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Hua Han – Changdu Kangyuan at Scam Center

August 26, 2016

The Basics	
Ticker:	HK:0587
Recent Price:	HK$0.55
Market Cap:	HK$4.1bn

Emerson Analytics Forecast
Delisting

A week after Hua Han Health's so-called "clarification" dated August 18, the regulators have all been sitting on their hands. This is disappointing. It is time they took concrete steps to look into the crimes perpetuated by the management of Hua Han. But the Stock Exchange of Hong Kong (HKEX) simply accepted the absurd excuses put up by Hua Han, as if nothing had happened.

Hua Han claims in its so-called "clarification" that data from the professional market research institutes China SME and Sinohealth Intelligence are not reliable. We are not here to defend these two entities, but we want to emphasize that in our August 10 report, we present at least two independent sources for sales volume of any key products, and they corroborate each other. Using Qijiao Shengbai capsules as an example, the production engineer at the manufacturer Guiyang DCX says in our audio clip that output in calendar 2015 was 4.05m boxes, while Guiyang DCX's sales executive says that output was more than 4m boxes. Taking into consideration the possible growth in the business, Sinohealth Intelligence's number (2.59m boxes sold in 2013) would not be unreasonable.

According to the "clarification" announcement, Hua Han's manufacturing subsidiaries rarely sell to third parties directly, but to fellow subsidiaries which are pharmaceutical distributors.

Our investigations show that of all the Hua Han subsidiaries, **only Tibet Changdu Kangyuan Pharmaceutical Co., Ltd** (Changdu Kangyuan, 西藏昌都地區康源醫藥有限公司) **is qualified as a distributor of pharmaceutical products**.

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Our main findings, mainly from Changdu Kangyuan's filings with the State Administration of Industry and Commerce (SAIC) through the Enterprise Credibility Information System (ECIS), are as follows:

- **Changdu Kangyuan reported combined revenue of Rmb2,469m in calendar years 2013 and 2014, equivalent to 84% of the revenue claimed by Hua Han during the same period;**

- **Never had Hua Han own any equity interest in this 84% revenue contributor Changdu Kangyuan.**

Therefore, the **revenue contribution from Changdu Kangyuan is pure fiction**. It is also doubtful if Changdu Kangyuan really had any business.

Sole Distributor Changdu Kangyuan Contributed 84% of Revenue

The table below reproduces Exhibit 16 in our August 10 report showing revenue breakdown by Hua Han's manufacturing subsidiaries. Among them, revenues for Guiyang DCX, Hanfang Pharma and GHMM are based on their respective ECIS filings and have been confirmed by the "clarification" announcement. We have to focus on Hua Han's 2013 performance because from 2014 the company ceased to disclose the revenue breakdown of its key pharmaceutical products.

Exhibit 1 – Revenue by Manufacturers 2013

Year end Dec 31 (Rmb m)	**2013**
Guiyang DCX	233
Hanfang Pharma	55
GHMM	75
Guilin Pavay	105
Guizhou Factorr	0
Revenue – Our estimate	**467**
Revenue from manufacturing - Hua Han's claim	1,572
Our estimate as % of Hua Han's claim	29.7%

Sources: ECIS (Guizhou), Emerson Analytics

The huge gap between Hua Han's consolidated revenue and the combined revenue of its manufacturing subsidiaries is explained by the "clarification" as follows:

> *The majority of the manufacturers' products are sold to the pharmaceutical distributors which are the subsidiaries of the Company at a base price. Then these pharmaceutical distributors will supply the products to external dealers based on the sales agreement entered into with the dealers. The statistics benchmark for sales revenue of the Company is based on the data regarding sales by the pharmaceutical distributors to external dealers.*

We all know that the manufacture and distribution of pharmaceutical products are heavily regulated, whether in China or other parts of the world. In mainland China, a pharmaceutical retailer needs a specific "medicine business permit". The wholesaling of drugs is subject to even tighter regulations. Any entity hoping to engage the manufacture, wholesale or retail drugs must obtain the appropriate permits before it can engage in such business. The regulation of the pharmaceutical industry is the ambit of China Food and Drug Administration (CFDA) and its subsidiary entities.

