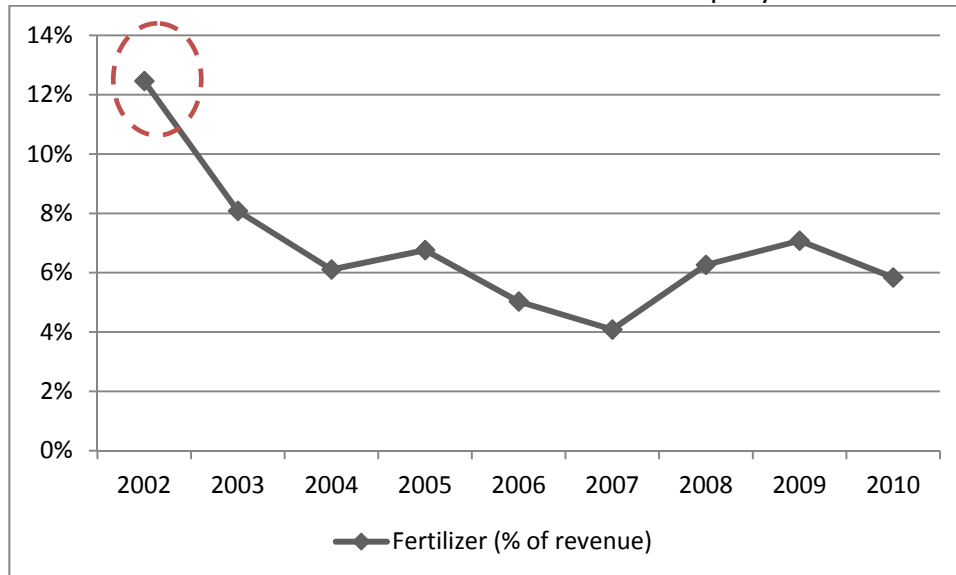




We believe Mr. Kwok understood the economics of Asian Citrus not from shareholders' perspective, but from his own. When Chaoda leases land from farmers, the land is in relatively good condition since its being maintained. However, the Hepu plantation was on neglected, poor land that lacked minerals. To get the land fertile enough to grow healthy oranges, the soil had to be revitalized and injected with nutrients. As shown in Exhibit 9, this translated into large amounts of fertilizer dumping, which probably had Mr. Kwok popping a few bottles of Cristal as he penned the deal with shareholder money.

### Exhibit 9

Fertilizer Purchased from Mr. Kwok's 'Fertilizer' Company



Source: Company reports. Note the large volume of fertilizer purchased in 2002FY to revitalize the land

One final note regarding Asian Citrus: Concerns have previously surfaced that Chaoda has exaggerated its land bank and does not grow all the produce it claims. In fact, it may be buying its produce from third parties and reselling them. Management has systematically denied these allegations. However, buried in Asian Citrus' 2005 AIM listing document, we see that in 2002 and 2003, ¥69,000 and ¥11,000 of oranges were purchased from Asian Citrus by one of Chaoda's operating subsidiaries.<sup>25</sup> While the sums are small, these related party transactions were never disclosed in Chaoda's financial statements. This glaring omission does not inspire confidence that management has been honest with investors regarding its production bases.

*All your bases are belong to lulz.*

<sup>25</sup> [http://www.asian-citrus.com/pdf/listing\\_documents.pdf](http://www.asian-citrus.com/pdf/listing_documents.pdf)



## Chaoda's Brand Building Strategy: Pay Another Fraudulent Company To Make You Look Good

The following is truly worthy of a mystery novel. Enjoy.

In each of its annual reports since 2004, Chaoda has made it a point to let shareholders and the world know that the 'Chaoda' brand is ranked as one of "China's 500 Most Valuable Brands" and worth billions of dollars. We were somewhat surprised an agricultural company could make such a list, especially since vegetables generally aren't branded. We can't remember the last time we shopped for brand name spinach.

Based on our research, not only do we doubt the credibility of these rankings, we believe that as a final insult to shareholders management is actively paying 'fees' to a questionable company to place Chaoda on a illegitimate list for bragging rights.

Exhibit 10 shows Chaoda's annual ranking and purported brand value since 2004.

