

## Hua Han – Bad for Your Financial Health

August 10, 2016

The Basics	
Ticker:	HK:0587
Recent Price:	HK\$0.68
Market Cap:	HK\$5.0bn

Emerson Analytics Forecast
<i><b>Delisting</b></i>

Hua Han has inflated its sales revenue by three-fold, thus exaggerating its net profit by about at least four times even if we generously assume that its gross margins were really as high as the 68.7% reported.

- Our investigations into Hua Han's four main products (which accounted for 76% of total revenue based on company data) yield evidence that:
  - It inflated the revenue of Yi Fu and Yi Bei, the rhEGF products, by 2.4x in 2013 from an estimated Rmb105m to a reported Rmb357m;
  - An authoritative third-party market survey shows that it exaggerated the revenue of Qijiao Shengbai capsules by 2.7x to a reported Rmb494m in 2013;
  - It fabricated sales of Rmb368m for Fuke Zaizaowan (including capsules) against our estimated Rmb100m actual sales; and
  - It created bogus sales of Rmb57m in Golden Peptides out of thin air in 2013.
- Three of Hua Han's main subsidiaries that produced traditional Chinese medicines (GHMM, Guiyang DCX and Hanfang Pharma) reported to the government revenue of Rmb362m in 2013. Add to that our estimated revenue for two other pharmaceutical manufacturing subsidiaries (Guilin Pavay and Guizhou Factorr) as well as Hua Han's trading business

## Hua Han – Bad for Your Financial Health

revenue (which we assume to be accurately reported), Hua Han probably had total revenue of Rmb565m in 2013, about 33.8% of that reported.

- To plug the gap on the balance sheet created by the phantom sales and profit, Hua Han has resorted to the usual tricks of:
  - "Paying" a Rmb200m deposit for a piece of land at Shawen Park on which Hua Han had built its new plant. The land was actually bought by related parties at a price 1/3 of Hua Han's claim;
  - "Paying out" over four years Rmb405m of deposits for buying machineries to an agent, whose filings with the government show that it is too small to have received any money from Hua Han;
  - Falsifying average bank balance of HK\$2.52bn during FY13 against our estimated HK\$584m based on the average interest rate acid test; and
  - Together with the non-existent HK\$437m receivables, thus creating an asset black hole of at least HK\$2.8bn at the end of FY13. This resulted in net tangible assets of merely HK\$1.73bn at the end of FY13, or just 38% of the shareholders' equity claimed by the company.
- We are convinced that the company is worth next to nothing and that its management must be criminally prosecuted. For a long-running case of criminal deception, the only appropriate regulatory action is Delisting.

# Hua Han – Bad for Your Financial Health

## Table of Contents

<b>Part 1. Key Products Revenue Hugely Inflated.....</b>	<b>8</b>
1.1. <i>Yi Fu and Yi Bei Revenue Inflated by 2.4x</i> .....	10
1.1.1. Products with 80% Market Share and 1.6x National rhEGF Sales?.....	11
1.1.2. Actual Sales Volume of Yi Fu and Yi Bei .....	12
1.1.3. We Estimate Actual Sales at 1/3 of Claim .....	13
1.2. <i>Qijiao Shengbai Capsules Revenue Exaggerated by 2.7x</i> .....	15
1.2.1. Sinohealth Intelligence Data Show Retail Value of Rmb154m .....	15
1.2.2. Qijiao Shengbai Capsules Production Volume .....	16
1.2.3. Qijiao Shengbai Capsules Revenue Estimates .....	17
1.3. <i>Fuke Zaizaowan (including capsules) Revenue Inflated by 2.7x</i> .....	18
1.3.1. Sales Volume of Fuke Zaizaowan (including capsules).....	18
1.3.2. Estimated Sales Revenue of Fuke Zaizaowan (including capsules).....	20
1.4. <i>The Non-existent Golden Peptides</i> .....	20
1.4.1. Disconnected Distributors .....	21
1.4.2. Shenzhen Spa Chain Has No Golden Peptides on Offer .....	22
1.4.3. Guizhou Factor' Staff Never Heard of Golden Peptides .....	23
1.5. <i>Real Revenue About a Quarter of Hua Han's Claim</i> .....	24
<b>Part 2. Outrageous Evidence from Enterprise Credibility Information System.....</b>	<b>25</b>
2.1. <i>Subsidiaries' Revenues Total Less Than a Third of Hua Han Claim</i> .....	26
2.2. <i>Analysis of Revenue Swings in Subsidiaries</i> .....	27
2.3. <i>Two Estimates of Hua Han Total Revenue</i> .....	29
<b>Part 3. HK\$2.8bn of Asset Black Hole .....</b>	<b>31</b>
3.1. <i>The Rmb200m Black Hole of Prepaid Land Lease Payment for Shawen</i> .....	31
3.1.1. Real Land Cost Only 1/3 of Hua Han's Claim.....	32
3.1.2. The Land was NOT bought by Hua Han .....	33
3.2. <i>The Rmb405m Placental Serum Albumin Equipment Black Hole</i> .....	38
3.3. <i>Non-existent Cash of HK\$2.0bn</i> .....	40
3.4. <i>The HK\$437m Receivables Black Hole</i> .....	42
3.5. <i>Estimates of Tangible Asset Value</i> .....	42
<b>Part 4. Hidden Connected Transactions.....</b>	<b>44</b>
4.1. <i>Sale of Hechuang Pharmaceutical in 2007</i> .....	44
4.2. <i>Sale of Hanfang Guomei in 2011</i> .....	47
4.3. <i>Sale of rhEGF's Technical Knowhow in 2011</i> .....	49
<b>Part 5. Financials and Valuation .....</b>	<b>52</b>
5.1. <i>Estimates of Real Profitability</i> .....	52
5.2. <i>Valuation</i> .....	52
<b>Appendix I: Analysis of Prices of Key Products .....</b>	<b>53</b>

# Hua Han – Bad for Your Financial Health

<i>I.1. Pharmaceutical Pricing System in China</i> .....	53
I.1.1. Key Prices in Pharmaceutical Industry .....	53
I.1.2. Price Assumptions in Hua Han Main Report .....	55
<i>I.2. Successful Tender Price of Key Products</i> .....	57
I.2.1. Successful Tender Prices of Yi Fu & Yi Bei .....	57
I.2.2. Successful Tender Prices of Qijiao Shengbai capsules .....	58
I.2.3. Successful Tender Prices of Fuke Zaizaowan (including capsules) .....	59
<i>I.3. Ex-factory Price of Key Products</i> .....	61
I.3.1. Ex-factory Prices of Yi Fu & Yi Bei .....	61
I.3.2. Ex-factory price of Qijiao Shengbai capsules .....	62
I.3.3. Ex-factory Prices of Fuke Zaizaowan (including capsules) .....	62
<b>Appendix II: Comparison of SAIC filings and annual reports by all Guizhou listed companies</b> .....	64
<b>Appendix III: Key Financial Statistics for Hua Han Subsidiaries 2013-2014</b> .....	65
<b>Appendix IV: Land Price of Shawen Park and Land Transactions in Liupanshui and Tongren</b> .....	68

# Hua Han – Bad for Your Financial Health

## List of Exhibits and Audio Evidences

Exhibit 1 – Revenue Breakdown FY12-15	8
Exhibit 2 – Half-yearly Revenue Breakdown FY11-1HFY14	9
Exhibit 3 – Revenue in Rmb by Calendar Year	9
Exhibit 4 – Market Size of rhEGF Products in China	11
Exhibit 5 – Sales Comparison Yi Fu and Yi Bei Vs. rhEGF Products in China	11
Exhibit 6 – Partial Screen Capture of <a href="http://pavay.com/about.php">http://pavay.com/about.php</a> on November 26, 2013	13
Exhibit 7 – Yi Fu and Yi Bei Sales Revenue Estimate, 2011	14
Exhibit 8 – Estimates of Real Yi Fu and Yi Bei Sales Revenue, 2011-2013	14
Exhibit 9 – Top 20 Antitumor Traditional Chinese Medicines Retail Market in 2013	15
Exhibit 10 – Qijiao Shengbai capsules Retail Market by Channels in 2013	16
Exhibit 11 – Qijiao Shengbai Capsules Revenue Estimate, 2013	18
Exhibit 12 – Estimated Revenue of Fuke Zaizaowan (including capsules), 2013	20
Exhibit 13 – Revenue Comparison, 2013	24
Exhibit 14 – Guiyang DCX's Annual Public Disclosures	25
Exhibit 15 – Guiyang DCX Key Financial Statistics 2013	26
Exhibit 16 – Revenue by Manufacturers 2013	27
Exhibit 17 – Subsidiaries' Revenue Change, 2013-2014	28
Exhibit 18 – Changes in Hua Han's Pharmaceutical Manufacturers	28
Exhibit 19 – Revenue Estimate by Products, 2013	29
Exhibit 20 – Revenue Estimates by Subsidiaries 2013	30
Exhibit 21 – Deposits Breakdown	31
Exhibit 22 – Three pieces of land "related" to Hua Han at Shawan Park	33
Exhibit 23 – Hanfang Group's Site 03-03-04-02 at Shawen Park	34
Exhibit 24 – Shareholders of Hanfang Group and their Roles in Hua Han	35
Exhibit 25 – Beike Factorr's Site 03-03-04-01 at Shawen Park	36
Exhibit 26 – Hanfang Guomei's Site 03-03-05 at Shawen Park	37
Exhibit 27 – Summary of Lands Held by Hua Han's Related Parties in Shawen Park	38
Exhibit 28 – Guizhou Shunzhi Key Financial Statistics 2014	39
Exhibit 29 – Hua Han's Average Deposit Interest Rates 2011-15	41
Exhibit 30 – Hua Han Cash Shortfall	42
Exhibit 31 – Hua Han receivables black hole 2013	42
Exhibit 32 – Hua Han Asset Discrepancy FY13	43
Exhibit 33 – Zhang Peter Y. attending Hechuang Group's third quarter meeting on October 16, 2015	45
Exhibit 34 – Hechuang Group's senior management	46
Exhibit 35 – Yang Chengquan elected chairman and appointed deputy general manager	47
Exhibit 36 – Equity Transfer Agreement of Hanfang Guomei	48
Exhibit 37 – Basic information of Xingda Yongsheng	50
Exhibit 38 – Biographical Details of Mr. Zhang Bing Sheng	50
Exhibit 39 – Hua Han Real Profitability 2015	52
Exhibit 40 – Tender prices vs. ex-factory prices of key products	55
Exhibit 41 – Hua Han invoicing mode analysis	56
Exhibit 42 – Highest tender prices vs. overall average tender prices of key products	57
Exhibit 43 – Range and average of Yi Fu tender prices	57
Exhibit 44 – Range and average of Yi Bei tender prices	58
Exhibit 45 – Range and average of Qijiao Shengbai capsules tender prices	58
Exhibit 46 – Sales receipt of Qijiao Shengbai capsules	59
Exhibit 47 – Range and average of Fuke Zaizaowan tender prices	59

## Hua Han – Bad for Your Financial Health

Exhibit 48 – Sales receipt for Fuke Zaizaowan	60
Exhibit 49 – Range and average of Fuke Zaizao capsules tender prices	61
Exhibit 50 – Range and average price of Yi Fu ex-factory prices	61
Exhibit 51 – Range and average of Yi Bei ex-factory prices	62
Exhibit 52 – Range and average of Qijiao Shengbai capsules ex-factory prices	62
Exhibit 53 – Range and average of Fuke Zaizaowan ex-factory prices	62
Exhibit 54 – Range and average of Fuke Zaizao capsules ex-factory prices	63
Exhibit 55 – Guiyang DCX Key Financial Statistics 2013	65
Exhibit 56 – Guiyang DCX Key Financial Statistics 2014	65
Exhibit 57 – GHMM Key Financial Statistics 2013	66
Exhibit 58 – GHMM Key Financial Statistics 2014	66
Exhibit 59 – Hanfang Pharma Key Financial Statistics 2013	67
Exhibit 60 – Hanfang Pharma Key Financial Statistics 2014	67
Exhibit 61 – Shawan Park land ownership	68
Exhibit 62 – Summary of Shawen Park Industrial Land Transactions	69
Exhibit 63 – Land Transaction Information for Liupanshui Hospital	70
Exhibit 64 – Land Transaction Information for Tongren Stem Cell Factory	70
Audio Evidence 1 – Telephone Conversation with Engineer W on Qijiao Shengbai Capsules	16
Audio Evidence 2 – Conversation with Sales Q on Qijiao Shengbai Capsules	17
Audio Evidence 3 – Telephone Conversation with Engineer W on Fuke Zaizaowan	19
Audio Evidence 4 – Telephone Conversation with Sales Z on Fuke Zaizaowan	19
Audio Evidence 5 – Conversation with Sales Q on Fuke Zaizao capsules	20
Audio Evidence 6 – Guizhou Factorr Staff Confirms Golden Peptides Do Not Exist	23
Audio Evidence 7 – Telephone Conversation with Director F	32
Audio Evidence 8 – Telephone Conversation with Guizhou Shunzhi Staff	40

# Hua Han – Bad for Your Financial Health

## 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.**

**We and/or our associates/partners may have long or short positions in the equities and/or their derivatives at the time of publication of our reports, and we and/or our associates/partners may maintain or change our positions at any time.**

# Hua Han – Bad for Your Financial Health

The Guizhou-based Hua Han Health Industry Holdings Limited (formerly known as Hua Han Bio-Pharmaceutical Holdings Limited) was listed in Hong Kong at the end of 2002. Initially a small manufacturer of traditional Chinese medicines, it has over the years diversified into the manufacture of Western drugs and bio-drugs, health food supplements, medicines trading as well as hospital operations.

Our investigations have shown that the company has doctored its books for years mainly by inflating its revenue (and therefore profit), by pretending to buy certain assets that do not actually exist, and by disposing of assets to related parties. A clear sign of suspicious accounting is Hua Han's deteriorating quality of disclosure.

One of the most crucial issues is that the company stopped revealing the sales revenue breakdown of its key products from the second half of the fiscal year ended June 30, 2014. The management may argue that there's no need to disclose revenue breakdown by key pharmaceutical products because the company has diversified into hospital operations. In reality, hospital operations contributed no revenue in FY14. In FY15, sales of pharmaceutical products still accounted for 88% of total revenue, as can be seen in the following table.

<b>Year end Jun 30 (HK\$ m)</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>2015 proportion</b>
Gross revenue from manufacturing	1,523	1,879	1,758	1,659	
- Rebates	-412	-162	-48	-59	
Manufacturing	1,110	1,717	1,711	1,600*	<b>88%</b>
Trading business	202	37	150		
Hospital management services				29	<b>2%</b>
Hospital supply chain business				192	<b>11%</b>
<b>Total</b>	<b>1,312</b>	<b>1,754</b>	<b>1,860</b>	<b>1,821</b>	<b>100%</b>
Rebates as % of gross revenue from manufacturing	27.1%	8.6%	2.7%	3.5%	

Sources: *Hua Han annual reports*

\*No separate disclosure for manufacturing and trading businesses

It is important to note that our analysis of Hua Han based on its own disclosures in the previous two to three years is still applicable now because pharmaceutical manufacturing still accounts for the majority of its revenue.

## Part 1. Key Products Revenue Hugely Inflated

Hua Han provided revenue breakdown by products in its Management Discussion and Analysis (MD&A) section only from the interim report for the FY12, but discontinued such disclosure in the second half of the FY14. The numbers for FY11 in the following table are derived from the FY12 growth rates reported.



# Hua Han – Bad for Your Financial Health

**Exhibit 2 – Half-yearly Revenue Breakdown FY11-1HFY14**

Year end Jun 30 (HK\$ m)	11H1	11H2	FY11	12H1	12H2	FY12	13H1	13H2	FY13	14H1
<b>Revenue</b>	<b>550</b>	<b>607</b>	<b>1,157</b>	<b>895</b>	<b>417</b>	<b>1,312</b>	<b>1,026</b>	<b>728</b>	<b>1,754</b>	<b>1,364</b>
Manufacturing	550	607	1,157	748	362	1,110	1,011	706	1,717	1,262
Trading business				147	55	202	15	22	37	101
<b>Prescription drugs</b>										
Qijiao Shengbai capsules	56	53	109	117	126	243	205	226	431	392
Zhisou Huatan pills	17	22	38	35	23	58	44	37	80	69
Yi Fu & Yi Bei	133	158	291	188	217	405	261	178	439	269
<b>OTC drugs</b>										
Fuke Zaizaowan (including capsules*)	102	107	209	145	180	325	210	196	406	264
<b>Dietary supplement</b>										
Golden Peptides							32	26	58	45

Sources: Hua Han annual and Interim reports

\*Fuke Zaizao capsules are a prescription drug

A particular confusion involves the prescription drugs Yi Fu and Yi Bei. In the interim report for FY12, Hua Han disclosed the "sales revenue" for these products, in line with the reporting of other products. Subsequently, it disclosed "gross sales revenue ... before deducting rebates" for these products instead. From Exhibit 1, it can be seen that rebates have always represented a small proportion of gross manufacturing revenue, except in FY12. We therefore believe that treating "gross sales revenue ... before deducting rebates" as identical to "sales revenue" will not have any major impact on our analysis and conclusion.