We conducted a search of all Hua Han subsidiaries with valid registration in 2013 in mainland China (including those not disclosed in Hua Han's annual report) in the CFDA database, and found that only Changdu Kangyuan was licensed for pharmaceutical wholesaling business. The company's pharmaceutical wholesale permit number is "Tibet AA8950016", and its Good Supply Practice (GSP) Number is "A-XZ10-008".

Exhibit 2 – CFDA Record Shows Changdu Kangyuan in Pharmaceutical Wholesaling Business

Source: CFDA

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Two other related parties, Hechuang Pharmaceutical and Hanfang Guomei, had also been licensed for pharmaceutical distribution. However, they had been sold off by Hua Han in 2007 and 2011, respectively, and therefore had no bearing on our discussions.

Hua Han's 2012-2015 annual reports have also demonstrated that Changdu Kangyuan is the only subsidiary that engages in pharmaceutical wholesaling. In Exhibit 3 below, we reproduce Hua Han's 2013 annual report and mark out the manufacturing subsidiaries in red dotted boxes.

Exhibit 3 – The Pharmaceutical Distributor According to Hua Han's FY13 Annual Report

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered capital	Percentage of equity attributable to the Company Direct	Indirect	Principal activities
Intended Features Limited	British Virgin Island ("BVI")	US$375,875	100	–	Investment holding
GHMM*	PRC/Mainland China	HK$466,909,000	–	100	Manufacture and trading of gynecological pharmaceutical products and feminine medicinal healthcare products
Factorr Universal Limited ("Factorr")	BVI	US$200	–	69.5	Investment holding
貴州泛特爾生物技術有限公司 ("泛特爾")**	PRC/Mainland China	RMB103,000,000	–	75.1	Manufacture and sales of bio-pharmaceutical products
DCX*	PRC/Mainland China	RMB200,000,000	–	99.7	Manufacture and sales of pharmaceutical products
華諾威*	PRC/Mainland China	RMB100,000,000	–	65	Manufacture and sales of bio-pharmaceutical products
Guilin Gu Jin*	PRC/Mainland China	RMB1,000,000	–	100	Investment holding
Tibet Changdu Kangyuan Pharmaceutical Co., Ltd 昌都康源*	PRC/Mainland China	RMB5,000,000	–	80#	Trading of pharmaceutical products
深圳市雲晨廣江貿易有限公司* Shenzhen Yunchen Guangjiang Trading Co., Ltd	PRC/Mainland China	RMB1,000,000	–	100	Investment holding

Source: Hua Han 2013 Annual Report, p.94

Exhibits 4 and 5 below show the 2013 and 2014 ECIS filings, respectively, by Changdu Kangyuan. As can be seen, this subsidiary reported Rmb1,906m of revenue for 2013 and Rmb564m for 2014.

Exhibit 4 – Changdu Kangyuan Key Financial Statistics 2013

企业名称	西藏昌都地区康源医药有限公司 Tibet Changdu Kangyuan Pharmaceutical Co., Ltd		
注册号/统一社会信用代码	542100200000494		
企业联系电话	4828642	企业电子邮箱	2402781156@.qq.com
企业通信地址	昌都西路31号	邮政编码	854000
企业经营状态	开业		
企业资产状况信息（币种：人民币）	资产总额		123,541.5万元
	所有者权益合计		88,164.7万元
	负债总额		35,376.79万元
	营业总收入 Revenue		190,586.47万元 Rmb 1,905.8647 million
		其中：主营业务收入	190,586.47万元
	利润总额		89,864.85万元
	净利润		85,603.08万元
	纳税总额		27,508.38万元

Source: ECIS (Tibet)

Exhibit 5 – Changdu Kangyuan Key Financial Statistics 2014

企业名称	西藏昌都地区康源医药有限公司 Tibet Changdu Kangyuan Pharmaceutical Co., Ltd		
注册号/统一社会信用代码	542100200000494		
企业联系电话	4828642	企业电子邮箱	2402781156@qq.com
企业通信地址	昌都西路31号	邮政编码	854000
企业资产状况信息（币种：人民币）	资产总额		93,462万元
	所有者权益合计		103,066万元
	负债总额		-9,603万元
	营业总收入 Revenue		56,357万元 Rmb 563.57 million
		其中：主营业务收入	56,357万元
	利润总额		21,458万元
	净利润		14,901万元
	纳税总额		11,861万元

Source: ECIS (Tibet)

Exhibit 6 below shows the 2013 and 2014 revenues as reported by Changdu Kangyuan to ECIS and those reported by Hua Han. There is obviously a considerable deviation in annual revenue reported by the two. While this may be partly due to their accounting policy difference in terms of the timing of revenue recognition, we doubt this can fully explain the difference.