### Exhibit 10

Chaoda's Rank and Brand Value

	Rank	Value (¥ billions)
2004	220	2.8
2005	177	3.5
2006	124	4.6
2007	123	4.9
2008	120	6.1
2009	84	8.1
2010	83	9.6
2011	82	12.3

### Enter World Brand Lab

The rankings are carried out by a company called World Brand Lab (WBL). From their website:

*"The World Brand Lab, established in New York City in the year of 2003, is the leading independent consultancy of brand valuation and marketing (sic) strategy in the world. We provide precise advices on branding to all kinds of commercial organizations, NPOs and governments. In particular, we guide commercial organizations maximizing their shareholders' value by the effective managements on their own intangible assets. In addition to the*



*consultancy on branding strategies, we rally professionals around the world in economics, corporate management, legislation and media to engage in the researches, promotions and protection of branding.”<sup>26</sup>*

Syntax and spelling aside, two things immediately struck us as strange. First, no marketing experts we contacted had ever heard of this ‘leading independent consultancy’. Second, for a branding company, the website looks like it had been created by a high school student. After some digging, we realized we were wrong. The website had in fact been created by a college student.

A DNS registry search reveals that “www.worldbrandlab.com” was first created on September 20, 2006 – two years after the first “China’s 500 Most Valuable Brands” list came out. In another words, this company didn’t even have a functional website while it was operating its ‘leading independent consultancy.’

### **Exhibit 11**

DNS Registry Data for worldbrandlab.com

#### REGISTRY WHOIS FOR WORLDBRANDLAB.COM

Domain Name: **worldbrandlab.com**

Updated: 21 minutes ago - [Refresh](#)

Registrar: REGISTER.COM, INC.

Whois Server: whois.register.com

Referral URL: <http://www.register.com>

Status: clientTransferProhibited

Expiration Date: 2015-09-20

Creation Date: 2006-09-20

Last Update Date: 2010-11-22

Name Servers:

[dns010.d.register.com](http://dns010.d.register.com)

[dns038.c.register.com](http://dns038.c.register.com)

[dns056.b.register.com](http://dns056.b.register.com)

[dns090.a.register.com](http://dns090.a.register.com)

[See worldbrandlab.com DNS Records](#)

Information Updated: Sat, 23 Jul 2011 23:10:10 UTC

#### WORLDBRANDLAB.COM SITE INFORMATION

IP: [211.154.164.205](#)

IP Location: Beijing, China

Website Status: [active](#)

Server Type: Resin/2.1.17

Alexa Trend/Rank: [▲](#) 1 Month: 1,080,956   3 Month: 1,478,373

Page Views per Visit: [▼](#) 1 Month: 2.3   3 Month: 3.6

<sup>26</sup> [http://www.worldbrandlab.com/aboutus\\_2.htm](http://www.worldbrandlab.com/aboutus_2.htm)



WBL is a subsidiary (for lack of a better word) of a group called World Executive Group (WEG). While WBL did not have a website when the first “500” list was compiled, WEG did. Another DNS search reveals that the website was registered on November 28, 2002 by an individual named Hai Sen Ding – the founder and CEO of WBL and WEG.

**Exhibit 12**

DNS Registry Data for worldexecutive.org

**REGISTRY WHOIS FOR WORLDEXECUTIVE.ORG**

Domain Name: **worldexecutive.org**

Updated: 22 minutes ago - [Refresh](#)

Registrar: Register.com, Inc. (R71-LROR)  
Status: CLIENT TRANSFER PROHIBITED

Expiration Date: 2011-11-28 10:48:16  
Creation Date: 2002-11-28 10:48:16  
Last Update Date: 2008-10-01 14:01:44

Name Servers:

[dns027.b.register.com](http://dns027.b.register.com)

[dns055.a.register.com](http://dns055.a.register.com)

[dns245.c.register.com](http://dns245.c.register.com)

[dns249.d.register.com](http://dns249.d.register.com)

[See worldexecutive.org DNS Records](#)

Information Updated: Sat, 23 Jul 2011 23:26:00 UTC

**WORLDEXECUTIVE.ORG SITE INFORMATION**

IP: [211.154.164.200](#)

IP Location: Beijing, China

Website Status: [active](#)

Server Type: Resin/3.1.0

Alexa Trend/Rank: [▲](#) 1 Month: 1,387,940 3 Month: 2,249,128

Page Views per Visit: [▲](#) 1 Month: 1.8 3 Month: 1.5

**WORLDEXECUTIVE.ORG WHOIS**

Updated: 22 minutes ago

Registrant Contact Information:

Name: hai sen ding

Organization: The World Executive Group Inc.