To facilitate our comparison with China domestic data, we have adjusted revenue of key products to calendar year basis by combining data from the second half of the previous fiscal year with those from the first half of the following fiscal year. We have also translated the Hong Kong dollar numbers into Rmb numbers using average exchange rates prevailing in the relevant periods. The result is presented below in Exhibit 3.

**Exhibit 3 – Revenue in Rmb by Calendar Year**

Year end Dec 31 (Rmb m)	2011	2012	2013	Total
<b>Revenue</b>	<b>1,247</b>	<b>1,174</b>	<b>1,671</b>	<b>4,092</b>
Manufacturing	1,125	1,117	1,572	<b>3,815</b>
Trading business	122	57	99	<b>278</b>
<b>Prescription drugs</b>				
Qijiao Shengbai capsules	141	270	494	<b>905</b>
Zhisou Huatan pills	47	54	85	<b>186</b>

## Hua Han – Bad for Your Financial Health

Yi Fu & Yi Bei	287	389	357	<b>1,033</b>
<b>OTC drugs</b>				
Fuke Zaizaowan (including capsules)	209	317	368	<b>894</b>
<b>Dietary supplement</b>				
Golden Peptides		26	57	<b>83</b>
<b>Sum of key products</b>	<b>684</b>	<b>1,055</b>	<b>1,360</b>	<b>3,100</b>
Key products as % of manufacturing	60.8%	94.4%	86.5%	<b>81.3%</b>

Source: Emerson Analytics

Revenue is driven by two components, volume and average price, both of which Hua Han has withheld from the investing public. We have done extensive research to ascertain these two drivers, by digging through various public information sources and by talking to people familiar with the company's operations.

In the following pages we will show that, using assumptions that are most advantageous to the company, Hua Han has:

- inflated its revenue of Yi Fu and Yi Bei by 2.4 times, from our estimated Rmb105m to its reported Rmb357m equivalent;
- over-reported its revenue of Qijiao Shengbai capsules by 2.7 times to a reported Rmb494m from our estimated Rmb134m;
- exaggerated its revenue of Fuke Zaizaowan (including capsules) by 2.7 times, from our estimated Rmb100m to its reported Rmb368m; and
- fabricated revenue of Rmb57m for the Golden Peptides dietary supplement, when it actually sold next to nothing.

All in all, we reckon that real revenue for the above products was only Rmb339m in 2013, about 26.6% of that reported by Hua Han.

### 1.1. Yi Fu and Yi Bei Revenue Inflated by 2.4x

Yi Fu and Yi Bei are recombinant human epidermal growth factor (rhEGF) drugs. During 2011-13, they were Hua Han's most important products with total sales of Rmb1.03bn, accounting for 25.2% of the company's revenue during the three-year period.

Yi Fu, an rhEGF gel, is used mainly for the treatment of burns. Yi Bei, an rhEGF eye drops, is mainly used for the treatment of corneal mechanical injuries.

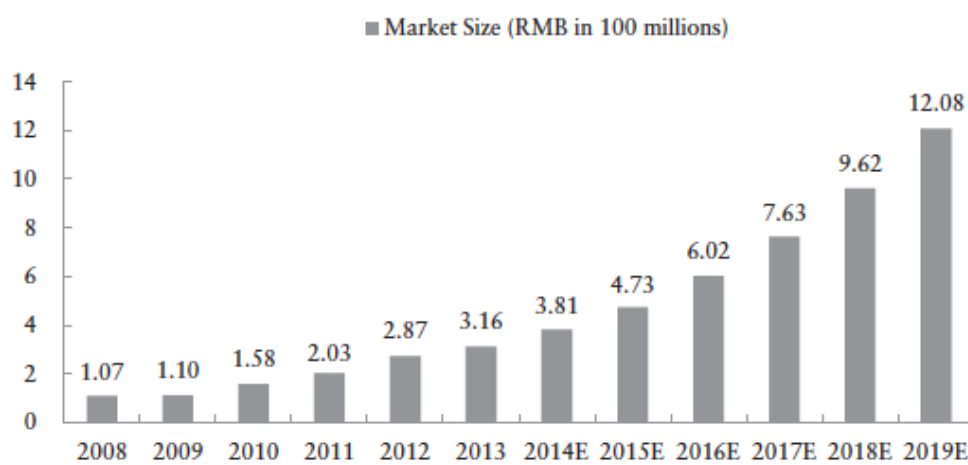
Yi Fu and Yi Bei are produced by Guilin Pavay Gene Pharmaceutical Co., Ltd. (Guilin Pavay), in which Hua Han acquired a 52% stake in July 2008.

# Hua Han – Bad for Your Financial Health

## 1.1.1. Products with 80% Market Share and 1.6x National rhEGF Sales?

Southern Medicine Economic Research Institute (SME) is a unit of the official China Food and Drug Administration and specializes in analyzing the pharmaceutical market. It has estimated that the entire market size of rhEGF products at the retail level in China in 2011 was Rmb203m. The relevant information can be found in the IPO prospectus of Shanghai Haohai Biological Technology Co., Ltd. (stock code 6826.HK) dated April 20, 2015, shown below:

**Exhibit 4 – Market Size of rhEGF Products in China**



Source: SME Research

Note: The market size is calculated in terms of sales to end users.

Source: Haohai Biological IPO prospectus, p.68

A comparison of Hua Han's disclosure with SME's national data shows that sales revenue of Yi Fu and Yi Bei claimed by the company turned out to be about 1.4x the total national retail revenue of all rhEGF products! This is shown below in Exhibit 5.

In China, the retail price of pharmaceutical products should be at least 1.15x of manufacturer's ex-factory price (see Appendix I: Analysis of Prices of Key Products). This implies that the retail value of Hua Han's Yi Fu and Yi Bei products were as much as 1.6x the national retail value of all rhEGF products.

**Exhibit 5 – Sales Comparison Yi Fu and Yi Bei Vs. rhEGF Products in China**

Year end Dec 31 (Rmb m)	2011	2012	2013
Hua Han's claim of Yi Fu & Yi Bei revenue	287	389	357
Minimum retail sales value of Yi Fu & Yi	330	447	410

# Hua Han – Bad for Your Financial Health

Bei (1.15x ex-factory price)

National retail sales value of all rhEGF products in China	203	287	316
Hua Han's claimed revenue as % of national retail revenue	141%	136%	113%
Yi Fu & Yi Bei retail revenue as % of national retail revenue	162%	156%	130%

Source: Emerson Analytics

SME data in p.69 of the [Haohai Biological IPO prospectus](#) also show the respective market shares of various manufacturers in the Chinese rhEGF market. Guilin Pavay achieved market shares of 81.8%, 76.7% and 73.4%, respectively, during 2011-13.

Yi Fu and Yi Bei were estimated by SME to have about 80% market share, but Hua Han dared claim sales revenue that exceeded the estimated national retail value of all rhEGF products. This is totally ludicrous.

## 1.1.2. Actual Sales Volume of Yi Fu and Yi Bei

Although Hua Han has been very careful and never disclosed the sales volume of Yi Fu and Yi Bei, Guilin Pavay did disclose its 2011 volume in its own website <http://www.pavay.com/>. Note that when we say "did", we mean there "was" such information in the website, not that there "is" still such information "now".

But how do we know? Well, on the Internet there is a very useful Internet archive tool, <https://archive.org/>. With this, we can trace through the history of Guilin Pavay's website. Our search shows that from March 2, 2001 through August 11, 2015, the archive saved Guilin Pavay's website a total of 89 times. As for the webpage <http://pavay.com/about.php>, which we will refer to later, it was saved five times from March 15, 2012 through February 22, 2015. The five versions of this webpage can be accessed via the links below:

May 15, 2012:<http://web.archive.org/web/20120515100036/http://www.pavay.com/about.php>  
June 17, 2012:<http://web.archive.org/web/20120617212036/http://www.pavay.com/about.php>  
October 28, 2013:<http://web.archive.org/web/20131028150848/http://www.pavay.com/about.php>  
November 26, 2013:<http://web.archive.org/web/20131126150724/http://pavay.com/about.php>  
February 22, 2015:<http://web.archive.org/web/20150222033153/http://pavay.com/about.php>

# Hua Han – Bad for Your Financial Health

As far as we can tell, the three versions of the webpage <http://pavay.com/about.php> on June 17, 2012, October 28, 2013 and November 26, 2013 are identical. A partial screen capture of the November 26, 2013 version is shown below:

## Exhibit 6 – Partial Screen Capture of <http://pavay.com/about.php> on November 26, 2013

经过八年努力，我公司开发的两个核心产品“易贝”（rhEGF滴眼液）和“易孚”（rhEGF凝胶）获得国家食品药品监督管理局颁发的一类新药证书，2000年公司投入过亿资金在桂林建设基因药物生产基地，滴眼液、凝胶年产能力分别为300万支、200万支。生产车间经过国家食品药品监督管理局认证中心检查，通过GMP认证，获得生产批文，产品已投入市场。  
**Production capacity is 3m doses of Yi Bei and 2m doses of Yi Fu a year**

公司通过8年多市场培育，重组人表皮生长因子滴眼液、重组人表皮生长因子凝胶市场集中在大中城市1000多家三甲医院，2011年重组人表皮生长因子滴眼液、重组人表皮生长因子凝胶销售量分别为200万支、100万支，随着公司销售力度加大，预计2013年产品将覆盖1500家三甲医院。  
**Sales volume of 2m doses of Yi Bei and 1m doses of Yi Fu in 2011**

Source: <http://web.archive.org/web/20131126150724/http://pavay.com/about.php>

According to the data disclosed above by Guilin Pavay on its own website, the company's production capacity was 2m doses of Yi Fu and 3m doses of Yi Bei a year. In 2011, it sold 1m doses of Yi Fu and 2m doses of Yi Bei.

The current version of the webpage <http://pavay.com/about.php> looks very much like the previous version of the same page, except that the reference to 2011 sales volume was deleted.

Our experience has taught us that deleting information is a clear signal that the perpetrator is trying to hide some important facts. In this case, Hua Han is trying to hide the sales volume of Yi Fu and Yi Bei.

When we estimate Hua Han's actual revenue, our calculations will be based on sales volume of 1m doses of Yi Fu and 2m doses of Yi Bei in 2011. This is to the advantage of the company, because generally speaking a company tends not to under-report its data.

### 1.1.3. We Estimate Actual Sales at 1/3 of Claim

Chinese pharmaceutical selling price is a complex subject. Appendix I to this report contains a brief description of China's pharmaceutical pricing system and a detailed analysis of Hua Han's product prices.

Of particular importance is "Section I.1.2 Price Assumptions in Hua Han Main Report". Readers shall go through that section for a basic understanding of our argument as the fundamental information is not repeated here.

## Hua Han – Bad for Your Financial Health

Based on our discussions of the sales volume (Section 1.1.2 of the main report above) and selling prices of Yi Fu and Yi Bei (Section I.2.1. of Appendix I), we can now estimate the sales revenue of the two products in 2011 as follows:

<b>Year end Dec 31 (Rmb m)</b>	<b>Highest price</b>	<b>Overall average price</b>
Sales volume (m boxes)		
-Yi Fu	1.0	1.0
-Yi Bei	2.0	2.0
ASPs (Rmb/box)		
-Yi Fu	57.2	44.3
-Yi Bei	39.4	27.1
Revenue – our estimate*	116	84
Revenue – Hua Han's claim	287	287
Our estimate as % of Hua Han's claim	40.5%	29.4%

Source: Emerson Analytics

\* Excluding VAT (same for subsequent analysis)

We can see that, based on the overall average tender prices, our estimated sales revenue of Yi Fu and Yi Bei combined in 2011 was only 29.4% of the amount reported by Hua Han.

Based on the highest tender price (i.e. assuming that Hua Han only sold Yi Fu in 20g:100000IU doses and Yi Bei in 4ml:400000IU doses), our estimated sales revenue of Yi Fu and Yi Bei was only 40.5% of that reported by the company.

Of these two methods, we believe the average price analysis is closer to the truth.

Applying the same 29.4% ratio to subsequent years, we estimate Hua Han's actual revenue from Yi Fu and Yi Bei amounted to merely Rmb105m in 2013, as shown in Exhibit 8 below.

<b>Year end Dec 31 (Rmb m)</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Revenue – Hua Han's claim	287	389	357
x Our estimate as % of Hua Han's claim	29.4%	29.4%	29.4%
= Revenue – our estimate	84	114	105

Source: Emerson Analytics

# Hua Han – Bad for Your Financial Health

## 1.2. Qijiao Shengbai Capsules Revenue Exaggerated by 2.7x

Qijiao Shengbai capsules are an antitumor traditional Chinese medicine (TCM) said to be effective in promoting the growth of white blood cells and therefore beneficial to a patient recovering from chemotherapy. They are produced by Guiyang De Chang Xiang Pharmaceutical Company Limited (Guiyang DCX) before 2014, in which Hua Han acquired an 80.4% stake for Rmb68.8m in late 2004 from independent third parties.

According to Hua Han, Qijiao Shengbai capsules achieved sales revenue of Rmb494m in 2013 and was the biggest selling product accounting for 29.6% of the company's revenue.

Our analysis shows that this is a huge lie!

### 1.2.1. Sinohealth Intelligence Data Show Retail Value of Rmb154m

Guangzhou Sinohealth Intelligence Co., Ltd. (廣州中康醫藥資訊有限公司, Sinohealth Intelligence) is another leading supplier of China's health industry information and data. We have obtained from them detailed retail sales data for antitumor TCM in 2013. Such information includes the name, dosage, manufacturer, sales revenue, sales volume and average price for all relevant drugs.

We have consolidated and ranked the detailed numbers supplied by Sinohealth Intelligence, and present the 20 best selling products in this category, as shown in Exhibit 9 below.

**Exhibit 9 – Top 20 Antitumor Traditional Chinese Medicines Retail Market in 2013**

Rank	Product	Sales to end users (Rmb m)
1	康艾注射液	2,381.7
2	參芪扶正注射液	1,761.7
3	艾迪注射液	1,624.6
4	復方苦參注射液	1,009.3
5	鴉膽子油乳注射液	820.6
6	康萊特注射液	696.0
7	消癌平注射液(靜脈注射)	579.0
8	復方斑蝥膠囊	549.8
9	槐耳顆粒	310.0
10	參壹膠囊	261.9
11	地榆升白片	211.3
12	華蟾素注射液	193.8
13	西黃丸	180.4
14	金龍膠囊	176.8
<b>15</b>	<b>Qijiao Shengbai capsules</b>	<b>153.6</b>
16	華蟾素膠囊	150.8
17	華蟾素片	147.8

# Hua Han – Bad for Your Financial Health

18	復方紅豆杉膠囊	139.6
19	貞芪扶正顆粒(無糖型)	137.9
20	平消膠囊	136.4

Source: Sinohealth Intelligence

According to Sinohealth Intelligence's data, Qijiao Shengbai capsules achieved retail sales of Rmb153.6m, way below the Rmb494m revenue reported by Hua Han.

Sinohealth Intelligence also supplies revenue and volume data by sales channels for individual products. In 2013, Qijiao Shengbai capsules were mainly sold through municipal hospitals, which accounted for 68% of total revenue. According to Sinohealth Intelligence, Hua Han sold 2.59m boxes of Qijiao Shengbai capsules at an average Rmb59.3 per box.

**Exhibit 10 – Qijiao Shengbai capsules Retail Market by Channels in 2013**

Channels	Revenue (Rmb m)	Volume (m boxes)	Average price (Rmb/box)
Municipal hospitals	103.9	1.72	60.2
City grassroot hospitals	1.2	0.02	51.2
County hospitals	45.0	0.78	57.6
Village hospitals	2.0	0.04	54.0
Retail outlets	1.6	0.02	68.0
<b>Total</b>	<b>153.6</b>	<b>2.59</b>	<b>59.3</b>

Source: Sinohealth Intelligence

Taking off the 15% markup, it is clear that medical institutions in China spent no more than Rmb134m purchasing this product in 2013. Hua Han has inflated Qijiao Shengbai capsules' sales revenue by at least 3.7x!

## 1.2.2. Qijiao Shengbai Capsules Production Volume

We have listened to the telephone conversation between a potential customer of Guiyang DCX and its engineer, referred to as W below, with regard to the production volume of Qijiao Shengbai capsules. An English translation of the transcript follows:

**Audio Evidence 1 – Telephone Conversation with Engineer W on Qijiao Shengbai Capsules**

Potential customer:	How many lots of Qijiao Shengbai capsules can you produce a month?
Hua Han Engineer W:	It's about seven to eight lots of Qijiao Shengbai capsules every month.
Potential customer:	Is there a fixed number of boxes per lot?
Hua Han Engineer W:	Yes, it's fixed. There are 45 thousand boxes of Qijiao Shengbai capsules per lot.
Potential customer:	Forty-five thousand boxes of Qijiao Shengbai capsules per lot?