Changdu Kangyuan is a subsidiary hardly ever mentioned by Hua Han and only makes its appearance in the "Investments in subsidiaries" once a year in its annual reports. Why would Hua Han never explain the role of this company that accounted for 84% of its reported revenue until we questioned its financial integrity?

Exhibit 6 – Revenue Comparison, Hua Han Vs. Changdu Kangyuan

Year end Dec 31 (Rmb m)	2013	2014	Total
Revenue - Hua Han's claim	1,671	1,284	**2,955**
Revenue - Changdu Kangyuan's claim	1,906	564	**2,469**
Changdu Kangyuan as % of Hua Han			**84%**

Sources: Hua Han, ECIS (Tibet)

Changdu Kangyuan is NOT at all related to Hua Han

(1) Changdu Kangyuan Shareholding Structure, end-2013

The biggest shock that we've unearthed is that, contrary to Hua Han's claim that it owned 80% of Changdu Kangyuan, the Hong Kong listed company actually had no interest in the Tibetan distributor.

Changdu Kangyuan was established in December 2009 with a registered capital of Rmb5m. According to Hua Han's FY2011 annual report, the company entered into an agreement on December 17, 2011 with two independent third parties to acquire **80% equity** of Changdu Kangyuan for a consideration of Rmb4m[1]. Strangely, Hua Han's directors decided not to treat the deal as a business combination[2]. Changdu Kangyuan was renamed in August 2015 as Changdu Bozhi Pharmaceutical Co., Ltd (昌都市博智醫藥有限公司).

[1] http://www.hkexnews.hk/listedco/listconews/SEHK/2011/1028/LTN20111028436.pdf, p.119 & p.128
[2] http://www.hkexnews.hk/listedco/listconews/SEHK/2011/1028/LTN20111028436.pdf, p.128

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Changdu Kangyuan 2013 ECIS filing shows that the 80% equity stake was held by a certain Shenzhen Yunchen Guangjiang Trading Co., Ltd (Shenzhen Yunchen, 深圳市雲晨廣江貿易有限公司). The remaining 20% was held by an individual named Dai Zhitian (戴智添).

Exhibit 7 – Changdu Kangyuan Shareholding Structure, end-2013

企业名称	西藏昌都地区康源医药有限公司 Tibet Changdu Kangyuan Pharmaceutical Co., Ltd						
注册号/统一社会信用代码	542100200000494						
企业联系电话	4828642			企业电子邮箱	2402781156@qq.com		
企业通信地址	昌都西路31号			邮政编码	854000		
企业经营状态	开业						
股东出资情况（……本币种相同）	股东 Shareholders	认缴出资额 Issued capital	认缴出资时间	认缴出资方式	实缴出资额	实缴出资时间	实缴出资方式
Shenzhen Yunchen Guangjiang Trading Co., Ltd	深圳市云层广江贸易有限公司	400	2011年9月26日	货币	400	2011年9月26日	货币
Dai Zhitian	戴智添	100	2010年7月31日	货币	100	2010年7月31日	货币

Source: ECIS (Tibet)

Hua Han claimed, in its FY2012 annual report, that it set up Shenzhen Yunchen on July 6, 2011[3]. However, Shenzhen Yunchen's 2013 ECIS filing shows that its shareholders were Cheng Yun (程雲) and Han Dong (韓東), with 60% and 40% equity interest, respectively.