Address 1: 60 Wadsworth Street no 18F

City: Cambridge

State: MA

Zip: 2142

Country: US

Phone: +1.6175775713

Email: [hsding@sloan.mit.edu](mailto:hsding@sloan.mit.edu)

Administrative Contact Information:

Name: hai sen ding

Organization: The World Executive Group Inc.

Address 1: 60 Wadsworth Street no 18F

City: Cambridge

State: MA

Zip: 2142

Country: US

Phone: +1.6175775713

Email: [hsding@sloan.mit.edu](mailto:hsding@sloan.mit.edu)

First, we note that the traffic to these sites is so low that they don't even register on Alexa statistics. Second, Exhibit 12 shows that the registered address of worldexecutive.org is:

60 Wadsworth Street, No. 18F  
Cambridge, MA  
United States



Given World Executive Group's grandiose name, one would almost expect this to be the corner office of a towering glass building in the heart of a prime commercial district. It is in fact the address of a dorm room at MIT.

**Exhibit 13**

60 Wadsworth Street, Cambridge, MA, United States



MIT Dorms: managing multinational branding firms between games of beer pong.

Granted, even Facebook started in a dorm, and its not unusual for start-ups to embellish the scope of their operations. But that was then. And this is now. The most recent contact information shows WEG with several offices, including one in Hong Kong and New York.

We contacted the Hong Kong office only to have a conversation with a receptionist who had never heard of WBL or WEG. In fact, we found out that the person we were talking to worked for SBC International, an operator of 'virtual offices'. For those who aren't familiar with the term, from the SBC website:



*“Virtual office is a tailor made service for the companies that do not have an operation address in Hong Kong... [SBC creates] an impression of local operation which helps to enhance the corporate status as well as the confident of the business partners... The use of our conference room can help to create a real and stable impression to the your clients”<sup>27</sup>*

Basically, for a fee SBC gives you a fake secretary, a PO Box, a phone number, and access to a conference room to make your back alley operation seem legitimate. Yes, this is definitely how credible global enterprises operate.

Next, we contacted WEG’s headquarters in New York, located at 44 Wall Street, Suite 1204. We called the property manager who told us that he had never heard of WEG or WBL. Moreover, the building doesn’t lease out individual suites, they lease out entire floors. The manager told us he had asked the occupants on the 12<sup>th</sup> floor on more than one occasion to stop labeling individual rooms as suites due to issues with mail delivery. According to their records, floor 12 was leased to a company called Nation Online.

#### Exhibit 14

DNS Registry Search of “The World Executive Group Inc.”

**Whois Record** | Site Profile | Registration | Server Stats | My Whois

Reverse Whois: **"The World Executive Group Inc." owns about 995 other domains**

Email Search: [hsding@sloan.mit.edu](mailto:hsding@sloan.mit.edu) is associated with about **1,000 domains**

[domainregistrar@register.com](mailto:domainregistrar@register.com) is associated with about **826,952 domains**

Registrar History: [1 registrar](#)

NS History: [1 change](#) on 2 unique name servers over 4 years.

IP History: [5 changes](#) on 4 unique name servers over 4 years.

Whois History: [24 records](#) have been archived since 2007-12-30 .

Reverse IP: [8 other sites](#) hosted on this server.

[Log In](#) or [Create a FREE account](#) to start monitoring this domain name

**DomainTools for Windows®**  
Now you can access domain ownership records anytime, anywhere...  
right from your own desktop! [Download Now>](#)

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Registrant:  
The World Executive Group Inc.  
hai sen ding  
60 Wadsworth Street no 18F  
Cambridge, MA 2142  
US  
Phone: +1.6175775713  
Email: [hsding@sloan.mit.edu](mailto:hsding@sloan.mit.edu)

<sup>27</sup> <http://sbc.com.hk/English/>



A DNS registry search shows that Nation Online is a website registered under Hai Sen Ding. As it turns out, Nation Online isn't the only other website/business Mr. Ding runs. As presented in Exhibit 14, archived records show there are almost 1,000 domains associated with his name. Nearly all of the domains/business sites we visited are poorly constructed, lacking, or simply non-operational. Ironically, one site we visited "www.bosslink.com" had a logo that was clearly plagiarized from E\*Trade.