## Hua Han – Bad for Your Financial Health

Hua Han Engineer W:	Yes.
Potential customer:	So, how many pills are there in each box?
Hua Han Engineer W:	There are 36 pills per box.
Potential customer:	So, they are all 36 pills per box?
Hua Han Engineer W:	Yes.

Source: Emerson Analytics

Assuming a monthly output of 7.5 lots, the annual production volume is therefore:

45,000 boxes x 7.5 lots x 12 months= 4,050,000 boxes

The information provided by Engineer W is confirmed by a Guiyang DCX sales executive, referred to below as Q.

### **Audio Evidence 2 – Conversation with Sales Q on Qijiao Shengbai Capsules**

Potential customer:	The Qijiao Shengbai capsules, how many are we selling throughout the country now?
Hua Han Sales Q:	You mean selling how many boxes?
Potential customer:	Yes.
Hua Han Sales Q:	Nationwide?
Potential customer:	Yes.
Hua Han Sales Q:	Nationally, more than 4m boxes.
Potential customer:	More than 4m boxes?
Hua Han Sales Q:	Yes.

Source: Emerson Analytics

The above conversations were recorded in the second half of calendar year 2015. We are sharing the audio recordings and the relevant information such as the interviewees' names, positions, contact telephone numbers and dates of meeting with the Securities and Futures Commission (SFC) of Hong Kong.

### **1.2.3. Qijiao Shengbai Capsules Revenue Estimates**

Assuming that Hua Han had sold 4.05m boxes of Qijiao Shengbai capsules in 2013, it could have achieved revenue of Rmb243m on price of Rmb67.7 per box. This implies that the company has exaggerated the revenue of Qijiao Shengbai capsules by one fold. Even if the company's average selling price was the same as the highest tender price of Rmb92.2 a box, the estimated revenue was only 65% of Hua Han's claim.

# Hua Han – Bad for Your Financial Health

**Exhibit 11 – Qijiao Shengbai Capsules Revenue Estimate, 2013**

<b>Year end Dec 31 (Rmb m)</b>	<b>Highest price</b>	<b>Overall average price</b>
Sales volume (m boxes)	4.05	4.05
ASPs (Rmb/box)	92.2	67.7
Revenue – our estimate	319	243
Revenue – Hua Han's claim	494	494
Our estimate as % of Hua Han's claim	64.6%	47.5%

Source: Emerson Analytics

According to Sinohealth Intelligence's data, the cost of Qijiao Shengbai capsules to medical institutions in the whole year should not exceed Rmb134m in 2013, compared with our estimated Rmb243m under this method. The deviation was mainly because the recent sales volume that we have obtained was 56% more than the actual volume in 2013.

In our analysis below, we will take Rmb134m as Hua Han's actual sales revenue in 2013 from Qijiao Shengbai capsules.

### **1.3. Fuke Zaizaowan (including capsules) Revenue Inflated by 2.7x**

Fuke Zaizaowan is a TCM mainly used for nourishing Chinese women and is sold over the counter. Fuke Zaizao capsules have the same ingredients as Fuke Zaizaowan but are sold in different dosages as a prescription drug. They are produced by Guiyang DCX before 2014, which also produced Qijiao Shengbai capsules, as we have noted in section 1.2 above.

Fuke Zaizaowan (including capsules) was Hua Han's second most important pharmaceutical product in 2013 with reported revenue of Rmb368m, or 22% of total revenue.

However, based on the relevant volume and average price data that we have obtained, we reckon Hua Han only sold Rmb100m worth of this product in 2013.

#### **1.3.1. Sales Volume of Fuke Zaizaowan (including capsules)**

A telephone conversation in 2H15 between a potential Hua Han customer and Engineer W in Guiyang DCX revealed the sales volume of Fuke Zaizaowan.

# Hua Han – Bad for Your Financial Health

## **Audio Evidence 3 – Telephone Conversation with Engineer W on Fuke Zaizaowan**

Potential customer:	How many Fuke Zaizaowan are you producing a month now?
Hua Han Engineer W:	Each lot is 200 cartons, and we produce about seven to eight lots a month, that makes more than a thousand cartons.
Potential customer:	What?
Hua Han Engineer W:	More than a thousand cartons, about seven to eight lots. Each month we produce seven to eight lots of Fuke Zaizaowan.
Potential customer:	You said more than a thousand cartons?
Hua Han Engineer W:	Yes, a carton is a big box. A lot is 40,000 boxes. There are 200 cartons in a lot, so there are 40,000 boxes in a lot. And we produce about seven to eight lots a month.

Source: Emerson Analytics

According to Engineer W:

- 1 lot = 200 cartons = 40,000 boxes
- Hua Han produces 7-8 lots a month

Assuming a monthly output of 7.5 lots, the annual production volume of Fuke Zaizaowan is therefore:

$$40,000 \text{ boxes} \times 7.5 \text{ lots} \times 12 \text{ months} = 3,600,000 \text{ boxes}$$

Another telephone conversation between a potential customer of Guiyang DCX and its sales executive, referred to as Z below, reveals that that sales volume of Fuke Zaizaowan and Fuke Zaizao capsules amounted to about 3:1. Thus the sales volume of Fuke Zaizao capsules is:

$$3,600,000 \text{ boxes} / 3 = 1,200,000 \text{ boxes}$$

## **Audio Evidence 4 – Telephone Conversation with Sales Z on Fuke Zaizaowan**

Potential customer:	What is the approximate ratio of Fuke Zaizaowan and Fuke Zaizao capsules?
Hua Han Sales Z:	You mean in terms of sales volume?
Potential customer:	Yes, in sales volume.
Hua Han Sales Z:	In terms of sales, it's about 3:1.
Potential customer:	3:1 right? So three Fuke Zaizaowan to one Fuke Zaizao capsules, right?
Hua Han Sales Z:	Yes.

Source: Emerson Analytics

The above information is confirmed by sales executive Q in Guiyang DCX. The conversation transcript is translated as follows:

# Hua Han – Bad for Your Financial Health

## Audio Evidence 5 – Conversation with Sales Q on Fuke Zaizao capsules

Potential customer:	How many Fuke Zaizao capsules are you selling in the country now?
Hua Han Sales Q:	Nationally, more than 1m boxes.
Potential customer:	More than 1m boxes?
Hua Han Sales Q:	Yes.

Source: Emerson Analytics

### 1.3.2. Estimated Sales Revenue of Fuke Zaizaowan (including capsules)

Based on our estimated sales volume and average successful tender prices, we believe Hua Han was able to sell approximately Rmb100m worth of Fuke Zaizaowan (including capsules) in 2013.

Note that we are using the current sales volume, which is presumably higher than that actually achieved by the company in 2013. This is to the immense advantage of Hua Han.

Even after conceding such an advantage to the company, we can see that our estimated sales revenue for Fuke Zaizaowan (including capsules) was only one third of the number reported by Hua Han, as shown in Exhibit 12 below.

## Exhibit 12 – Estimated Revenue of Fuke Zaizaowan (including capsules), 2013

Year ended Dec 31 (Rmb m)	Highest price	Overall average price
Sales volume (m boxes)		
- Fuke Zaizaowan	3.6	3.6
- Fuke Zaizao capsules	1.2	1.2
ASPs (Rmb/box)		
- Fuke Zaizaowan	23.5	21.4
- Fuke Zaizao capsules	42.7	33.3
Revenue – our estimate	116	100
Revenue – Hua Han's claim	368	368
Our estimate as % of Hua Han's claim	31.6%	27.2%

Source: Emerson Analytics

### 1.4. The Non-existent Golden Peptides

Golden Peptides are a placenta-based dietary supplement produced by Guizhou Factorr Bio-Technology Co., Ltd. (Guizhou Factorr), a 75% held subsidiary set up by Hua Han. Production of the beverage was

# Hua Han – Bad for Your Financial Health

licensed on May 16, 2013 by the Guizhou Bureau of Quality and Technical Supervision<sup>1</sup>. This line of products also includes the Polar Peptides and UC Small Peptides launched in subsequent years.

The Golden Peptides range of products is supposedly sold through different distributors<sup>2</sup> across the country. According to Hua Han's own data, in 2013 the company achieved revenue of Rmb57m for its Golden Peptides, the fifth largest sales product.

However, we have had no luck in buying such a tremendous product despite all our efforts to find the various distribution channels, including the chain of beauty salon mentioned by the management as a key distributor. Staff at the manufacturer, Guizhou Factorr, even told us they had never heard of such products.

## 1.4.1. Disconnected Distributors

The Golden Peptides range of products is supposedly distributed by the three entities listed below. Interestingly, each entity is named after one product. However, they were either unreachable or they never responded to our approaches.

- Shenzhen Gital Bio-Technology Company Limited (Shenzhen Gital, 深圳市極肽生物科技有限公司)

Its WeChat (a Chinese mobile messaging service much like Twitter) public number is "gitalmall".

- Guangzhou Golden Peptides Bio-Technology Company Limited (Guangzhou Golden Peptides, 廣州市金紫肽生物科技有限公司)
- UC International Group (Hong Kong) Limited (UC International Group (Hong Kong), 優曦國際集團(香港)有限公司)

The latter two companies share a public WeChat number "UCjinzitai". The two WeChat numbers for the three companies attract very few readers.

Our attempts to contact these companies from mid-July 2015 through April 2016 had been completely futile.

Shenzhen Gital's latest WeChat page<sup>3</sup> listed four telephone numbers as contacts for retailers/agents interested in distributing Golden Peptides. The first two numbers, ending in 1233 and 1865, belong to former employees who have no idea of the current situation. The last one, ending in 5025, was always powered off during our three call attempts. The remaining number, ending in 2009, was answered by someone who simply said that no Golden Peptides was available.

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<sup>1</sup><http://www.gzqts.gov.cn/images/zwxz2012/zfxxgk/xgkml/tzgg/spscjdg/201306/20130605025248602.xls>

<sup>2</sup><http://www.guuzhang.com/forum.php?mod=attachment&aid=NDE2fGMvMTQzY2FfDE0NDYxMDEyODh8MHw5OTY%3D>, p.20

<sup>3</sup>[http://mp.weixin.qq.com/s?\\_biz=MjM5MzlxNDgxMw==&mid=200278741&idx=1&sn=20923a46d28f6b9221a848128f07b131&scene=4#wechat\\_redirect](http://mp.weixin.qq.com/s?_biz=MjM5MzlxNDgxMw==&mid=200278741&idx=1&sn=20923a46d28f6b9221a848128f07b131&scene=4#wechat_redirect)

# Hua Han – Bad for Your Financial Health

The page also lists two advisory hotlines. The 400 toll-free number is connected to a recording that says services are temporarily suspended. The other, a Shenzhen number, is non-existent.

Compared with Shenzhen Gital, the other two companies may give a casual observer the impression that they are doing good business. They continue to update the information in their joint WeChat public number and seem to be conducting some promotional activities. In reality, Hua Han is perpetuating a public deception.

For example, an update on October 23, 2015 invited interested parties to a site visit on November 18-20 to Guiyang<sup>4</sup>. The customer hotline for these promotional activities, 020-22153281, was a landline in Guangzhou. However, our numerous calls to this number on a daily basis from November 2015 through January 2016, at different times of the day, suggested that our calls were forwarded to a mobile number which was always powered off.

After extensive searches on the Internet, we managed to find another contact number for Guangzhou Golden Peptides from a recruitment advertisement placed by the company in December 2012. We called this Guangzhou landline, 020-28848910, several times. The receptionist who answered our calls confirmed that the number belonged to the Guangzhou Golden Peptides but said she and none of the staff had any idea about any Golden Peptides products. She conceded that her boss might know, but no one returned our calls even though we left her our contact number several times.

So, what are these three Golden Peptides distributors doing?

## 1.4.2. Shenzhen Spa Chain Has No Golden Peptides on Offer

Golden Peptides are said to be sold mainly through "established beauty parlors and professional chain stores"<sup>5</sup>. But who are they?

Hua Han has never officially disclosed any such relevant information. However, the WeChat public numbers mentioned above have given us some clues. In September 2013, for example, Shenzhen Gital disclosed that it had reached a strategic co-operation agreement with Shenzhen Spa Moment Investment Development Company Limited (Spa Moment, company website [www.spamoment.net](http://www.spamoment.net)) and had provided two days of closed training for the staff of 25 Spa Moment outlets<sup>6</sup>.

At an investor conference in March 2014, Hua Han CEO Deng Jie cited Spa Moment as an example in explaining the pricing of Golden Peptides<sup>7</sup>.

It seems logical to conclude that Golden Peptides were available at most if not all Spa Moment outlets.

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<sup>4</sup>[http://mp.weixin.qq.com/s?\\_biz=MjM5MjkwMTY5MQ==&mid=400107764&idx=1&sn=a1b39bee643810ed85fc8b3cda85d7d2&scene=4#wechat\\_redirect](http://mp.weixin.qq.com/s?_biz=MjM5MjkwMTY5MQ==&mid=400107764&idx=1&sn=a1b39bee643810ed85fc8b3cda85d7d2&scene=4#wechat_redirect)

<sup>5</sup><http://www.hkxnews.hk/listedco/listconews/SEHK/2013/1030/LTN20131030244.pdf>, p.12

<sup>6</sup>[http://mp.weixin.qq.com/mp/appmsg/show?\\_biz=MjM5MzIxNDgxMw==&appmsgid=10000069&itemidx=1&sign=602e4cac424d02e715c1e34041e6c55c&scene=4#wechat\\_redirect](http://mp.weixin.qq.com/mp/appmsg/show?_biz=MjM5MzIxNDgxMw==&appmsgid=10000069&itemidx=1&sign=602e4cac424d02e715c1e34041e6c55c&scene=4#wechat_redirect)

<sup>7</sup><http://www.guuzhang.com/forum.php?mod=attachment&aid=NDE2fGMvMTQzY2FifDE0NDYxMDEyODh8MHw5OTY%3D>, p.21

# Hua Han – Bad for Your Financial Health

When we called up the head office of Spa Moment in Shenzhen to find out more about Golden Peptides, the receptionist told us that they did not have such products on offer and suggested that we contact their outlets directly.

According to Spa Moment's website, there are 34 Spa Moment outlets in Shenzhen<sup>8</sup>.

Of these 34 outlets, two of them have identical name, address and phone number. One outlet claimed it was not part of Spa Moment, three outlets had their telephones powered off, while two outlets could not be reached by phone.

The remaining 27 outlets were in normal operations, but all of them told us that they had no Golden Peptides, Polar Peptides and UC Small Peptides on offer. There was no exception.

If the Golden Peptides range of products are really selling at a brisk pace and at the highest margins of any Hua Han products, why are they not available at the outlets that Hua Han's CEO mentioned?

### 1.4.3. Guizhou Factorr' Staff Never Heard of Golden Peptides

It may not be a big deal if the staff at a purported distributor/reseller has not heard of a product, but it will be shocking if no one at the "general office" of the manufacturer has heard of it. In a typical Chinese enterprise, the "general office" handles all the communications between the general manager/board of directors and all other divisions/branches/subsidiaries.

The following transcript shows that no one at the general office of Guizhou Factorr, the manufacturer of Golden Peptides, has heard of such a product!

#### **Audio Evidence 6 – Guizhou Factorr Staff Confirms Golden Peptides Do Not Exist**

Potential customer:	Good day! I called you earlier about Golden Peptides. Have you checked around for me?
Guizhou Factorr' Staff:	We don't know anything about this Golden Peptides.
Potential customer:	Are you Guizhou Factorr?
Guizhou Factorr' Staff:	Yes, this is Factorr.
Potential customer:	So, you don't know about this product?
Guizhou Factorr' Staff:	I don't know. I don't know.
Potential customer:	You don't know, right?
Guizhou Factorr' Staff:	Yes, that's correct. What do you want?
Potential customer:	Can you transfer me to someone who knows about this product?
Guizhou Factorr' Staff:	I can't transfer you. No one in the company knows about this thing.
Potential customer:	No one knows?
Guizhou Factorr' Staff:	Correct. Why don't you simply ask the person who told you about this?
Potential customer:	I saw it on the Internet.
Guizhou Factorr' Staff:	Internet? Is this product on our website?
Potential customer:	You don't have this Golden Peptides?
Guizhou Factorr' Staff:	No, no. I don't know about this. Wherever you see this, just ask them. How can our

<sup>8</sup><http://www.spamoment.net/about.asp?id=4>

# Hua Han – Bad for Your Financial Health

website mention this thing?  
 Potential customer: Some customers mentioned this.  
 Guizhou Factorr' Staff: Some customers mentioned this? Then you go ask them?  
 Potential customer: Well, then do you have any contact phone numbers for your distributors?  
 Guizhou Factorr' Staff: We at our company don't know anything about this thing. I don't know about this, so how can I tell you? I don't know about this thing.  
 Potential customer: Then what department is this? Do you have a sales department?  
 Guizhou Factorr' Staff: This is the general office.  
 Potential customer: Oh, the general office. Then have you got a sales department? May be it's just you who don't know.  
 Guizhou Factorr' Staff: No sales department.  
 Potential customer: No sales department?  
 Guizhou Factorr' Staff: Correct. That's right.