Exhibit 8 – Shenzhen Yunchen Shareholding Structure, end-2013

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深圳市云晨广江贸易有限公司年报情况

Shenzhen Yunchen Guangjiang Trading Co., Ltd Annual Report

年报情况： 2013年度报告已公示

2013 Annual Report

登记事项 备案事项 注册资本实缴情况 分支机构情况

出资人姓名（名 称）及出资额 Shareholders and issued capital

名称	认缴出资额（万元） Issued capital (in ten thousand Rmb)		实缴金额（万元）
程云 Cheng Yun	60.0000	60	0.0000
韩东 Han Dong	40.0000	40	0.0000

Source: ECIS (Guangdong)

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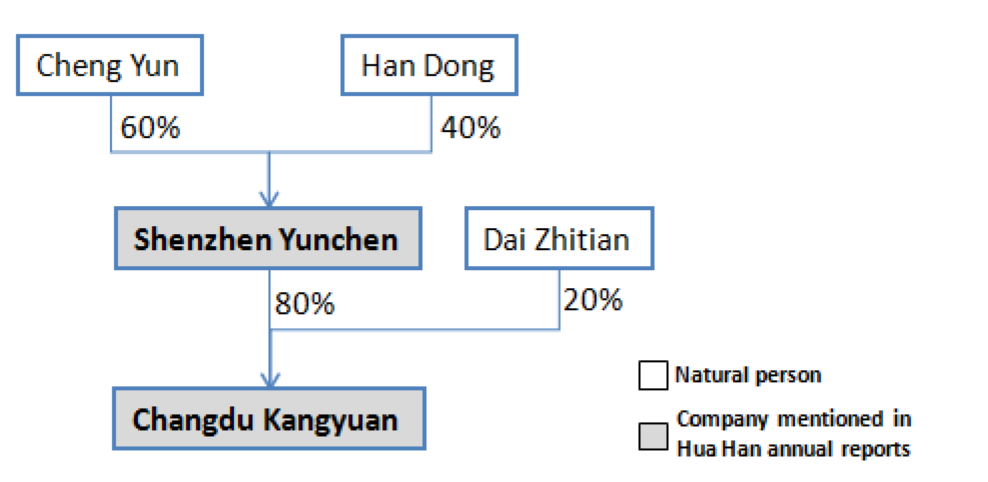
3 http://www.hkexnews.hk/listedco/listconews/SEHK/2012/1030/LTN20121030175.pdf, p.118

The complete shareholding structure of Changdu Kangyuan at the end of 2013 is shown below in Exhibit 9.

Exhibit 9 – Changdu Kangyuan Ultimate Controlling Shareholders, end-2013



Sources: ECIS (Guangdong), ECIS (Tibet)

Thus, despite Hua Han's claim of taking an 80% stake in 2011, there is nothing to prove that it actually had ownership in the Tibetan distributor in 2013, even though the latter supposedly accounted for the bulk of Hua Han's revenue.

Of course we know what the liars at Hua Han management will say:

- Changdu Kangyuan simply forgot to amend the shareholders information; or

- Cheng Yuan and Han Dong are nominees holding Changdu Kangyuan through Shenzhen Yunchen on behalf of Hua Han.

We'll call the latter situation the "**after-being-exposed nominee holding**" to signify that a nominee situation is announced, unwillingly, AFTER IT HAS BEEN REVEALED THAT THERE IS ACTUALLY NO SHAREHOLDING RELATIONSHIP BETWEEN THE TWO. Anyway, Hua Han's regulator HKEX, its auditors Ernst and Young, and its lawyers should be more than happy to accept any of the two explanations.

(2) Changdu Kangyuan Shareholding Structure, end-2014

There's one more thing: in 2014, there was a change in Shenzhen Yunchen's shareholders – Cheng Yun and Han Dong exited the scene and were replaced by Xu Yuanhao (徐苑皓). Still, there was no discernible relationship between Shenzhen Yunchen and Hua Han.

Exhibit 10 – Shenzhen Yunchen Shareholding Structure, end-2014

深圳市云晨广江贸易有限公司　注册号：440301105540684

Shenzhen Yunchen Guangjiang Trading Co., Ltd

2014年度报告 红色为修改过的信息项

2014 Annual Report

基本信息

注册号/统一社会信用代码	440301105540684	企业名称	深圳市云晨广江贸易有限公司
主体类型	有限责任公司（自然人独资）	法人代表	徐苑皓
企业电子邮箱	18018179570@qq.com	邮政编码	518100
企业通信地址	深圳市罗湖区罗沙路聚宝花园1002		
有限责任公司本年度是否发生股东股权转让	有 Equity transfer or not in this year: Yes	是否有投资信息或购买其他公司股权	无
企业经营状态	登记成立	是否有网站或网店	无
企业联系电话	13828782906	从业人数	不公示