### Exhibit 15

Comparison of Boss Link and E\*Trade Logos



We find it ironic that the CEO of a self purported global branding agency would blatantly plagiarize such a well known brand.

***Dean Jones:** I've been reviewing Darren's internship journal. Doing laundry, mending chicken wire, high tea with a Mr. Newman?*

***Kramer:** Well, it all sounds pretty glamorous, but it's business as usual at Kramerica Industries.*

***Dean Jones:** Far as I can tell, your entire enterprise is little more than a solitary man with a messy apartment which may or may not contain a chicken."*

-Seinfeld



## World Brand Lab – Down The Rabbit Hole

All these satellite issues aside, we have some serious concerns with WBL/WEG's credibility, honesty, and ranking methodologies.

With regard to ranking methodology, we simply can't find any specifics to speak of. Generally, legitimate companies such as Forbes and Fortune make their methodologies clear, available and replicable.<sup>28</sup> However, a comparison of WBL's lists year over year makes us wonder if they even have one. Companies that appeared on the list one year with billion dollar valuations, disappeared the next. Companies that are second tier in their industry trumped, much larger competitors. Other times, minor companies appeared out of nowhere.

We believe the companies on the list fall into two groups: The first group is your PetroChinas and China Mobiles. This is the group that adds legitimacy to the list. The second group is smaller companies who pay fees to be on the list and gain publicity. This is the group Chaoda belongs to. Some of these issues as well as the legality of WBL were touched on in a Global Times article titled "Brand Appraisal Company Deemed a Fraud".<sup>29</sup>

All this said, we do tip our hat to WBL for making our job easier. Instead of compiling a list of China's most valuable brands, WBL has inadvertently created a list of companies where management is willing to waste shareholder money. Suddenly, screening for fraud has become a lot easier.

### How a Fraudulent Company Fooled Some of the West's Greatest Academics

Perhaps the most bizarre and interesting chapter of the WEG/WBL saga is who the organization claims as its chairman and associates.

On its website<sup>30</sup>, the company states its team includes experts and consultants from Harvard, Yale, MIT, Columbia University, Oxford, and Cambridge. Listed on its main page are:

Robert Mundell – Professor at Columbia University and Nobel Laureate  
Edmund Phelps – Professor at Columbia University and Nobel Laureate  
John Deighton – Professor at Harvard  
Thomas C. Schelling – Professor at Harvard and Nobel Laureate  
Stephan Woolgar – Professor at Oxford  
Ravi Dhar – Professor at Yale

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<sup>28</sup> <http://www.fortunedatastore.com/ds/samples/Methodology.pdf>

<sup>29</sup> <http://business.globaltimes.cn/china-economy/2011-04/452581.html>

<sup>30</sup> <http://www.worldexecutive.org/>





**Exhibit 16**  
**WEG's Main Page**

**世界经理人**  
World Executive 世界最大的管理门户

**Robert Mundell (Dr. Robert A. Mundell) 1999 Nobel Laureate in Economics**  
Father of Euro "optimum currency area theory" founder. Currently a professor of economics at Columbia University, the World Executive Group Chairman of the Board ... >> more

**Edmund Phelps (Dr. Edmund S. Phelps) 2006 Nobel Laureate in Economics**  
Professor of Economics at Columbia University, "American Economic Review" Editorial Board. Internationally renowned economist, the U.S. Academy of Sciences, American Academy of Social Sciences ... >> more

**Thomas Schelling (Dr. Thomas C. Schelling) 2005 Nobel Laureate in Economics**  
Ph.D. in economics from Harvard University, Harvard University's Kennedy School long before teaching. Create and develop a "non-mathematical game theory." Worked at the U.S. Treasury ... >> more

**John Professor Dai Teng (Professor John Deighton) Harvard Business School professor**  
Harvard Business School marketing professor at the Department veteran, "Journal of Consumer Research," edited, "Journal of Interactive Marketing," the

**Stephen vag Professor (Professor Stephen Woolgar), Oxford University business school professor**  
Oxford Said Business School professor, Head of marketing, global marketing experts, the World Brand Lab Group members ... >> more

**Laiweiduoer Professor (Professor Ravi Dhar), Professor at Yale School of Management**  
Yale School of Management professor, director of Yale user observation, well-known brand management expert, "Journal of Marketing",

Certainly many of these names will sound familiar, as they are some of the most recognized professors and academics not only in the West, but arguably in the world. These individuals are often tapped by media outlets for expert advice and appear as regulars on news networks.