Source: Emerson Analytics

May be Hua Han had tried to market Golden Peptides. However, our investigation shows that this supposedly high growth, high margin product that investors have high hopes for is simply a lie fabricated by the management.

## 1.5. Real Revenue About a Quarter of Hua Han's Claim

All in all, we have shown that Hua Han has inflated the revenue of Yi Fu and Yi Bei by about 2.4 times, of Qijiao Shengbai capsules and Fuke Zaizaowan (including capsules) by about 2.7 times, and has made up a considerable amount of revenue for the Golden Peptides out of thin air. All together, our estimates show that Hua Han's real revenue for the above four products was only Rmb339m, about 26.6% of that reported by Hua Han.

**Exhibit 13 – Revenue Actual and Claimed, 2013**

Year end Dec 31 (Rmb m)	Hua Han's claim	Our estimate	Our estimate as % of Hua Han's claim
Yi Fu & Yi Bei	357	105	29.4%
Qijiao Shengbai capsules	494	134	27.1%
Fuke Zaizaowan (including capsules)	368	100	27.2%
Golden Peptides	57	0	0.0%
<b>Total</b>	<b>1,275</b>	<b>339</b>	<b>26.6%</b>

Source: Emerson Analytics



# Hua Han – Bad for Your Financial Health

## Part 2. Outrageous Evidence from Enterprise Credibility Information System

The reform of the annual inspection system for Chinese enterprises in 2013 requires the public disclosure of enterprise annual reports. Relevant information is released to the public on Enterprise Credibility Information System (ECIS) by the State Administration of Industry and Commerce (SAIC) and its provincial branches. A company can either disclose to or withhold from the public the key financial data in its annual reports.

Among Hua Han's pharmaceutical subsidiaries, Guizhou Hanfang Medicine Manufacture Co., Ltd. (GHMM), Guizhou Hanfang Pharma Co., Ltd. (Hanfang Pharma) and Guiyang DCX choose to disclose publicly their key financial data, while Guizhou Factorr and Guilin Pavay choose not to.

Exhibit 14 – Guiyang DCX's Annual Public Disclosures

The screenshot shows the ECIS (Guizhou) website interface. At the top, there is a logo and the text '全国企业信用信息公示系统 (贵州)'. Below this, the company name '贵阳德昌祥药业有限公司' and its registration number '注册号: 520100000030438' are displayed. A navigation menu includes '企业年报', '股东及出资信息', '股权变更信息', '行政许可及变更信息', '知识产权出质登记信息', and '行政处罚信息'. The '企业年报' section is active, showing a table of disclosures. A red box highlights the text '企业公示信息由该企业提供, 企业对其公示信息的真实性、合法性负责'. Below this, a table lists disclosures for 2013 and 2014, both dated 2015年5月14日. A vertical label on the left side of the table reads '企业公示信息'.

序号	年份	发布日期
1	2013年	2015年5月14日
2	2014年	2015年5月14日

Source: ECIS (Guizhou)

Although SAIC requires an enterprise to be accountable for the "truthfulness and legality of the information", we do not take the accuracy of such information for granted.

# Hua Han – Bad for Your Financial Health

As a test, we have compared revenue and total assets found in ECIS against the annual reports released by all publicly listed Guizhou companies. As shown in Appendix II, there is no discrepancy between what the Guizhou companies reported to their shareholders and what they filed with ECIS.

We sometimes run into illogical and inaccurate data in ECIS. However, revenue and total assets are two simple and clearly defined entries, and are therefore unlikely to be misreported. We restrict ourselves to just these two indicators in our report. Any other data error in ECIS will have no impact on our current analysis.

## 2.1. Subsidiaries' Revenues Total Less Than a Third of Hua Han Claim

Hua Han's pharmaceutical products are all produced by its three subsidiaries in Guizhou province, except for Yi Fu and Yi Bei which are produced by Guilin Pavay in Guangxi. The three Guizhou subsidiaries are GHMM, Guiyang DCX, and Hanfang Pharma, the first two of which were sold in February 2015.

Exhibit 15 shows the key financial statistics of Guiyang DCX for 2013, when it reported revenue of Rmb233m to ECIS.

**Exhibit 15 – Guiyang DCX Key Financial Statistics 2013**

企业资产状况信息			
资产总额	48,385.47 万元	所有者权益合计	22,013.80 万元
Revenue 销售总额	23,289.14 万元	利润总额	860.04 万元
销售总额中主营业务收入	23,289.01 万元	净利润	720.85 万元
纳税总额	2,502.58 万元	负债总额	24,351.67 万元

Source: ECIS (Guizhou)

# Hua Han – Bad for Your Financial Health

Key financial statistics for the three subsidiaries in 2013 and 2014 can be found in Appendix III.

In Exhibit 16 below, all revenue numbers for Guiyang DCX, Hanfang Pharma and GHMM are derived from the respective entities' 2013 ECIS filings. For Guilin Pavay, we use the revenue estimate derived from our volume and unit price studies in Part 1. For Guizhou Factorr, we assume that any revenue it may have generated from Golden Peptides is negligible. We also have not found any pharmaceutical products registered with China Food and Drug Administration under Guizhou Factorr's name.

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

Sources: ECIS (Guizhou), Emerson Analytics

**As shown in Exhibit 13 above, the combined sales revenue of Qijiao Shengbai capsules and Fuke Zaizaowan (including capsules), both manufactured and distributed by Guiyang DCX, amounted to Rmb234m in 2013 according to our estimate. This number turns out to be not far off the SAIC data though a bit on the high side. Clearly we have been very lenient with Hua Han.**

It can therefore be seen that the five subsidiaries probably had revenue of Rmb467m in aggregate in 2013, as compared with Rmb1,572m of pharmaceutical manufacturing revenue reported by Hua Han for that year. The listed company has inflated its revenue by more than three times!

## 2.2. Analysis of Revenue Swings in Subsidiaries

In Exhibit 17 below, we present the 2013 and 2014 revenue reported by the three Guizhou pharmaceutical subsidiaries to ECIS. It can be seen that while the total revenue of the three manufacturers in 2014 was little changed from that in 2013, individual manufacturers saw huge change in their respective performance. For example, Hanfang Pharma reported a 3.5x revenue growth to Rmb243m in 2014 from Rmb55m a year ago.

# Hua Han – Bad for Your Financial Health

**Exhibit 17 – Subsidiaries' Revenue Change, 2013-2014**

Year end Dec 31 (Rmb m)	2013	2014	Change
Guiyang DCX	233	109	-123
Hanfang Pharma	55	243	189
GHMM	75	6	-69
<b>Total</b>	<b>362</b>	<b>359</b>	<b>-3</b>

Source: ECIS (Guizhou), Emerson Analytics

It is important to understand the revenue swing not only because it allows us to have more confidence in the ECIS numbers, it also allows us to have a better understanding of the sales of Hua Han's core products.

We have mentioned above that Hua Han sold two of its subsidiaries, GHMM and Guiyang DCX, in February 2015. Prior to the disposal, the production of certain drugs had been transferred from these two subsidiaries to Hanfang Pharma.

Exhibit 18 below shows some of the relevant pharmaceutical information disclosures made by various provincial pharmaceuticals procurement centers. It can be seen that Qijiao Shengbai capsules and Fuke Zaizao capsules were transferred to Hanfang Pharma from Guiyang DCX in early 2014, while Yeosure Natural Medicine Lotion (a key product of Hua Han when it was listed in 2002) was transferred to Hanfang Pharma from GHMM in late 2013.

**Exhibit 18 – Changes in Hua Han's Pharmaceutical Manufacturers**

Product name	New manufacturer	Old manufacturer	Date	Announced by
新生化顆粒	Hanfang Pharma	GHMM		
黃芪顆粒	Hanfang Pharma	GHMM		
康艾扶正膠囊	Hanfang Pharma	GHMM		
<b>Yeosure Natural Medicine Lotion</b>	<b>Hanfang Pharma</b>	<b>GHMM</b>	Oct 24, 2013	<a href="#">Shandong Pharmaceuticals Central Purchase Service Center</a>
<b>Fuke Zaizao capsules</b>	<b>Hanfang Pharma</b>	<b>Guiyang DCX</b>		
半枝蓮片	Hanfang Pharma	Guiyang DCX		
產後逐瘀片	Hanfang Pharma	Guiyang DCX		
杜仲壯骨膠囊	Hanfang Pharma	Guiyang DCX		
兒童回春顆粒	Hanfang Pharma	Guiyang DCX		
復方石斛片	Hanfang Pharma	Guiyang DCX		
清熱散結片	Hanfang Pharma	Guiyang DCX		
消腫痔瘡片	Hanfang Pharma	Guiyang DCX		
<b>Qijiao Shengbai capsules</b>	<b>Hanfang Pharma</b>	<b>Guiyang DCX</b>		
復方巖連片	Hanfang Pharma	Guiyang DCX		
平胃片	Hanfang Pharma	Guiyang DCX	May 2014	<a href="#">Qinghai Pharmaceuticals Purchase Center</a>
金鱗消渴顆粒	Hanfang Pharma	GHMM	Mar 31,	<a href="#">Shaanxi Medical</a>

# Hua Han – Bad for Your Financial Health

雷公藤多甙片	Hanfang Pharma	GHMM	2015	<a href="#">Organizations</a> <a href="#">Pharmaceuticals</a> <a href="#">Purchase Center</a>
附子理中片	Hanfang Pharma	Guiyang DCX		

Source: Emerson Analytics

According to Hua Han's data, Qijiao Shengbai capsules achieved sales revenue of Rmb494m in 2013. If that were true, then Hanfang Pharma should have achieved in 2014 significantly more sales revenue than its reported Rmb243m (representing a gain of only Rmb189m on the previous year revenue) after taking over production in early 2014. This is another sign that the SAIC numbers are much closer to the truth than what Hua Han has told its shareholders!

## 2.3. Two Estimates of Hua Han Total Revenue

All in all, we have discussed two ways for estimating Hua Han's revenue.

In Part 1, we studied Hua Han's key products: Yi Fu and Yi Bei, Qijiao Shengbai capsules, Fuke Zaizaowan (including capsules) and Golden Peptides.

Based on assumptions that are most advantageous to the company, we conclude that the actual revenue of these products in 2013 was about 26.6% (see Exhibit 13 earlier) of the revenue disclosed by the company. Using this as a benchmark, we estimate that Hua Han's total revenue from pharmaceutical manufacturing was only Rmb418m rather than the Rmb1.57bn in calendar 2013.

As shown in the following table, we believe that Hua Han's total revenue (including trading revenue, which we heroically assume was not inflated) was only 30.9% of that reported.

<b>Year end Dec 31 (Rmb m)</b>	<b>2013</b>
Manufacturing – Hua Han's claim	1,572
x our benchmark percentage	26.6%
= Manufacturing – our estimate	418
+ Trading business	99
Total revenue – our estimate	516
Total revenue – Hua Han's claim	1,671
Our estimate as % of Hua Han's claim	30.9%

Source: Emerson Analytics

## Hua Han – Bad for Your Financial Health

In Part 2 above, we arrive at a total revenue of Rmb467m for all manufacturing subsidiaries in 2013, which is only 29.7% of pharmaceutical revenue claimed by Hua Han for calendar 2013 (see Exhibit 16 above). Adding back the trading revenue, the total is only one-third of the reported amount under the second method.

**Exhibit 20 – Revenue Estimates by Subsidiaries 2013**

<b>Year end Dec 31 (Rmb m)</b>	<b>2013</b>
Manufacturing	467
+ Trading business	99
Total revenue – our estimate	565
Total revenue – Hua Han's claim	1,671
Our estimate as % of Hua Han's claim	33.8%

Source: Emerson Analytics

To conclude, the two paths yield revenue estimates of some Rmb516m to Rmb565m for 2013, merely 1/3 of that reported by the company. From this point onward, we'll adopt the second approach and assume that the company's actual revenue was 33.8% of its reported amount.

# Hua Han – Bad for Your Financial Health

## Part 3. HK\$2.8bn of Asset Black Hole

If a company has been making up its revenue and profit figures for years, it is bound to have a number of unusual items on the balance sheet to balance the numbers. These "black holes" are often phantom assets that management creates to conceal the fact that it does not really have the appropriate amount of cash that is commensurate with the reported profit.

### 3.1. The Rmb200m Black Hole of Prepaid Land Lease Payment for Shawen

At the end of FY15, Hua Han carried on its balance sheet HK\$839m of deposit payments, which represented 8.3% of the company's total assets. At the end of 1HFY16, deposit payments surged to Rmb2.47bn or a whopping 23.6% of total assets. The following table shows the details of this category for FY11-15. Hua Han did not provide a breakdown in 1HFY16.

<b>Year end Jun 30 (HK\$ m)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>
Stem cell plant				193	
Prepaid land lease payments		244	251	252	334
Placental serum albumin equipment	186	189	195	505	491
Others	11	2	21	9	14
<b>Total</b>	<b>197</b>	<b>436</b>	<b>467</b>	<b>959</b>	<b>839</b>
% total assets	5.4%	9.9%	9.1%	16.3%	8.3%

Source: Emerson Analytics

The HK\$334m prepaid land lease payments at the end of FY15 mainly consisted of Rmb200m of deposit for a piece of land at Guiyang Shawen Ecological Scientific Park (Shawen Park) and Rmb62.7m for land purchases relating to the Liupanshui hospital and the Tongren stem cell factory. Hua Han's disclosures on the latter land purchases are largely accurate (please see Exhibits 63 and 64 in Appendix IV), but its announcements regarding the Shawen Park land are complete lies.

On October 25, 2011, Hua Han said it had agreed to buy a piece of land totaling 521mu (a mu is a Chinese unit for measuring area and is equal to 1/15 of a hectare, the land in question thus totals 34.7 hectares) at Shawen Park for Rmb250m. The land for industrial use will become Hua Han's pharmaceutical research center and its new production base.

Emerson Analytics has obtained detailed information about Shawen Park (including the respective areas of each piece of land, their owners, and a precise map), which we have reproduced in Exhibit 61 of Appendix IV.

# Hua Han – Bad for Your Financial Health

## 3.1.1. Real Land Cost Only 1/3 of Hua Han's Claim

According to Hua Han's disclosure, the purchase price of its Shawen land works out to Rmb480k per mu (= 250,000/521), about three times the average price of industrial land at the Shawen Park!

We have three pieces of evidence:

*(1) Land transaction information released by Ministry of Land and Resources shows that the average selling price of Shawen land is Rmb168k per mu*

Land transactions are managed and governed by Ministry of Land and Resources of China. Relevant information such as land supply plans, land sale notices, transaction notifications and land supply results must be filed with <http://www.landchina.com/> or the ministry's website <http://landchina.mlr.gov.cn/><sup>9</sup>.

Searches in these two websites yield complete and accurate land transaction information on 33 pieces of land in Shawen Park. So far, there are 43 transactions on these 33 pieces of land, and their detailed information is reproduced in Appendix IV. The average selling price of all these transactions from August 2010 through November 2014 is Rmb168k per mu. The lowest price was achieved on August 10, 2010 at Rmb144k per mu for a piece of land 112mu in size, while the highest price was achieved on October 29 and November 18, 2014 at Rmb188k, for two pieces of land 89mu and 63mu, respectively, in size.

*(2) Officials at Guiyang Hi-tech Industrial Development Area Supervisory Committee told Emerson Analytics investigators that the land cost at Shawen Park was less than Rmb200k per mu*

The Shawen Park is managed by Guiyang Hi-tech Industrial Development Area Supervisory Committee. We have talked to three officials from the committee, and they all confirmed that the current selling price of industrial land at the park is below Rmb200k per mu.

The English transcript of our conversation with one of the officials follows:

### **Audio Evidence 7 – Telephone Conversation with Director F**

Emerson investigator:	Hello, is this Director F?
Director F:	Yes, hello.
Emerson investigator:	May I ask you, how much is the cost of land, on a per mu basis, at the Hi-tech Area?
Director F:	Well, land price at the Hi-tech Area has been held down for more than a decade with no increase at all, generally close to 200,000 (yuan) each mu.

Source: Emerson Analytics

*(3) Hua Han's connected party has revealed that the actual land cost was Rmb169k per mu*

Please see section 3.1.2. below for more details.