网站或网店信息

类型	名称	网址

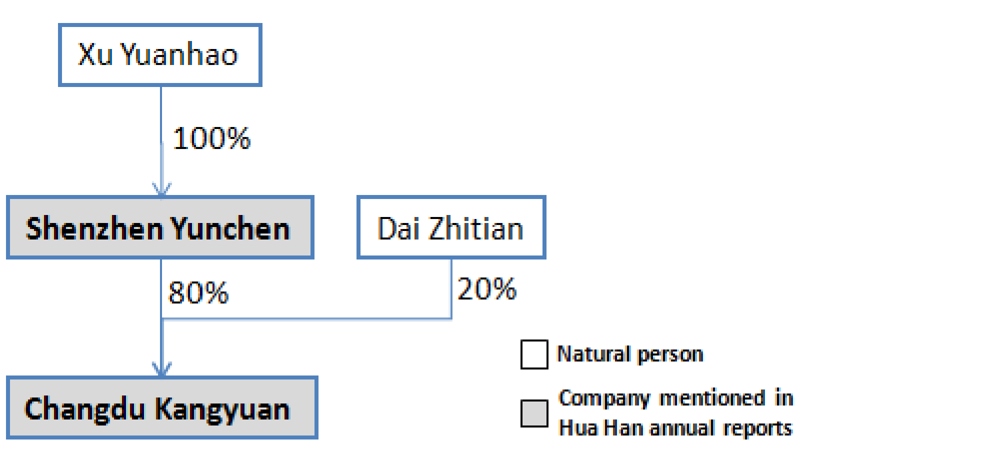
股东及出资信息

股东 (Shareholders)	认缴出资额（万元） (Issued capital (in ten thousand Rmb))	认缴出资时间	认缴出资方式	实缴出资额（万元）	出资时间	出资方式（万元）
徐苑皓 (Xu Yuanhao)	100.000000	2011年07月06日	货币	100.000000	2011年07月06日	货币

Source: ECIS (Guangdong)

The complete shareholding structure of Changdu Kangyuan at the end of 2014 is shown below in Exhibit 11.

Exhibit 11 – Changdu Kangyuan's Ultimate Controlling Shareholder, end-2014



Sources: ECIS (Guangdong), ECIS (Tibet)

But of course the Hua Han liars can always say that they forgot to turn Shenzhen Yunchen a subsidiary of the Hong Kong listed company, or that they had found a new nominee holder in the person of Xu Yuanhao.

With respect to the issue of nominee holding, we will come back to this twice in the remainder of this report. As we have said earlier, we will describe the declaration of nominee holding after a company has been accused of forgery as an "after-being-exposed nominee holding". If an "after-being-exposed nominee holding" can be accepted as a valid explanation, it means that one company can consolidate any other company's accounts at will. If this fraud is not exposed, great! If it is exposed, the "after-being-exposed nominee holding" will be offered as a valid explanation.

But isn't it true that in a disclosure-based market, everything should be disclosed upfront and accounting treatment will be dealt with accordingly? What's the point of making disclosures, then?

(3) Changdu Kangyuan Shareholding Structure, end-2015

On August 3, 2015, ownership of 80% of Changdu Kangyuan was transfered from Shenzhen Yunchen to Guangzhou Keershi Bio-Technology Co., Ltd. (Guangzhou Keershi, 廣州珂爾施生物技術有限公司), as shown in Exhibit 12 below.

Exhibit 12 – Changdu Kangyuan Shareholding Information

变更信息			
变更事项	Before Change 变更前内容	After Change 变更后内容	Date of Change 变更日期
经营场所	昌都西路31号	西藏昌都市昌都西路31号	2015年8月3日
股东、发起人、出资人（出资情况） Shareholders	深圳市云晨广江贸易有限公司;戴智添; Shenzhen Yunchen Guangjiang Trading Co., Ltd	戴智添;广州珂尔施生物技术有限公司; Guangzhou Keershi Bio-Technology Co., Ltd	2015年8月3日 Aug 3, 2015
[illegible]责人、独资投资人）	何奕	郑羽萍	2015年8月3日
企业名称	西藏昌都地区康源医药有限公司	昌都市博智医药有限公司	2015年8月3日
			<< 1 >>

Source: ECIS (Tibet)

The shareholders of Guangzhou Keershi are two individuals, as shown below in Exhibit 13. Are they the new "nominees"?