Our sources have been able to reach most of these individuals. Below is a summary and quotes of what we were told regarding WBL. In order to protect their reputation, we have withheld the names of who said what.

**Person 1:** This person was under the impression that WBL was “a bona fide concern based mainly in Beijing, Shanghai, Hong Kong, and New York.” He also claimed to have done some work with them on strategy advice and brand valuation, but would not elaborate.

**Person 2 and 3:** Both claimed they had been compensated to give speeches at a WBL conference, but they were in no way associated with WBL.

**Person 4:** On showing him the website with his picture: “I can’t read the Chinese, so I don’t know what they said. The only connection I can make is that Bob Mundel arranged a visit with **(Person 5)** and me to China, three or four years ago, and maybe I spoke to them then, or something. Otherwise I’ve no idea who they are or why they posted my picture.”



The only person we will discuss by name is Robert Mundell, as its an exercise in futility to protect the name of someone who is the Chairman of WEG/WBL. That's right, Robert Mundell - the same Nobel Laureate who laid the groundwork for the introduction of the euro currency - is evidently the Chairman of this organization. We could not reach him to independently verify this claim, but several credible sources have confirmed him as the Chairman. We don't know what to make of Mundell's involvement with such a questionable company, but we suspect Hai Sen Ding may be using Mundell as an emeritus figurehead in an effort to legitimize WBL, and likely keeping him in the dark regarding the company's day-to-day operations. While we are willing to give the benefit of the doubt to Mundell, we suspect Hai Sen Ding will have some explaining to do in the near future. It would appear Mr. Ding is following the #1 marketing strategy of fake Chinese companies: legitimize yourself by associating with white guys in suits.<sup>31</sup>

### **Coming Full Circle**

WBL recently released its 2011 list of "China's 500 Most Valuable Brands." Chaoda has since issued an announcement boasting its ranked 82<sup>nd</sup>, with a brand value of ¥12.3 billion (more than its entire market cap)<sup>32</sup>. On this announcement, the Company's market value jumped HK\$688 million in a single day. We would like to take this opportunity to congratulate Chaoda on this accomplishment and hope to read more about it when they release their 2011 Annual Report. We are sure it is well deserved.

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<sup>31</sup> <http://www.theatlantic.com/magazine/archive/2010/07/rent-a-white-guy/8119/>

<sup>32</sup> <http://www.chaoda.com.hk/n4/main.asp?id=725&yjbh=16&ejbh=152>



## Valuation

Without having any faith in management, the financial statements, or the cash balance, it becomes difficult to value Chaoda with any degree of confidence. With that caveat, the two most reasonable valuation methods would be a Net Asset Value approach and a dividend model.

### NAV Approach

Historically, Chaoda has had difficulty securing bank loans. This is primarily due to the issues with land ownership, and its corporate structure.

At the beginning of our report, we mentioned that Chaoda doesn't actually own any of the land it cultivates. It's all leased from farmers. In a liquidation scenario equity holders and creditors would not be able to claim this land. In fact, the Company would be on the hook for the significant long term contracts it signed with the farmers. Moreover, the bulk of Chaoda's long term assets are attributed to farmland infrastructure, such as irrigation systems. Without ownership of the land, this too is lost.

Then there is the issue of Chaoda's corporate structure. Often mistaken for an H-share company, Chaoda is actually a P-chip stock and technically not recognized by China as a national enterprise<sup>33</sup>. As shown on the next page, the organization consists of a labyrinth of PRC subsidiaries and offshore BVI entities. If current senior convertible bond holders carefully read through the CB Proposal, they will notice that all the guarantors to their holdings are BVI entities. Not a single one of them is a PRC operating subsidiary. We doubt this is a coincidence. Even if Chaoda had the cash balance it reports, it would be nearly impossible for creditors to collect. A lawyer we consulted explained to us, "I've had these types of cases before. It's not about collecting 10 cents on the dollar. It's about collecting 0 cents on the dollar."