<sup>9</sup>[www.landchina.com/User/default/Upload/attachfile/bulitin/2D9AEAF0-5C70-4AE7-992E-30760BA602B9.doc](http://www.landchina.com/User/default/Upload/attachfile/bulitin/2D9AEAF0-5C70-4AE7-992E-30760BA602B9.doc)



# Hua Han – Bad for Your Financial Health

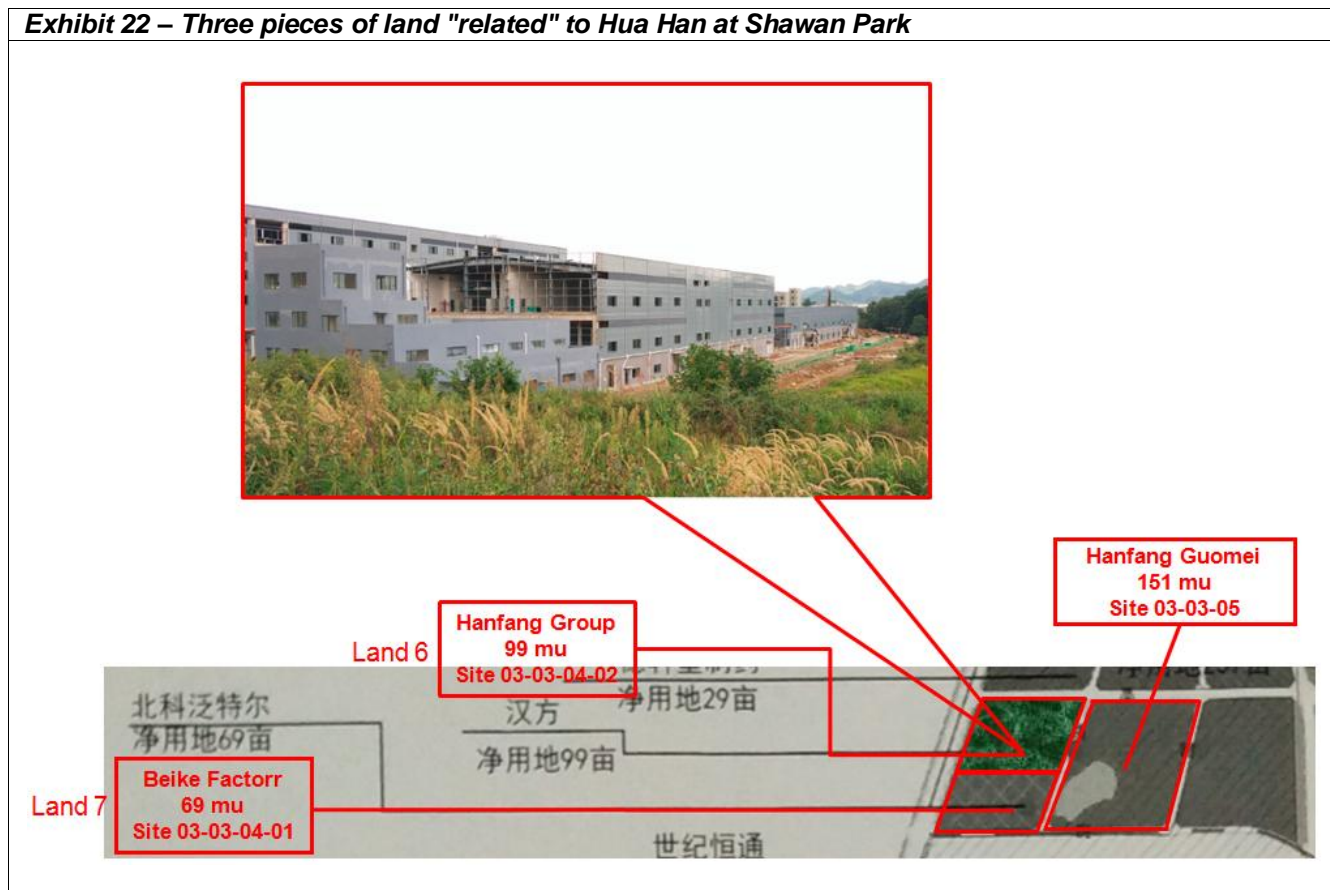
So, why did Hua Han buy its land at almost three times the average price?

## 3.1.2. The Land was NOT bought by Hua Han

If you find it outrageous that Hua Han has bought land at three times the market price, sit tight for this news: it didn't actually buy any land!

Our on-site investigation at the Shawen Park revealed that Hua Han had built its new plant on Land 6 identified as 03-03-04-02 in the following picture in Exhibit 22.

**Exhibit 22 – Three pieces of land "related" to Hua Han at Shawan Park**



Source: Emerson Analytics

(1) Site 03-03-04-02 is held by Hanfang Group, a related party of Hua Han

# Hua Han – Bad for Your Financial Health

According to Ministry of Land and Resources information, site 03-03-04-02 was bought by Guizhou Hanfang (Group) Co., Ltd. (Hanfang Group) on July 29, 2012. The 99-mu site was sold for Rmb16.8m or Rmb169k per mu.

**Exhibit 23 – Hanfang Group's Site 03-03-04-02 at Shawen Park**

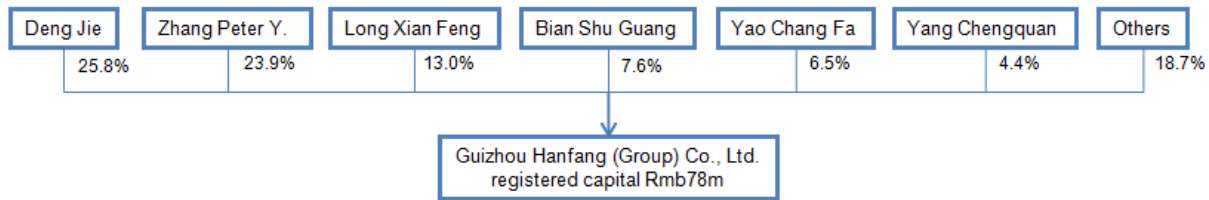
中国土地市场网				
www.landchina.com		土地市场信息发布		
网站首页	土地供应	开发利用	市场监测	行业动态
政策法规   专项服务				
今日导读: 1.甘肃:建设用地审批迈入“互联网+”时代 [2015-09-09] <b>News</b> 2.不动产登记与房屋交易衔接启动 [2015-09-09] <b>News</b> 3.国家审计署:严查土地闲置 背后				
供地结果信息				
行政区: 白云区	电子监管号: 5201132012B00209			
项目名称: 高新(沙文)2012-07(03-03-04-02)	<b>Site: 03-03-04-02</b>			
项目位置: 沙文生态科技产业园	<b>Location: Guiyang Shawen Ecological Scientific Park</b>			
面积(公顷): 6.622300	<b>Area (Hectare): 6.622300</b>		土地来源: 新增建设用地	
土地用途: 工业用地	<b>Land Use: Industrial Land</b>		供地方式: 挂牌出让	
土地使用年限: 50	行业分类: 医药制造业			
土地级别: 三级	<b>成交价格(万元): 1680.0000</b> <b>Transaction Price (Ten Thousand) : 1,680</b>			
分期支付约定:	支付期号	约定支付日期	约定支付金额(万元)	备注
	1	2012年08月12日	1680.0000	
土地使用权人:	<b>贵州汉方(集团)有限公司</b> <b>Land Owner: Guizhou Hanfang (Group) Co., Ltd.</b>			
约定容积率:	下限: 0.70	上限: 0.00	约定交地时间: 2012年08月27日	
约定开工时间:	2012年11月27日		约定竣工时间: 2014年11月27日	
实际开工时间:			实际竣工时间:	
批准单位: 贵阳市人民政府	<b>合同签订日期: 2012年07月29日</b> <b>Date of Signature: July 29, 2012</b>			

Source: Ministry of Land and Resources of China

Hanfang Group is controlled by Hua Han's major shareholder and senior management including CEO Deng Jie and chairman Zhang Peter Y. According to ECIS (Guizhou), their shareholdings in Hanfang Group are 25.8% and 23.9%, respectively. Deng Jie is the legal representative of Hanfang Group.

# Hua Han – Bad for Your Financial Health

**Exhibit 24 – Shareholders of Hanfang Group and their Roles in Hua Han**



Deng Jie – CEO and executive director of Hua Han  
 Zhang Peter Y. – major shareholder, chairman and executive director of Hua Han  
 Long Xian Feng – executive director and general manager of Hua Han (resigned June 28, 2016)  
 Bian Shu Guang – deputy general manager of Hua Han  
 Yao Chang Fa – chairman of Guizhou Hanfang Pharma Co., Ltd.  
 Yang Chengquan – chairman and general manager of Chengdu Hechuang Pharmaceutical Co., Ltd.

Source: ECIS (Guizhou)

(2) Site 03-03-04-01 held by Beike Factorr, Hua Han's associated company

According to Ministry of Land and Resources information, the neighboring Land 7 identified as 03-03-04-01 was bought by Guizhou Beike Factorr Bio-Technology Co., Ltd. (Beike Factorr) on July 30, 2012. The 69-mu site cost Rmb11.6m or Rmb169k per mu, same as the Land 6 unit price.

# Hua Han – Bad for Your Financial Health

**Exhibit 25 – Beike Factorr's Site 03-03-04-01 at Shawen Park**

The screenshot shows the 'China Land Market Network' (中国土地市场网) website. The main content area is titled '供地结果信息' (Land Supply Result Information). The information is presented in a structured layout with various fields and tables. Key details include the project name '高新(沙文)2012-06(03-03-04-01)', location '沙文生态科技产业园', area '4.576000 Hectare', and transaction price '1160.0000 Ten Thousand RMB'. The land owner is identified as '贵州省北科泛特尔生物科技有限公司' (Guizhou Beike Factorr Bio-Technology Co., Ltd.). The date of signature is '2012年07月30日' (July 30, 2012).

行政区: 白云区	电子监管号: 5201132012B00190-1				
项目名称: 高新(沙文)2012-06(03-03-04-01)	Site: 03-03-04-01				
项目位置: 沙文生态科技产业园	Location: Guiyang Shawen Ecological Scientific Park				
面积(公顷): 4.576000	Area(Hectare): 4.576000				
土地用途: 工业用地	Land Use: Industrial Land				
土地来源: 新增建设用地	供地方式: 挂牌出让				
土地使用年限: 50	行业分类: 医药制造业				
土地级别: 三级	成交价格(万元): 1160.0000				
Transaction Price (Ten Thousand) : 1,160					
分期支付约定:		支付期号	约定支付日期	约定支付金额(万元)	备注
		1	2012年08月13日	1160.0000	
土地使用权人:	贵州省北科泛特尔生物科技有限公司				
Land Owner: Guizhou Beike Factorr Bio-Technology Co., Ltd.		约定容积率:	下限: 0.70	上限: 0.00	约定交地时间: 2012年08月27日
约定开工时间:	2012年11月27日		约定竣工时间: 2014年11月27日		
实际开工时间:			实际竣工时间:		
批准单位: 贵阳市人民政府	合同签订日期: 2012年07月30日		Date of Signature: July 30, 2012		

Source: Ministry of Land and Resources of China

Beike Factorr is an associated company of Hua Han<sup>10</sup>. With only 46.76% of attributable stake, Hua Han does not consolidate Beike Factorr's accounts. This land purchase is not related to Hua Han's deposits.

(3) Site 03-03-05 held by Hanfang Guomei, a de facto connected party of Hua Han

According to Ministry of Land and Resources information, another neighboring site 03-03-05 was bought by Guizhou Hanfang Guomei Pharmaceutical Co., Ltd. (Hanfang Guomei) on July 28, 2013. The 151-mu site cost Rmb25.5m, or Rmb168k per mu.

<sup>10</sup><http://www.hkexnews.hk/listedco/listconews/SEHK/2015/1029/LTN20151029282.pdf>, p.116

# Hua Han – Bad for Your Financial Health

Exhibit 26 – Hanfang Guomei's Site 03-03-05 at Shawen Park

The screenshot shows the 'China Land Market Network' (中国土地市场网) website. The main content is a table titled '供地结果信息' (Land Supply Result Information) for a site in Baiyun District, Guiyang. The table lists various details including project name, location, area, land use, transaction price, and dates.

供地结果信息				
行政区:	白云区	电子监管号:	5201132013B00725-1	
项目名称:	高新(沙文)2013-06(03-03-05)	Site:	03-03-05	
项目位置:	沙文生态科技产业园	Location:	Guiyang Shawen Ecological Scientific Park	
面积(公顷):	10.097900	Area(Hectare):	10.097900	
土地用途:	工业用地	Land Use:	Industrial Land	
土地来源:	新增建设用地			
供地方式:	挂牌出让			
土地使用年限:	50	行业分类:	医药制造业	
土地级别:	三级	成交价格(万元):	2545.0000	Transaction Price(Ten Thousand) : 2,545
分期支付约定:	支付期号	约定支付日期	约定支付金额(万元)	备注
	1	2013年08月11日	2545.0000	
土地使用权人:	贵州汉方国美医药有限公司 Land Owner: Guizhou Hanfang Guomei Pharmaceutical Co., Ltd.			
约定容积率:	下限: 0.70	上限: 0.00	约定交地时间:	2013年07月28日
约定开工时间:	2013年10月28日		约定竣工时间:	2015年10月28日
实际开工时间:			实际竣工时间:	
批准单位:	贵阳市人民政府		合同签订日期:	2013年07月28日 Date of Signature: July 28, 2013

Source: Ministry of Land and Resources of China

In section 4.2, "Sale of Hanfang Guomei in 2011", we'll show that Hanfang Guomei is actually a connected party of Hua Han.

In sum, we have shown that:

- Hua Han's related parties have three pieces of land at Shawen Park with a total area of 319mu at a total cost of Rmb53.9m, with unit prices at Rmb168k or Rmb169k per mu rather than Rmb480k that Hua Han apparently paid for; and
- Hua Han has built a new plant on the land owned by a related party.

# Hua Han – Bad for Your Financial Health

**Exhibit 27 – Summary of Lands Held by Hua Han's Related Parties in Shawen Park**

Site number	Area (mu)	Value (Rmb m)	Date	Average price (Rmb k/mu)	Owner
03-03-04-02	99	16.8	7/29/2012	169	Hanfang Group
03-03-04-01	69	11.6	7/30/2012	169	Beike Factorr
03-03-05	151	25.5	7/28/2013	168	Hanfang Guomei
<b>Total/average</b>	<b>319</b>	<b>53.9</b>		<b>169</b>	

Source: Emerson Analytics

Our investigation also shows that:

- The Ministry of Land and Resources of China has no information on any land in Shawen Park owned by Hua Han itself, or any of its subsidiaries;
- We made a thorough investigation of every single piece of land at Shawen Park and its neighboring area for nearly two months. Other than the three pieces of land owned by Hua Han's related parties, we could find no information that might suggest that Hua Han and/or its subsidiary has a piece of land there.

Did Hua Han really buy its own land of 521 mu? If not, where has the Rmb200m deposit gone?

### 3.2. The Rmb405m Placental Serum Albumin Equipment Black Hole

According to Hua Han's FY11 annual report, the company would invest in a human placenta serum albumin plant. The annual report does not reveal the total investment of this project, but says that Hua Han signed an agreement on May 9, 2011 with Guizhou Shunzhi Trade Co., Ltd. (Guizhou Shunzhi), an independent third party, for the purchase of plant and equipment for the proposed plant. About two and a half years later, on December 18, 2013, Hua Han signed a second agreement with Guizhou Shunzhi for the project.

Is the Hua Han management out of its mind? After more than four years and two huge payments of Rmb155m and approximate Rmb250m, the equipment and machineries are still nowhere to be seen. If the senior executives of Hua Han were not totally negligent and paid out large sums of deposits years before the equipment and machineries were to be shipped, then they were plain stupid!

But we don't think Hua Han's senior executives are reckless or stupid. So, we ask a simple but natural question: What sort of company is this Guizhou Shunzhi, the middleman that is supposed to buy equipment on Hua Han's behalf?

A search in ECIS reveals that Guizhou Shunzhi is a tiny little import and export company with revenue of Rmb5.4m and total assets of Rmb29.2m in 2014. The Rmb405m Hua Han paid to Guizhou Shunzhi was 500x the 2013 revenue of Rmb0.81m reported by the latter, and 75x its 2014 revenue.

# Hua Han – Bad for Your Financial Health

By the end of December 2014, Hua Han had paid Guizhou Shunzhi deposits totaling Rmb405m. Accordingly, Guizhou Shunzhi's total assets should exceed Rmb405m at the end of 2014:

- Scenario 1: If Guizhou Shunzhi had not paid any money to the supplier of placental serum albumin equipment, then it should have at least Rmb405m of cash on its balance sheet; or
- Scenario 2: If Guizhou Shunzhi had paid some money to the supplier of placental serum albumin equipment, then it should carry at least Rmb405m in cash and prepayments on its balance sheet.

Either way, Guizhou Shunzhi should have at least Rmb405m of total assets.

**Exhibit 28 – Guizhou Shunzhi Key Financial Statistics 2014**

The screenshot shows the credit information page for Guizhou Shunzhi Trade Co., Ltd. The company name is highlighted in red. Below the company name, there is a table titled '企业资产状况信息' (Enterprise Asset Status Information) with the following data:

企业资产状况信息	
<b>Total assets</b> 资产总额	2,922.49 万元
<b>Revenue</b> 销售总额	539.20 万元
销售总额中主营业务收入	539.20 万元
纳税总额	企业选择不公示
<b>所有者权益合计</b>	3,051.38 万元
<b>利润总额</b>	企业选择不公示
<b>净利润</b>	企业选择不公示
<b>负债总额</b>	企业选择不公示

Source: ECIS (Guizhou)

However, Guizhou Shunzhi had only Rmb29.2m of total assets at the end of 2014, as shown in Exhibit 28 above. So where was the Rmb405m that Hua Han supposedly gave to Guizhou Shunzhi for the purchase of equipment and machineries?