Exhibit 13 – Guangzhou Keershi Shareholding Structure, end-2015

广州珂尔施生物技术有限公司 统一社会信用代码：914401060545432034

Guangzhou Keershi Bio-Technology Co., Ltd

2015年度年度报告 红色为修改过的信息项

2015 Annual Report

基本信息

统一社会信用代码	914401060545432034		
注册号	440106000697476	企业名称	广州珂尔施生物技术有限公司
企业联系电话	18902257188	邮政编码	510000
企业通信地址	广州市天河区龙口东路129号A栋11层自编1103房		
电子邮箱		有限责任公司本年度是否发生股东股权转让	否
企业经营状态	开业	是否有网站或网店	否
企业是否有对外投资设立企业信息	否	从业人数	企业选择不公示

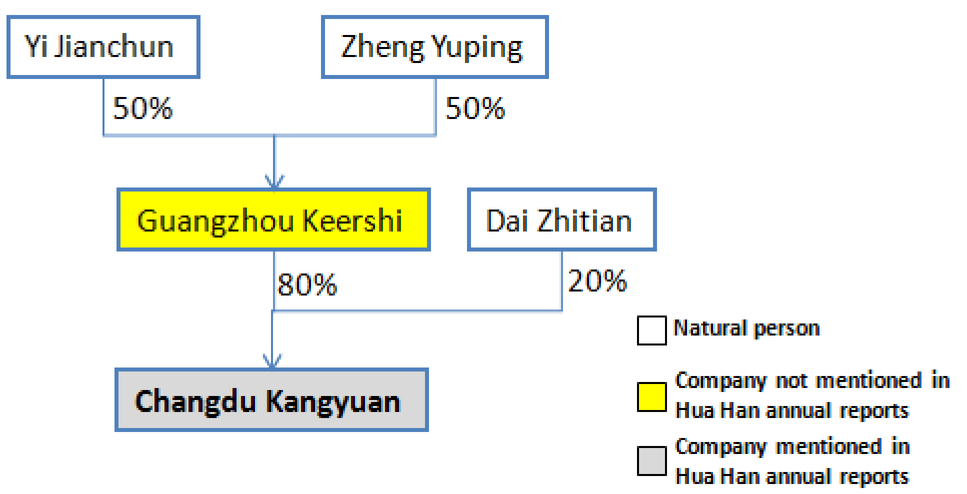
股东及出资信息

股东 (Shareholders)	认缴出资额 (Issued capital (in ten thousand Rmb))	认缴出资时间	认缴出资方式	实缴出资额	出资时间	出资方式
易建春 郑羽萍 (Yi Jianchun/Zheng Yuping)	1000000万	2014年09月23日	货币	1000000万	2014年09月23日	货币

Source: ECIS (Guangdong)

The complete shareholding structure of Changdu Kangyuan at the end of 2015 is shown below in Exhibit 14.

Exhibit 14 – Changdu Kangyuan Ultimate Shareholding Structure, end-2015



Sources: ECIS (Guangdong), ECIS (Tibet)

Whatever Changdu Kangyuan's business and no matter how much money it made, we don't see any evidence that it is in any way related to Hua Han. It is inconceivable that Hua Han would not bother to effect the shareholding change if it were actually channeling more than 80% of its revenue through Changdu Kangyuan. The only explanation is that Hua Han had nothing to do with Changdu Kangyuan.

We believe this is a case similar to Beijing Epure International Water Co., Ltd., which was created by Sound Global Ltd. (0967.HK) to book Rmb1.0bn of fictitious "technology revenue"[4]. Only that Hua Han is even more outrageous -- it simply makes use of someone's else company. If forced to, Hua Han can always come up with a post-dated agreement "proving" a "nominee" relationship that had been in existence since March 2011.

