

Why Would FMCN Buy a Ginseng Plantation? From One of its Employees?

FMCN's bizarre acquisition of a ginseng plantation at the Russian and North Korean border illustrates that FMCN's acquisitions are not kosher. The most troubling aspect of this acquisition is that the selling shareholders, who had purchased the plantation only five months earlier from the founders, included at least one FMCN employee. Strangely, this company seems to have no operations; yet, most recently reported a net profit margin of 48.9% on \$1.5 million in revenue.¹ We therefore wonder what purpose the ginseng plantation entity serves, and whether there are ongoing improprieties associated with it. We encourage FMCN's auditor, Deloitte Touche Tohmatsu, to look at this acquisition for improprieties – along with examining the numerous other issues we have identified.

On November 21, 2011, Muddy Waters labeled FMCN “The Olympus of China.” Olympus (7733 JT) is down by 57.6% since the October 14, 2011 revelation that it had deliberately overpaid by at least \$1.3 billion for acquisitions. An internal investigation of Olympus called management “rotten to the core,”² and concludes that Olympus deliberately overpaid for acquisitions in order to hide losses.³

FMCN has written off approximately \$1.1 billion out of roughly \$1.6 billion over at least 21 acquisitions – in other words, FMCN itself has determined that it massively overpaid on almost two dozen occasions. FMCN's response to our reports has been that these overpayments were due to (still existing) management's incompetence. While we think that FMCN's business model is flawed and that the Company is poorly managed, we do not believe that FMCN management's destruction of shareholder value is in good faith. Consistent with management's long history of misrepresentations (including booking acquisitions that FMCN never made)⁴ and self-dealing, we believe that FMCN deliberately overpaid for numerous acquisitions, begging the question “What are FMCN's true historical accounts?”

¹ There is no record of preferential tax treatment in the entity's SAIC file; further, its registered capital is only \$64,000 (RMB 500,000) as of its establishment date. This would seem unlikely to qualify for

² <http://www.ft.com/intl/cms/s/0/c61a2bd0-1fb2-11e1-9916-00144feabdc0.html#axzz1iLkPcBeH>

³ Thanks to John Hempton of Bronte Capital who provided a simple explanation for why companies may deliberately overpay for acquisitions, which is as follows: fake profits generate fake cash; however, companies can only get away with having a certain amount of fake cash on the balance sheet before they risk the auditors catching on. Therefore the companies often make fake acquisitions – i.e., accounting entries that show cash payments many times the actual payments – in order to “spend” the fake cash and justify why the verifiable cash balances are lower than the reported profits would otherwise dictate.

⁴ See Muddy Waters's November 21, 2011 report on FMCN, pp.26-31.

Ginseng Plantation Acquisition History

Hunchun Shengtai Ginseng Plantation Co. Ltd. (珲春盛泰人参种植有限公司) was incorporated on January 31, 2007 by a husband and wife team, Mr. Liu and Mrs. Xue. The couple is from the local area, Hunchun. Hunchun, population 250,000,⁵ is in the far northeast of China, on the Russian and North Korean borders.

Mr. Liu and Mrs. Xue registered the company with equity capital of \$64,000⁶ (RMB 500,000); however, they only paid-in \$13,000⁷ (RMB 100,000). While Mr. Liu and Mrs. Xue appear to be farmers, and these were likely large sums of money to them, it is curious as to why such a small company would arouse the attention of a multi-billion dollar market capitalization advertising powerhouse such as FMCN.

Shengtai Ginseng's scope of business (i.e., the range of activities for which it was approved and was allowed to conduct business) was "ginseng plantation." Shengtai Ginseng's registered office⁸ was (and still is) in a desolate place near the border. According to Shengtai Ginseng's SAIC file, it pays \$73 (RMB 500) per month for the office.

Below are photos of the area around Shengtai's registered office.



⁵ <http://en.wikipedia.org/wiki/Hunchun>

⁶ at 7.78 RMB.

⁷ Id.

⁸ The given address is Hunchun Border Economic Cooperation Zone, Number 2 Zone (吉林省珲春市边境经济全区 2 号小区).



On May 21, 2008, two individuals purchased the entirety of Shengtai Ginseng from Mr. Liu and Ms. Xue. Although FMCN was not one of the new shareholders, the purchasers renamed the company Hunchun Focus Media Advertising Co. Ltd. They also changed the scope of business from “ginseng plantation” to “building LCD television advertising production, distribution and outdoor advertising production and distribution.” The new shareholders were Mr. Wang Feng and Mr. Chen Yu, with each owning 50%. As part of the local registration procedures, Mr. Wang (who became Shengtai’s Legal Representative), had to submit his resume to SAIC. According to the resume, Mr. Wang was an employee of Focus Media at the time he purchased half of Shengtai Ginseng’s shares.

We do not know what transpired over five months after Messrs. Wang and Chen acquired Shengtai, but on October 21, 2008 Mr. Wang and Mr. Chen transferred ownership of Shengtai to FMCN.⁹ There is no indication in the SAIC files as to what the consideration for either transfer was. The key open issues from this series of transactions are:

- Why did a tiny ginseng plantation company merit FMCN’s attention?
- How much did Wang and Chen pay for Shengtai?
- How much did FMCN book for the acquisition of Shengtai, and how does that compare to the price Wang and Chen paid?
- How much cash actually changed hands, and did Wang and Chen keep it or was it redirected elsewhere?

⁹ The acquiring entities were Shanghai Focus Media Advertising Co. Ltd., and Shanghai Focus Media Advertising Agency Co. Ltd.

Along with many issues we identified in prior years financial statements, we encourage FMCN's auditor, Deloitte Touche Tohmatsu, to closely examine the Shengtai transactions for improprieties.

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