## Hua Han – Bad for Your Financial Health

We have listened to the telephone conversation between a potential customer of Guizhou Shunzhi and its staff. In the recorded conversation, a Guizhou Shunzhi staff acknowledged that the company had not done any similar business for years. An English translation of the transcript follows:

### **Audio Evidence 8 – Telephone Conversation with Guizhou Shunzhi Staff**

Guizhou Shunzhi staff:	Hello?
Potential customer:	Hi, is this Guizhou Shunzhi Trade Co., Ltd.?
Guizhou Shunzhi staff:	What can I do for you?
Potential customer:	Are you from that company?
Guizhou Shunzhi staff:	Yes, what is the matter?
Potential customer:	Now we want to buy some equipment. Do you do this business?
Guizhou Shunzhi staff:	Buy equipment? What equipment are you buying?
Potential customer:	Equipment for making bio-tech products.
Guizhou Shunzhi staff:	You want to buy equipment or do transport?
Potential customer:	We want you to help buy some equipment.
Guizhou Shunzhi staff:	Buy from abroad?
Potential customer:	Yes.
Guizhou Shunzhi staff:	I'm not sure about this. It seems we haven't done this business for a long time.
Potential customer:	Well, then, can you still help? Importing from abroad. I'm calling just to ask, to confirm that you're still doing this business.
Guizhou Shunzhi staff:	We haven't done this for many years.

Source: Emerson Analytics

All in all, what does the above tell you about the Rmb405m of deposits for placental serum albumin equipment carried on Hua Han's books at as June 30, 2015?

- More than four years of prepayment and still no schedule of delivery;
- The agent is a tiny little company with limited revenue;
- The agent's ECIS filings shows no evidence that it had ever received Rmb405m of deposits; and
- The agent's staff says it has not done equipment import for years.

We believe only one conclusion is possible: the Rmb405m of deposits do not exist. They are simply a black hole to hide the fact that Hua Han does not have the cash level that is commensurate with the profits that it has reported over the years.

### **3.3. Non-existent Cash of HK\$2.0bn**

According to the company's FY14 annual report, Hua Han had cash and bank balances of HK\$2,725m (99.7% of which was denominated in Rmb) and interest-bearing debts of only HK\$38m. With net cash amounting to 51.5% of equity, a gross debt to equity ratio of merely 0.7% and a current ratio of 9.5x, how could the company find it necessary to raise more cash? But that's exactly what Hua Han did. In February



## Hua Han – Bad for Your Financial Health

and June 2015, the company raised, respectively, HK\$620m of convertible bonds and HK\$3,145m of equity via a share placement.

The two fundraising exercises were totally unreasonable: by the end of FY15, Hua Han had Rmb6.6bn of cash and equivalent, representing an astonishing 77.1% of shareholders equity and 65.3% of total assets! It was these two rounds of financing that prompted us to suspect that Hua Han was a complete scam and to investigate its businesses in details.

But Hua Han's thirst for cash continued. In June 2016, it raised US\$150m in senior notes.

A usually reliable indicator of accounting fraud is the relationship between interest income and the amount of cash and bank balances. Not surprisingly, Hua Han fails this acid test.

As can be seen below, Hua Han has steadily built up a huge cash pile over the last few years. However, Hua Han's effective deposit rates have consistently held below normal bank interest rates. In FY13, its effective interest rate was only 0.34%, even below the 0.35% savings deposit rate for that year. This is a clear sign that a large part of its cash and bank balances simply didn't exist.

**Exhibit 29 – Hua Han's Average Deposit Interest Rates 2011-15**

Year end Jun 30 (HK\$ m)	FY10	1H11	FY11	1H12	FY12	1H13	FY13	1H14	FY14	1H15	FY15
Interest income			5.8		8.6		8.6		19.8		35.3
Cash	1,407	1,481	1,457	1,445	2,095	2,671	2,799	2,468	2,725	2,029	6,599
Average Cash			1,448		1,666		2,522		2,664		3,784
Effective deposit interest rate (%)			0.40		0.51		<b>0.34</b>		0.74		0.93
Normal bank deposit rate (%)*			1.31		1.79		1.48		1.48		1.21
Gap			-0.91		-1.27		-1.13		-0.73		-0.28

Source: Emerson Analytics

\*Assuming that Hua Han placed half of its money in savings account and half in three-month deposits

The People's Bank of China lowered interest rates once during the 12 months ended June 30, 2013, when it cut savings deposit rate to 0.35% from 0.4% and three-month deposit rate to 2.6% from 2.85% on July 6, 2012. The central bank then left interest rates unchanged until November 2014. Thus, if Hua Han had placed half of its money in savings accounts and another half in three-month deposits during FY13, it would have achieved an average deposit rate of 1.48% in FY13.

If Hua Han's HK\$8.6m interest income in 2013 was derived on an average deposit rate of 1.48% throughout the year, the company should have had an average HK\$584m of cash and bank balances outstanding during the year. That's not even a quarter of the average HK\$2.5bn cash and bank balances that the company supposedly had during the year!

# Hua Han – Bad for Your Financial Health

**Exhibit 30 – Hua Han Cash Shortfall**

Year end Jun 30 (HK\$ m)	2013
Interest income	8.6
Normal bank deposit rate	1.48%
Estimated average cash	584
Reported average cash	2,522
Cash gap	1,938

Source: Emerson Analytics

This situation reminds us of the cases of China Lumena New Materials (stock code 0067.HK) and Sound Global Ltd. (stock code 0967.HK). We used exactly the same method to demonstrate that their actual cash/bank balances were at least Rmb2.0bn less than the amount claimed by the company. Subsequent developments showed that our method was right but far too conservative.

### 3.4. The HK\$437m Receivables Black Hole

Given its inflated revenue, Hua Han's accounts receivable are almost certain to be overstated.

Assuming that Hua Han's 2.7x receivables turnover was accurate, the real amount of receivables outstanding at the end of FY13 was probably about Rmb223m, implying a non-existent receivable amount of some HK\$437m.

**Exhibit 31 – Hua Han Receivables Black Hole 2013**

Year end Jun 30 (HK\$ m)	Hua Han's claim	Our estimate	Black hole
Revenue	1,754	594*	
Accounts receivable	660	223	437
Receivables turnover	2.7	2.7	

Source: Emerson Analytics

\* Based on our estimated revenue at 33.8% of reported amount in Exhibit 20

### 3.5. Estimates of Tangible Asset Value

Naturally, bogus profit requires phantom assets to make the balance sheet sensible. At the end of FY13, we estimate that Hua Han's asset black holes totaled HK\$2.8bn, comprising non-existent cash of about HK\$1.94bn, bogus prepaid land lease payments of HK\$251m, illusory deposits for placental serum albumin machines and equipment totaling HK\$195m, and inflated accounts and bills receivables to the

## Hua Han – Bad for Your Financial Health

tune of about HK\$437m. Removing all of these items, Hua Han would now be left with merely HK\$1.73bn of tangible assets at the end of FY13, as shown below.

### **Exhibit 32 – Hua Han Asset Discrepancy FY13**

<b>Tangible asset value estimates (HK\$ m)</b>	<b>FY13</b>
Net book value reported	4,547
- Non-existent cash	-1,938
- Prepaid land lease payments	-251
- Placental serum albumin equipment	-195
- Accounts and bills receivables	-437
<b>Net tangible assets</b>	<b>1,727</b>
<b>NTA as % of NBV reported</b>	<b>38%</b>

Source: Emerson Analytics

To put it in perspective, the HK\$2.8bn asset black hole exceeded the cumulative profit during the 14 years from FY00-13 reported by Hua Han.

## Part 4. Hidden Connected Transactions

Companies that doctor their books often resort to hidden connected transactions to manipulate their balance sheet numbers, and Hua Han is no exception. In this section, we show our readers three such transactions.

### 4.1. Sale of Hechuang Pharmaceutical in 2007

Hua Han announced on June 22, 2007 that it would dispose of its entire stake in Chengdu Hechuang Pharmaceutical Co., Ltd.<sup>11</sup> (Hechuang Pharmaceutical, held through Hua Han's subsidiary GHMM) for Rmb52.2m to an unnamed buyer said to be an independent third party. According to the SAIC information that we have obtained, Hechuang Pharmaceutical achieved net profit of Rmb370k in calendar 2007. The sale was therefore priced at a staggering 140x current year P/E.

In November 2013, Hechuang Pharmaceutical changed its name to Hechuang Pharmaceutical Group Co., Ltd (Hechuang Group). The company's web address is <http://www.hcyyjt.com/>.

Was Hechuang Pharmaceutical really sold to an independent third party in 2007 and has remained unrelated to Hua Han? Absolutely not. Rather, it has always remained under the control of Hua Han's connected party, Hanfang Group. We have three pieces of evidence:

*(1) Zhang Peter Y. has attended Hechuang Group's work meeting many times*

We can see from Hechuang Group's own news releases that Zhang Peter Y., Hua Han's major shareholder, chairman and executive director, attended Hechuang Group's work meeting four times in 2015, on January 23, February 14, July 20 and October 16.

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<sup>11</sup><http://www.hkexnews.hk/listedco/listconews/SEHK/2007/0622/LTN20070622107.pdf>



# Hua Han – Bad for Your Financial Health

## Exhibit 34 – Hechuang Group's senior management

集团介绍 组织机构 业务架构 **领导班子** 公司沿革 资质荣誉 宣传视频 社会责任

Senior Management

您的位置: 走进禾创 > 领导班子

**成都禾创药业集团有限公司法人代表、董事长杨剑波先生简介:** Yang Jianbo, legal representative and chairman of Chengdu Hechuang Pharmaceutical (Group) Co., Ltd.

杨剑波, 男, 汉族, 出生于1970年5月19日, 四川永川人。

1993年7月-1996年7月在贵州财经学院财务会计系学习。

1996年8月, 进入贵州汉方(集团)有限公司财务部工作, 任出纳员; Hanfang Group

1996年11月-1998年8月, 任贵州汉方(集团)有限公司财务部主管; Hanfang Group

1998年9月-2000年5月, 任贵州省锦屏县汉方长启林场有限公司财务部副经理、经理; Hanfang

2000年6月-2003年9月, 任贵州汉方息烽药业有限公司副总经理; Hanfang Pharma

2003年10月-2007年7月, 任贵州汉方(集团)有限公司资金运营部经理; Hanfang Group

2007年8月-2013年11月, 任贵州汉方(集团)有限公司董事长助理; Hanfang Group

2013年12月至今, 任贵州汉方国美医药有限公司董事长、法人代表。 Hanfang Guomei

2014年4月至今, 任成都禾创药业集团有限公司董事长、法人代表。 Hechuang Group

Source: <http://www.hcyjyt.com/about.aspx?mid=481>

(3) Yang Chengquan, a shareholder of Hanfang Group, was chairman of Hechuang Pharmaceutical before and after the sale in question

Perhaps Hua Han might say that it did sell Hechuang Pharmaceutical to an independent third party in June 2007. Subsequently, parties related to Hanfang Group took it over.

This sounds quite reasonable. In fact, after the June 2007 sale, the nominal shareholders of Hechuang Pharmaceutical have changed several times. However, actual control of Hechuang Pharmaceutical has never changed. The key person is Yang Chengquan, a shareholder of Hanfang Group with 4.4% stake (see Exhibit 24 earlier).

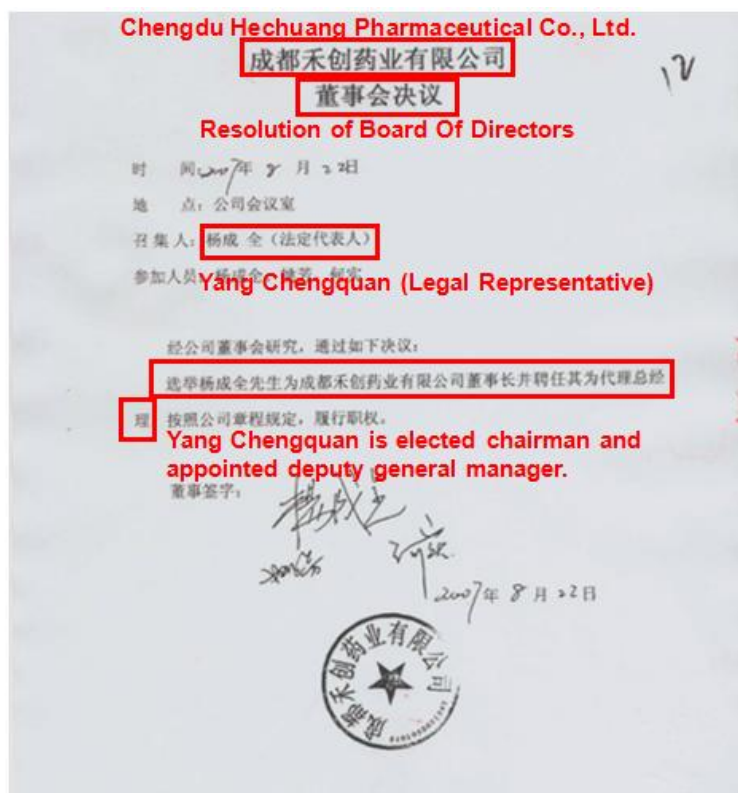
Before the June 2007 sale, Yang Chengquan was seconded by GHMM to Hechuang Pharmaceutical as its chairman. After the sale, he remained chairman and took up the position of deputy general manager of Hechuang Pharmaceutical, as shown in the board of directors' resolution below.

He continued to be a director and the general manager of Hechuang Pharmaceutical/Hechuang Group, sometimes doubling as chairman/legal representative, until his death in March 2014.

There is absolutely no doubt that the June 2007 sale was a connected transaction and Hechuang Group remains to this date a related party!

# Hua Han – Bad for Your Financial Health

Exhibit 35 – Yang Chengquan elected chairman and appointed deputy general manager



Source: Hechuang Pharmaceutical SAIC Filing

## 4.2. Sale of Hanfang Guomei in 2011

Hua Han acquired a 100% stake in pharmaceuticals trading company Hanfang Guomei in FY08. According to its FY11 annual report, Hua Han sold its entire stake in Hanfang Guomei to an independent third party during the year.

Hua Han's FY08-FY11 annual reports show that it had always maintained a 100% stake in Hanfang Guomei, whose registered capital was Rmb5m.

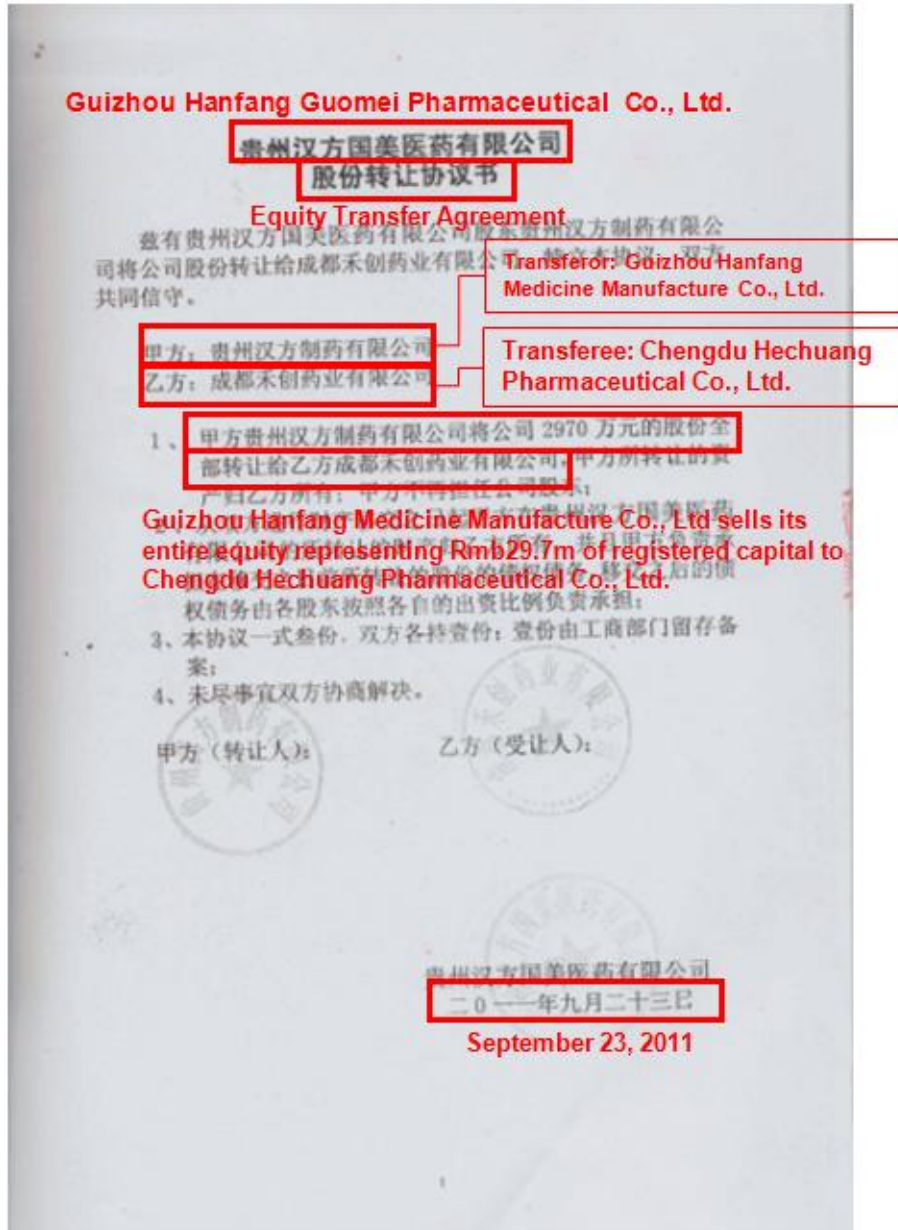
However, according to Hanfang Guomei's SAIC filings, Hua Han only acquired 99% of Hanfang Guomei in May 2008 and maintained this ratio unchanged. In January 2011, Hanfang Guomei's existing shareholders increased their capital in the company proportionally, raising the registered capital to Rmb30m. As can be seen in Exhibit 36, Hua Han's sale only covered Rmb29.7m of registered capital, proving that it only had a 99% stake.