These are the reasons even Chinese banks refuse to lend to Chaoda.

The one asset Chaoda holds that we can confirm is its stake in Asian Citrus, which over the years has slipped from 49% to 13.4% interest. However, with a VP who loves trading on insider information, questionable related party transactions with Mr. Kwok's fertilizer company, and discrepancies we found in its listing documents (which are beyond the scope of this report), we have our own concerns with Asian Citrus. But assuming recent market prices, Chaoda's stake is worth approximately HK\$870 million or HK\$0.57 per share. Of course, this type of theoretical valuation still leaves investors with the very practical issue of collectability. What happens if management continues to sell the stake and abscond with the proceeds?

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<sup>33</sup> P-chip stocks are associated with an abnormally higher level of fraud, embezzlement, and forgery relative to H-Shares.





## Dividend Model

We believe that as long as Chaoda continues to operate, it will likely continue to pay dividends – at least in the interim. Of course, this is nothing to applaud. Chaoda’s annual dividend payout of approximately HK\$0.06 per share represents less than 5% of reported net income. Despite holding steady in the last few years, that’s half of what it was in 2006. Still, assuming 0% growth and a generous 10% discount, we believe the share price to be worth:

$$\frac{0.05}{(0.10-0.0)} = \text{HK\$}0.60$$

This exercise in Equity Valuation 101 aside, we feel that a delisting is imminent.

## Industry Risks and Caveat Emptor

The result of the research we carried out on this sector left us shaking our heads and feeling uninspired. Investors need to understand that first and foremost, Chaoda is not investment opportunity – it’s a national service.

For the PRC government, these type of companies are expected to help feed the population. That’s why most of them are tax exempt.

For the local governments these companies are expected to come in to increase crop yields and raise the standard of living for farmers in their jurisdiction. This leads to higher reportable GDP figures for the municipalities which lets government officials keep their jobs. You don’t want to be the mayor who couldn’t hit this year’s GDP growth quota. If Chaoda doesn’t play ball, it may soon find that there is no more land to be leased from the authorities. In this business, corruption is rampant and shareholders are on the bottom rung of the totem pole. The idea that Chaoda’s primary mandate is to create shareholder value is naïve at best.



## Conclusion

Chaoda's long history as a public company is mired in lies and corporate fraud. Under the cover of inflated capex spending and related party transactions, management has transferred more than US\$400M out of Chaoda. In so doing, the Company has overstated its cash balance and falsified its financial statements. The CEO, with the support of the board of directors has invested in risky projects that have robbed shareholders of returns in order to line his own pockets. In an attempt to cover their egregious actions, management has paid a fraudulent company to provide Chaoda positive marketing exposure.

Corporate fraud has become problematic in both the Mainland and Hong Kong. Both governments have wisely renewed calls for tougher action in the face of this growing epidemic. The fact that the HK Exchange and the SFC have allowed this obvious fraud to operate under their watch will not go unnoticed. To maintain market confidence, we expect in the coming weeks and months for the SFC to conduct their own investigation into Chaoda's operations and business activities. In addition to what has been presented here, we have reason to believe Chaoda will not be able to survive scrutiny. Accordingly, we expect this Company to eventually be delisted.



## Last Words

In preparing this report, we have been aided by various parties. These parties worked independently of each other and were unaware of the nature of the end product. This was both for their protection and ours. While well compensated, we would like to take this moment to thank those who helped us. At this point, you probably know who you are.

As the cases of Sean Hoare and Li Guofu showed, this type of business can be a short one. To us, nothing is more important than protecting our sources and those who have assisted us or may do so in the future. At the beginning of this report we mentioned that we are in possession of certain information, which given its nature we have decided against publishing.

Instead, the information has been encrypted, stored online, and protected with a codeword. Consider this insurance – for us, our associates, and our consultants. If we feel the safety and anonymity of any party has been jeopardized, we will release the codeword into the public domain.



A N O N Y M O U S