Ingenious "Clarifications"

Hua Han's "clarification" announcement really makes a very interesting read. Some of the more ingenious explanations are as follows:

- The production volume of Yi Fu and Yi Bei as disclosed in Guilin Pavay's website was way below the amount commensurate with the reported revenue. Hua Han's explanation is this:

  The Group was given to understand that the data published on the website…referred to the production volume and sales volume for a specific Yi Fu and Yi Bei product of specific dosage. As the senior management of Guilin Pavay did not pay sufficient attention of the website development and neglected the management of the same website, such information was thus not meticulously reviewed prior to its release.

After reporting some "wrong" production volume numbers for several years, the outcome of a "meticulous" review was to delete such numbers entirely? That's certainly very "good" management practice.

- Following our revelation that Hua Han's Shawen factory has been built on third party's land, the company's "clarification" says:

  The Company therefore entrusted Hanfang Group and other two companies to undertake such land parcel and entered into a nominee holding agreement with these companies. The nominees have undertaken to assign the ownership of such land parcel to the Company.

See? Perfect example of "after-being-exposed nominee holding" situation. Works any time, anywhere!

[4] http://emersonanalytics.cloud/downloads/SoundGlobal-HK_0967-StrongSell.pdf, p.10

- Guizhou Shunzhi's ECIS filings do not reflect the Rmb450m deposits that it supposedly has received from Hua Han for purchasing equipment and machineries. Hua Han's explanation is very simple:

  Guizhou Shunzhi replied that it is sufficient for them to declare only the commission income.

Yes, Guizhou could merely account for the commission income in its income statement, but it needed to account for the entire amount of deposits on its balance sheet. The cash was not on Hua Han's balance sheet, nor was it on Guizhou Shunzhi's balance sheet. It simply vanished!

- Hua Han's effective interest rate on its cash and equivalent balance was even lower than demand deposit rate. Hua Han explains that:

  The then cash management of the Company indeed had defects as no other financial methods have been adopted on banks deposits, resulting in low interest income of the Company.

It's hard to believe that any of Hua Han's banks would ignore a client with so much surplus cash.

- In its attempting to distant itself from Chengdu Hechuang, which we argue is actually a connected party to Hua Han because its chairman Zhang Peter Y. attended several of its work meetings, Hua Han's excuse is that:

  Due to the historical relationship between Chengdu Hechuang and the Company, the management of Chengdu Hechuang invited Mr. Zhang Peter Y., chairman of the Company, to attend in several activities after the death of Mr. Yang Chengquan, in order to strengthen and expand its cooperation with the Company.

For the benefit of readers not very well versed in the Chinese way of writing, we need to make this footnote: only the senior leaders of an entity will make an "important speech"!

- As to the fact that Hua Han actually owned just 99% of Hanfang Guomei, rather than 100% as it had always pretended, the explanation is really simple:

  Hanfang Guomei was owned 99% by the Company and 1% by a pharmaceutical company on behalf of the Company.

Voila! Another example of "after-being-exposed nominee holding" situation.

When reading such a "clarification", one cannot help but think that the almighty management is really capable of explaining all mysteries in this world.

We still expect the Securities and Futures Commission of Hong Kong to initiate procedures to delist Hua Han.

Disclaimer

We are a group of seasoned equities analysts with many years of experience in the research of economic and political trends as well as individual stocks around the world. With background in various international investment banks, we have followed the development of the Chinese equities market right from day one.

We are determined to expose as much of the fraud in the Chinese stock market as we can. The most widespread and serious fraud is probably that undertaken by listed companies, in fabricating non-existent businesses and stealing shareholders money, among other tricks.

In exposing these crimes we challenge the listed companies to prove the integrity of their announcements and financial statements. The listed companies, of course, want everybody to believe that their announcements and financial statements are true. Their auditors, employees, independent directors, lawyers, shareholders and even the general public all hope that these announcements and financial statements are true.

We have made our best effort to ascertain that everything we say in this report is accurate. We have obtained our information from public sources that we believe to be accurate and reliable, or from sources whom we believe are not insiders or connected parties to the companies mentioned herein. However, we are certainly NOT in the business of making investment recommendations. This is not an investment report and should not be regarded as such. Read and use our reports at your own risk. Most important of all, DO YOUR OWN RESEARCH BEFORE YOU COMMIT OTHER PEOPLE'S MONEY.

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