Is it possible that Hua Han made a mistake in how many percent of a company it was buying? Is it possible that it was confused about how many percent interest it continued to hold in a subsidiary? Is it possible that it did not know how much registered capital its subsidiary had?

# Hua Han – Bad for Your Financial Health

We have obtained a copy of an agreement dated September 23, 2011 (i.e. after the end of FY11) between GHMM, the direct parent of Hanfang Guomei, and Hechuang Pharmaceutical with respect to the sale of Hanfang Guomei, as shown below.

## Exhibit 36 – Equity Transfer Agreement of Hanfang Guomei



Source: Hanfang Guomei SAIC Filing

As we have shown above, Hechuang Pharmaceutical was in fact a related party in 2011. The sale was therefore a disposal to a related party, which was not properly disclosed.



# Hua Han – Bad for Your Financial Health

## 4.3. Sale of rhEGF's Technical Knowhow in 2011

At the end of FY10, out of the HK\$140m of deposits on the balance sheet, HK\$112m was paid to an unnamed Beijing pharmaceutical institute for the acquisition of certain technical knowhow of rhEGF technology. According to the acquisition agreement, the total value of the knowhow was HK\$229m, and the deposit would be fully refunded to Hua Han if the seller failed to properly register the technical knowhow with relevant Chinese authorities by December 31, 2011<sup>12</sup>.

According to the FY11 annual report, Hua Han entered into an agreement on May 5, 2011 with the said Beijing pharmaceutical institute and an independent third party, Beijing Xingda Yongsheng Investment Company Limited (Xingda Yongsheng) for the sale of the knowhow for Rmb98m, same as the deposit that it had paid.

The thing that caught our attention was that even in the Chinese version of the FY11 annual report, only the English name of the buyer but not its Chinese name is available<sup>13</sup>.

So, why was Hua Han hiding the Chinese name of Xingda Yongsheng? Because it was a related party!

There are a large number of possible Chinese characters that are pronounced as "Xing Da Yong Sheng". We searched all of them in the ECIS (Beijing) <http://qyxy.baic.gov.cn/>, and we are confident that Beijing Xingda Yongsheng Investment Company Limited is "北京興大永盛投資有限公司".

According to information from ECIS (Beijing), Xingda Yongsheng has set up 北京林盛投資有限公司 (Beijing Linsheng Investment Company Limited, Beijing Linsheng) with Hanfang Group and another person. Beijing Linsheng's legal representative is Long Xian Feng, former executive director and general manager of Hua Han who resigned on June 28, 2016.

Basic information of Xingda Yongsheng is shown below in Exhibit 37. It was set up on May 7, 2008 by Zhang Bing Sheng (張炳生), the only shareholder and legal representative.

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<sup>12</sup><http://www.hkexnews.hk/listedco/listconews/SEHK/2010/1029/LTN20101029752.pdf>, p.99

<sup>13</sup>[http://www.hkexnews.hk/listedco/listconews/SEHK/2011/1028/LTN20111028437\\_C.pdf](http://www.hkexnews.hk/listedco/listconews/SEHK/2011/1028/LTN20111028437_C.pdf), p.106

# Hua Han – Bad for Your Financial Health

## Exhibit 37 – Basic information of Xingda Yongsheng

The screenshot displays the profile of Beijing Xingda Yongsheng Investment Company Limited. Key information includes:

- Current Location:** 北京兴大永盛投资有限公司 Beijing Xingda Yongsheng Investment Company Limited
- Investor Information:** 张炳生 Zhang Bing Sheng, Type: 自然人股东 (Natural Person Shareholder)
- Company Registration Information:**
  - 名称: 北京兴大永盛投资有限公司
  - 注册号: 110115011006503
  - 住所: 北京市石景山区八大处高科技园区西井路3号1号楼205
  - 法定代表人: 张炳生 Legal Representative: Zhang Bing Sheng
  - 公司类型: 有限责任公司(自然人独资)
  - 企业状态: 开业
  - 经营范围: 项目投资; 资产管理; 投资管理; 生物、医药技术开发、转让、咨询; 代理进出口。
  - 营业期限自: 2008-05-07
  - 营业期限至: 2028-05-06
  - 成立日期: 2008-05-07
  - 登记机关: 石景山分局
- Capital Information:**
  - 注册资本: 1000 万元
  - 实收资本: 1000 万元
- Organizational Code Information:**
  - 组织机构代码: 675076943
  - 代码证颁发机关: 北京市石景山区质量技术监督局
- Shareholder History:** 张炳生, Type: 自然人股东
- Main Personnel:** 张炳生, 执行董事

Source: ECIS (Beijing)

Interestingly, a certain Zhang Bing Sheng (張炳生) joined Hua Han in May 2007. According to Hua Han's annual reports from FY13 to FY15, he was chief investment supervisor during the relevant periods. This can be seen in Exhibit 38 below.

## Exhibit 38 – Biographical Details of Mr. Zhang Bing Sheng

Mr. Zhang Bing Sheng (張炳生), aged 38, is the Chief Investment Supervisor of the Group. He joined the Group in May 2007. Mr. Zhang graduated from Hubei Medical College (湖北醫學院) majoring in Clinical Medication. He worked in Shenzhen Medical Enhancement Import and Export Company Limited (深圳醫藥保健品進出口有限公司) and Shenzhen Qing Hua Yuan Xing Bio-pharmaceutical Technology Company Limited (深圳市清華源興生物醫藥科技有限公司) etc.. He has extensive experience in the academic promotion of market specialization as well as the marketing and operation of prescription drugs. Especially, Mr. Zhang achieved outstanding results in areas such as marketing, sales planning and expert network construction. He has solid personal network in Chinese Medical Association (中華醫學會) and its subordinate professional institutions and the large and medium scale local general hospitals.

Source: Hua Han FY14 annual report, p.21

## **Hua Han – Bad for Your Financial Health**

Are the two Zhang Bing Sheng the same person? We are sure that's the case.

Clearly, this is another hidden connected transaction.

# Hua Han – Bad for Your Financial Health

## Part 5. Financials and Valuation

Having done a careful and detailed analysis of Hua Han's lies and fabrications as presented earlier, we doubt if there is a real need to analyze the company's financial statements. Can one possibly identify the truth out of a heap of lies?

### 5.1. Estimates of Real Profitability

As explained earlier, we are convinced that Hua Han's actual revenue in calendar 2013 was probably only 33.8% of that reported by the company. With this benchmark, we can assume that the company actually achieved revenue of about HK\$616m in FY15. Further, assume heroically that its gross margin was really 68.7%, and that selling and distribution costs made up 24.6% of revenue while administrative overhead was 6.4%, as reported by the company. It follows that Hua Han's real profitability was only a quarter of that reported.

In other words, by exaggerating its revenue to about three times the actual level, Hua Han was able to report a profit that was four times as large.

<b>Year end Jun 30 (HK\$ m)</b>	<b>Hua Han's claim</b>	<b>Our estimate</b>	<b>Remarks</b>
<b>Revenue</b>	<b>1,821</b>	<b>616</b>	33.8% of claimed revenue
Cost of sales	-570	-193	
<b>Gross profit</b>	<b>1,250</b>	<b>423</b>	assume 68.7% gross margin as reported
Selling and distribution costs	-448	-152	assume at 24.6% of revenue as reported
Administrative expenses	-117	-39	assume at 6.4% of revenue as reported
Other revenue and expenses	-53	-53	assume no change
Finance costs	-38	-38	assume no change
<b>Profit before tax</b>	<b>595</b>	<b>141</b>	
Tax	-162	-48	assume 25% standard tax rate
<b>Profit for the year</b>	<b>433</b>	<b>93</b>	
Attributable to:			
- Equity holders of the Company	398	85	actual profit merely 21.4% of reported
- Minority interests	34	7	assume unchanged 7.9% of net profit

Source: Emerson Analytics

### 5.2. Valuation

There is no doubt Hua Han's financial statements are seriously fraudulent, to the extent that there is simply no need for a valuation analysis. For a long-running case of criminal deception, the only appropriate regulatory action is **Delisting**.

# Hua Han – Bad for Your Financial Health

## Appendix I: Analysis of Prices of Key Products

### I.1. Pharmaceutical Pricing System in China

China's pharmaceutical pricing is a complex system and has gone through several rounds of reform. Familiarization with the pharmaceutical pricing system is crucial to understanding our main report on Hua Han.

In June 2015, China officially implemented the most wide-sweeping reform ever on its pharmaceutical pricing system. With this reform, the government no longer fixes prices for any drugs, other than anesthetic and certain neurological drugs. There is also no ceiling for retail prices. To mirror the time frame relevant to the discussions in our main report on Hua Han, our discussions in this appendix concern only the pricing system prior to the June 2015 reform.

#### I.1.1. Key Prices in Pharmaceutical Industry

The key prices to understand are as follows:

##### ➤ **Ex-factory price**

This is the price actually achieved by the pharmaceutical manufacturer and comprises all its costs and expected profit (if any). Ex-factory price is also known as base price.

##### ➤ **Invoice price**

For a pharmaceutical product to move from the manufacturer to the medical institution (a hospital or clinic), it usually has to pass through one or more distributors, as a pharmaceutical manufacturer is not allowed to sell directly to a medical institution.

If only one distributor is involved, the pharmaceutical product is said to have gone through a "two-invoice" system: when the pharmaceutical manufacturer sells the product to the distributor, it writes the first invoice; and when the distributor sells the product to the medical institution, it writes the second invoice. Otherwise, the pharmaceutical product is said to have gone through a "multi-invoice" system.

The invoice price is the price on the invoice that the pharmaceutical manufacturer writes when it sells the product to its first distributor. There are two modes for setting the invoice price, the so-called "High Invoicing" and the "Low Invoicing".

##### *(1) Low Invoicing*

In Low Invoicing, the pharmaceutical manufacturer invoices its first distributor at the ex-factory price. In this mode, the distributor is responsible for settling all rebates to the medical institution (including its doctors and relevant staff).

##### *(2) High Invoicing*

## Hua Han – Bad for Your Financial Health

In 2012, the National Development and Reform Commission (NDRC) conducted an investigation into the invoice price (i.e. the ex-factory price under the Low Invoicing mode) of pharmaceutical products. The huge gap between the invoice price under the Low Invoicing mode and the retail price gave the government a reason to lower the retail price of pharmaceutical products, thus affecting the profit for all participants. Pharmaceutical manufacturers increasingly resorted to "High Invoicing", defeating the government's price control objective, leaving the market as chaotic as before.

According to China's general accounting practice, the invoice is the basis for revenue recognition, whether it is "Low Invoicing" or "High Invoicing". In the case of "High Invoicing", the pharmaceutical manufacturer will bear all rebates, and the sales and distribution cost will be higher than that in the case of "Low Invoicing".

### ➤ **Maximum retail price**

There were three types of retail price for pharmaceutical products: government fixed price, government guidance price and market price. For the first two prices, the government would set a ceiling for retail price.

### ➤ **Retail price**

According to 《關於進一步整頓藥品和醫療服務市場價格秩序的意見》 ("Opinions on Further Improving the Regulation of the Market Prices of Pharmaceutical Products and Medical Services") issued by the NDRC, the retail price of pharmaceutical products charged by a medical institution is set by reference to the actual purchase price paid by the medical institution, adding a margin of no more than 15%. This means the retail price is set at 1.15x of the medical institution's actual purchase price. Generally speaking, most retail prices are the same as maximum retail prices.

### ➤ **Successful tender price**

Pharmaceutical products are sold to medical institutions through a tender process. The successful tender price is the purchase price paid by the medical institutions.

With respect to pharmaceutical products subject to government fixed price and government guidance price, pharmaceutical manufacturers may submit a price with reference to the maximum retail price (i.e. maximum retail price divided by 1.15). If this price is accepted through the tender process, it becomes the successful tender price.

The Price Ratio (扣率) is a term that comes up in the pharmaceutical industry frequently. It is arrived at by dividing the invoice price with the successful tender price.

If a certain pharmaceutical product has a maximum retail price of Rmb100, and if the manufacturer sells that product to its distributor(s) at a 20% Price Ratio, then the key prices for this particular product are as follows:

- Maximum retail price: Rmb100

## Hua Han – Bad for Your Financial Health

- Retail price: Rmb100
- Successful tender price: Rmb86.96 (= 100 / 1.15)
- Invoicing price: Rmb17.39 (= 86.96 \* 20%)

### I.1.2. Price Assumptions in Hua Han Main Report

In I.2. and I.3. of this appendix, we present a detailed analysis of the ex-factory prices and successful tender prices (including the relevant price range and average price) of Hua Han's major products. The following table summarizes its successful tender prices and ex-factory prices. As can be seen, the ex-factory prices of Hua Han's major products are far below their tender prices.

Key Products	Dosage	Pills per box	Overall average tender prices	Average ex-factory prices	Price Ratio
Yi Fu	10g:50000IU		28.0	4.5	16.1%
	20g:100000IU		51.7	5.5	10.6%
Yi Bei	2ml:20000IU		20.0	3.2	16.0%
	3ml:30000IU		27.7	4.3	15.5%
	4ml:40000IU		37.3	5.3	14.2%
Qijiao Shengbai capsules	0.5g	36	63.6	9.1	14.3%
	0.5g	48	78.7	13.8	17.5%
Fuke Zaizaowan	2.6g/10 pills	100	18.0	N.A.	
	2.6g/10 pills	120	22.0	3.2	14.5%
Fuke Zaizao capsules	0.41g	36	33.3	5.8	17.4%

Source: Emerson Analytics

Note: Price data exclude obviously irregular or incomplete data

The main invoicing mode adopted by a Chinese pharmaceutical manufacturer can be observed by analyzing the correlation between revenue and selling and distribution costs. In essence, the High Invoicing mode entails high revenue and high selling and distribution costs. The contrary is true for the Low Invoicing mode. Note that it is possible that a pharmaceutical supplier may use both High-Invoicing mode and Low-Invoicing mode at the same time, even for the same product. It all depends on how it deals with its distributors -- essentially it is a question of who pays for the selling and distribution costs.

Up to FY12, Hua Han essentially only used Low-Invoicing mode. Subsequently, there was no discernible pattern in the principal invoicing mode adopted, as can be seen from Exhibit 41 below. We believe this is a sign of accounting forgery, especially in 2HFY14, when the selling and distribution cost amazingly turned positive.

# Hua Han – Bad for Your Financial Health

**Exhibit 41 – Hua Han invoicing mode analysis**

Year end Jun 30 (HK\$ m)	1HFY13	2HFY13	1HFY14	2HFY14	1HFY15	2HFY15	1HFY16
Revenue from manufacturing	1,026	728	1,364	497	1,102	498	639
Selling and distribution costs	-445	-434	-706	62	-442	-6	-78
As % of revenue	-43%	-63%	-52%	18%	-40%	-1%	-12%
<b>Dominant invoicing mode</b>	<b>High Invoicing</b>	<b>High Invoicing</b>	<b>High Invoicing</b>	<b>Low Invoicing</b>	<b>High Invoicing</b>	<b>Low Invoicing</b>	<b>Low Invoicing</b>

Source: Emerson Analytics

In our main report on Hua Han, we always use the successful tender price in calculating the company's revenue derived from key pharmaceutical products. As can be seen from the above discussion of the pharmaceutical pricing system, this is the most advantageous assumption for Hua Han, for the following reasons:

- Because of the discount to at least one distributor, the price on the invoice issued by a pharmaceutical manufacturer must be below the successful tender price, even if the manufacturer adopts High Invoicing mode;
- Hua Han never disclosed which products were sold under High-Invoicing and which under Low-Invoicing. In our analysis, we assume that all its main products were sold under the High-Invoicing mode, an assumption most advantageous to the company; and
- In practice, we understand from industry participants that it is almost impossible to sell everything at High-Invoicing mode. For any pharmaceutical product, there is always something sold under the Low-Invoice mode.

In our analysis, we calculate Hua Han's revenue based on successful tender prices, an assumption most advantageous to the company. Generally speaking, successful tender prices change according to dosage (such as number of pills per box), timing and location (all provincial based) of the tender.

In our main report, we show our calculations using the highest successful tender price and the overall average tender price. The highest price refers to the highest ever successful tender price for the largest dosage of a particular product. For example, the highest price of 57.2 for Yi Fu in Exhibit 42 below refers to the specification of 20g: 100000IU, which was achieved in a tender in Jilin province. The overall average price is the simple arithmetic average for all tenders during all the years for which tender results are available, regardless of specifications.



# Hua Han – Bad for Your Financial Health

The assumption that Hua Han could somehow sell a particular product at the highest ever successful tender price is, of course, totally unrealistic as it could not possible sell everything at the highest dosage and demand that other provinces also pay the same high price. This is no doubt a generous assumption giving the company the maximum benefits of the doubt.

In the case of Yi Fu and Yi Bei, our calculations show that if Hua Han were able to sell everything at the highest price, their combined revenue in 2011 would have been merely 40.5% of the amount claimed by the company. Based on the overall average price, our calculations show that their actual combined revenue would have been only 29.4% of that claimed by Hua Han (please see Exhibit 7). Other products show a similar pattern.

**Exhibit 42 – Highest tender prices vs. overall average tender prices of key products**

Key Products	Highest price	Overall average price
Yi Fu	57.2	44.3
Yi Bei	39.4	27.1
Qijiao Shengbai capsules	92.2	67.7
Fuke Zaizaowan	23.5	21.4
Fuke Zaizao capsules	42.7	33.3

Source: Emerson Analytics

## I.2. Successful Tender Price of Key Products

Pharmaceutical price information may be obtained from the various official websites for the central tendering of pharmaceutical products by different provinces. The tender information website <http://zb.sosoyy.com/zb/> provides an amalgamation of relevant information from several provinces. Although the information on this website is not very up to date, but its data are sufficient for our purpose.

### I.2.1. Successful Tender Prices of Yi Fu & Yi Bei

The successful tender prices of Yi Fu & Yi Bei can be found here:

<http://zb.sosoyy.com/zb/Default.aspx?area=&name=&name2=&zlcc=&comp=8D8AA8E8D0956617&comp2=>

From January 2007 through March 2013, the successful tender prices of Yi Fu, in 10g:50000IU and 20g:100000IU dosages, averaged Rmb28 and Rmb51.7, respectively, with an overall average of Rmb44.3.

**Exhibit 43 – Range and average of Yi Fu tender prices**

Dosage	Price range	Average price	Overall average
10g:50000IU	25.2-30.1	28.0	<b>44.3</b>
20g:100000IU	45.9- <b>57.2</b>	51.7	

Source: Emerson Analytics

# Hua Han – Bad for Your Financial Health

The price range and average prices of the three dosages of Yi Bei are as follows:

<b>Dosage</b>	<b>Price range</b>	<b>Average price</b>	<b>Overall average</b>
2ml:20000IU	18.0-20.8	20.0	
3ml:30000IU	20.0-30.6	27.7	<b>27.1</b>
4ml:40000IU	35.3- <b>39.4</b>	37.3	

Source: Emerson Analytics

## I.2.2. Successful Tender Prices of Qijiao Shengbai capsules

The successful tender prices of Qijiao Shengbai capsules can be found here:

<http://zb.sosoy.com/zb/Default.aspx?area=&name=C4C61696FF237434D0DF7E103CF26D52&name2=&zlcc=&comp=&comp2=>

The price range and average prices of different packages of Qijiao Shengbai capsules are shown below:

<b>Pills per box</b>	<b>Price range</b>	<b>Average price</b>	<b>Overall average</b>
36	48.3-77.4	63.6	
48	66.9- <b>92.2</b>	78.7	<b>67.7</b>

Source: Emerson Analytics

In late September, 2015, an investigator of Emerson Analytics bought a box (36 pills) of Qijiao Shengbai capsules for Rmb52. The receipt of the purchase is shown below:

# Hua Han – Bad for Your Financial Health

**Exhibit 46 – Sales receipt of Qijiao Shengbai capsules**



Source: Emerson Analytics

Comparing our purchase price with the successful tender prices, it can be seen that our use of the overall average tender price in the calculation of Hua Han's revenue is to its great advantage.

### 1.2.3. Successful Tender Prices of Fuke Zaizaowan (including capsules)

The successful tender prices of Fuke Zaizaowan can be found here;

<http://zb.sosoyy.com/zb/Default.aspx?area=&name=D0E853D5E5DC99604905FD23AA5AE21F&name2=&zlcc=&comp=&comp2=>

The price range and average prices of different packages of Fuke Zaizaowan are shown below:

**Exhibit 47 – Range and average of Fuke Zaizaowan tender prices**

Pills per box	Price range	Average price	Overall average
100	18.0	18.0	<b>21.4</b>
120	21.6- <b>23.5</b>	22.0	

Source: Emerson Analytics

# Hua Han – Bad for Your Financial Health

The medical institutions are allowed to charge their patients a maximum of 15% add-on to their tender price. Thus, the average tender price of Rmb22 per box of 120 Fuke Zaizaowan implies a retail price of about Rmb25.3 (= 22 x 1.15).

Fuke Zaizaowan is an OTC drug and is mainly distributed through drugstores.

In early September 2015, Emerson Analytics bought a box (120 pills) of Fuke Zaizaowan at a drugstore for Rmb25. Two months later, we inquired about Fuke Zaizaowan's retail price at the same outlet and another drugstore, and were told that the price had been raised to Rmb30 a box. We bought five boxes of Fuke Zaizaowan at the latter shop for Rmb149.5, or Rmb29.9 each. The receipt is shown below.

**Exhibit 48 – Sales receipt for Fuke Zaizaowan**



Source: Emerson Analytics

# Hua Han – Bad for Your Financial Health

Prior to its November 2015 price revamp, Hua Han set its retail prices at OTC channels at similar levels to those sold to end users by medical institutions. It was, therefore, reasonable for us to use the tender prices in Exhibit 47 in our calculations.

The successful tender prices of Fuke Zaizao capsules can be found here:

<http://zb.sosoyy.com/zb/Default.aspx?area=&name=D0E853D5E5DC9960C14228F863778975&name2=&zlcc=&comp=&comp2=>

The price range and average price of Fuke Zaizao capsules are as follows:

<b>Exhibit 49 – Range and average of Fuke Zaizao capsules tender prices</b>		
Pills per box	Price range	Average price
36	28.6- <b>42.7</b>	<b>33.3</b>

Source: Emerson Analytics

## I.3. Ex-factory Price of Key Products

The website <http://m.jiangyaojia.com/price> (降藥價網) provides a large amount of information regarding the ex-factory prices of pharmaceutical products. According to the website's administrator, its data are derived from "藥廠的結算收據 (settlement receipts of pharmaceutical manufacturers)"<sup>14</sup> and are therefore highly reliable.

### I.3.1. Ex-factory Prices of Yi Fu & Yi Bei

The ex-factory prices of Yi Fu can be found here:

<http://m.jiangyaojia.com/price?page=1&name=重组人表皮生长因子凝胶>

The price range and average price of different dosages of Yi Fu are as follows:

<b>Exhibit 50 – Range and average price of Yi Fu ex-factory prices</b>			
Dosage	Ex-factory prices	Average price	Overall average
10g:50000IU	3.7-5.3	4.5	5.2
20g:100000IU	4.9-6.1	5.5	

Source: Emerson Analytics

The ex-factory prices of Yi Bei can be found here:

<http://m.jiangyaojia.com/price?page=1&name=重组人表皮生长因子滴眼液>

The range and average of ex-factory prices for different dosages of Yi Bei are tabulated as follows:

<sup>14</sup>[http://china.cnr.cn/yaowen/201112/t20111218\\_508942274\\_1.shtml](http://china.cnr.cn/yaowen/201112/t20111218_508942274_1.shtml)

# Hua Han – Bad for Your Financial Health

**Exhibit 51 – Range and average of Yi Bei ex-factory prices**

Dosage	Ex-factory price	Average price	Overall average
2ml:20000IU	2.9-3.6	3.2	
3ml:30000IU	3.9-5.0	4.3	4.5
4ml:40000IU	4.7-6.0	5.3	

Source: Emerson Analytics

## I.3.2. Ex-factory price of Qijiao Shengbai capsules

The ex-factory prices of Qijiao Shengbai capsules can be found here:

<http://m.jiangyaojia.com/price?page=1&name=芪胶升白胶囊>

The range and average of ex-factory prices for different packages of Qijiao Shengbai capsules are as follows:

**Exhibit 52 – Range and average of Qijiao Shengbai capsules ex-factory prices**

Pills per box	Ex-factory price	Average price	Overall average
36	5.4-12.6	9.1	
48	8.6-16.2	13.8	10.7

Source: Emerson Analytics

## I.3.3. Ex-factory Prices of Fuke Zaizaowan (including capsules)

The ex-factory prices of Fuke Zaizaowan can be found here:

<http://m.jiangyaojia.com/price?page=1&name=妇科再造丸>

The range and average of ex-factory prices of Fuke Zaizaowan are as follows:

**Exhibit 53 – Range and average of Fuke Zaizaowan ex-factory prices**

Pills per box	Ex-factory prices	Average price
120	3.0-3.7	3.2

Source: Emerson Analytics

The ex-factory prices of Fuke Zaizao capsules can be found here:

<http://m.jiangyaojia.com/price?page=1&name=妇科再造胶囊>

The range and average of the ex-factory prices of Fuke Zaizao capsules are as follows:

# Hua Han – Bad for Your Financial Health

**Exhibit 54 – Range and average of Fuke Zaizao capsules ex-factory prices**

<b>Pills per box</b>	<b>Ex-factory prices</b>	<b>Average price</b>
36	4.0-7.1	5.8

Source: Emerson Analytics

# Hua Han – Bad for Your Financial Health

## Appendix II: Comparison of SAIC filings and annual reports by all Guizhou listed companies

Year ended Dec 31 (Rmb m)		SAIC data 2013		SAIC data 2014		Annual report 2013		Annual report 2014		2013 gap		2014 gap	
Stock code	Company name	Total assets	Revenue	Total assets	Revenue	Total assets	Revenue	Total assets	Revenue	Total assets	Revenue	Total assets	Revenue
000540.SZ	Zhongtian Urban Development	12,394	932	16,533	197	12,425	932	16,562	197	0.2%	0.0%	0.2%	0.0%
000589.SZ	Guizhou Tyre	7,267	6,460	9,251	5,173	7,267	6,460	9,251	5,173	0.0%	0.0%	0.0%	0.0%
000733.SZ	Zhenghua Group	2,347	10	3,565	12	2,347	10	3,565	12	0.0%	0.0%	0.0%	0.0%
000851.SZ	GoHigh Data	N.A.	N.A.	N.A.	N.A.								
000920.SZ	South Huiton	1,643	1,619	1,330	1,190	1,643	1,619	1,330	1,190	0.0%	0.0%	0.0%	0.0%
002025.SZ	Guizhou Space	2,481	1,371	2,832	1,604	2,481	1,371	2,832	1,604	0.0%	0.0%	0.0%	0.0%
002037.SZ	Jiulian Industrial	2,474	474	2,661	460	2,474	474	2,661	460	0.0%	0.0%	0.0%	0.0%
002039.SZ	Qianyuan Power	3,149	163	3,150	318	3,149	163	3,150	318	0.0%	0.0%	0.0%	0.0%
002390.SZ	Xinbang Pharmaceutical	N.A.	N.A.	5,223	2,476			5,223	2,476			0.0%	0.0%
002424.SZ	Bailing Pharmaceutical	3,122	1,070	3,263	1,239	3,122	1,070	3,263	1,239	0.0%	0.0%	0.0%	0.0%
300288.SZ	Longmaster Information	N.A.	N.A.	N.A.	N.A.								
600112.SH	Tiancheng Holding	1,962	161	1,913	5	1,962	161	1,913	5	0.0%	0.0%	0.0%	0.0%
600145.SH	Guochuang Energy*	N.A.	N.A.	N.A.	N.A.								
600227.SH	Chitianhua	5,126	2,343	4,220	3,287	5,126	2,343	4,220	3,287	0.0%	0.0%	0.0%	0.0%
600367.SH	Redstar Developing	1,767	1,053	1,305	450	1,767	1,053	1,305	450	0.0%	0.0%	0.0%	0.0%
600395.SH	Panjian Refined Coal	N.A.	N.A.	N.A.	N.A.								
600519.SH	Kweichow Moutai	N.A.	N.A.	N.A.	N.A.								
600523.SH	Guihang Automotive	3,224	2,720	3,756	3,068	3,224	2,720	3,756	3,068	0.0%	0.0%	0.0%	0.0%
600594.SH	YiBai Pharmaceutical	2,849	1,938	4,997	2,163	2,849	1,938	4,997	2,163	0.0%	0.0%	0.0%	0.0%
600765.SH	AVIC Heavy Machinery	N.A.	N.A.	N.A.	N.A.								
600992.SH	Guizhou Wire Rope	1,914	1,928	2,056	1,848	1,914	1,928	2,056	1,848	0.0%	0.0%	0.0%	0.0%

Sources: ECIS (Guizhou), annual reports of relevant companies

Note 1: All annual report data are for the listcos only without consolidating their respective subsidiaries, except for Guizhou Space, Xinbang Pharmaceutical, Chitianhua 2014, Redstar Developing 2013 and Guihang Automotive which are consolidated data

Note 2: Zhongtian Urban Development SAIC data are mistakenly presented in units of Rmb10,000 when in fact they are in units of Rmb. The values shown also include revenue from educational services.

\* Renamed Xinjiang Yilu Wanyuan Industrial Investment Holding Co., Ltd. from June 5, 2015.



# Hua Han – Bad for Your Financial Health

## Appendix III: Key Financial Statistics for Hua Han Subsidiaries 2013-2014

Exhibit 55 – Guiyang DCX Key Financial Statistics 2013

全国企业信用信息公示系统 (贵州)  
**Guiyang De Chang Xiang Pharmaceutical Co., Ltd.**

企业资产状况信息	
资产总额	46,365.47 万元
<b>Revenue 销售总额</b>	23,269.14 万元
销售总额中主营业务收入	23,269.01 万元
纳税总额	2,502.58 万元
所有者权益合计	22,013.80 万元
利润总额	860.04 万元
净利润	720.85 万元
负债总额	24,351.67 万元

Source: ECIS (Guizhou)

Exhibit 56 – Guiyang DCX Key Financial Statistics 2014

全国企业信用信息公示系统 (贵州)  
**Guiyang De Chang Xiang Pharmaceutical Co., Ltd.**

企业资产状况信息	
资产总额	38,781.77 万元
<b>Revenue 销售总额</b>	10,940.70 万元
销售总额中主营业务收入	10,940.70 万元
纳税总额	1,574.03 万元
所有者权益合计	22,406.90 万元
利润总额	481.43 万元
净利润	393.10 万元
负债总额	16,374.87 万元

Source: ECIS (Guizhou)

# Hua Han – Bad for Your Financial Health

Exhibit 57 – GHMM Key Financial Statistics 2013

全国企业信用信息公示系统 (贵州)  
Guizhou Hanfang Medicine Manufacture Co., Ltd.

企业资产状况信息			
资产总额	152,024.91 万元	所有者权益合计	148,035.82 万元
Revenue 销售总额	7,463.97 万元	利润总额	555.81 万元
销售总额中主营业务收入	7,463.97 万元	净利润	416.86 万元
纳税总额	138.95 万元	负债总额	3,989.09 万元

Source: ECIS (Guizhou)

Exhibit 58 – GHMM Key Financial Statistics 2014

全国企业信用信息公示系统 (贵州)  
Guizhou Hanfang Medicine Manufacture Co., Ltd.

企业资产状况信息			
资产总额	54,801.96 万元	所有者权益合计	54,801.96 万元
Revenue 销售总额	570.38 万元	利润总额	-50.50 万元
销售总额中主营业务收入	570.38 万元	净利润	-50.50 万元
纳税总额	80.55 万元	负债总额	3,096.36 万元

Source: ECIS (Guizhou)

# Hua Han – Bad for Your Financial Health

Exhibit 59 – Hanfang Pharma Key Financial Statistics 2013

全国企业信用信息公示系统 (贵州)  
 贵州省食品药品监督管理局  
**Guizhou Hanfang Pharma Co., Ltd.**

企业资产状况信息

资产总额	7,790.00 万元	所有者权益合计	8,630.00 万元
Revenue 销售总额	5,453.00 万元	利润总额	117.00 万元
销售总额中主营业务收入	5,453.00 万元	净利润	88.93 万元
纳税总额	640.00 万元	负债总额	6,926.42 万元

Source: ECIS (Guizhou)

Exhibit 60 – Hanfang Pharma Key Financial Statistics 2014

全国企业信用信息公示系统 (贵州)  
 贵州省食品药品监督管理局  
**Guizhou Hanfang Pharma Co., Ltd.**

企业资产状况信息

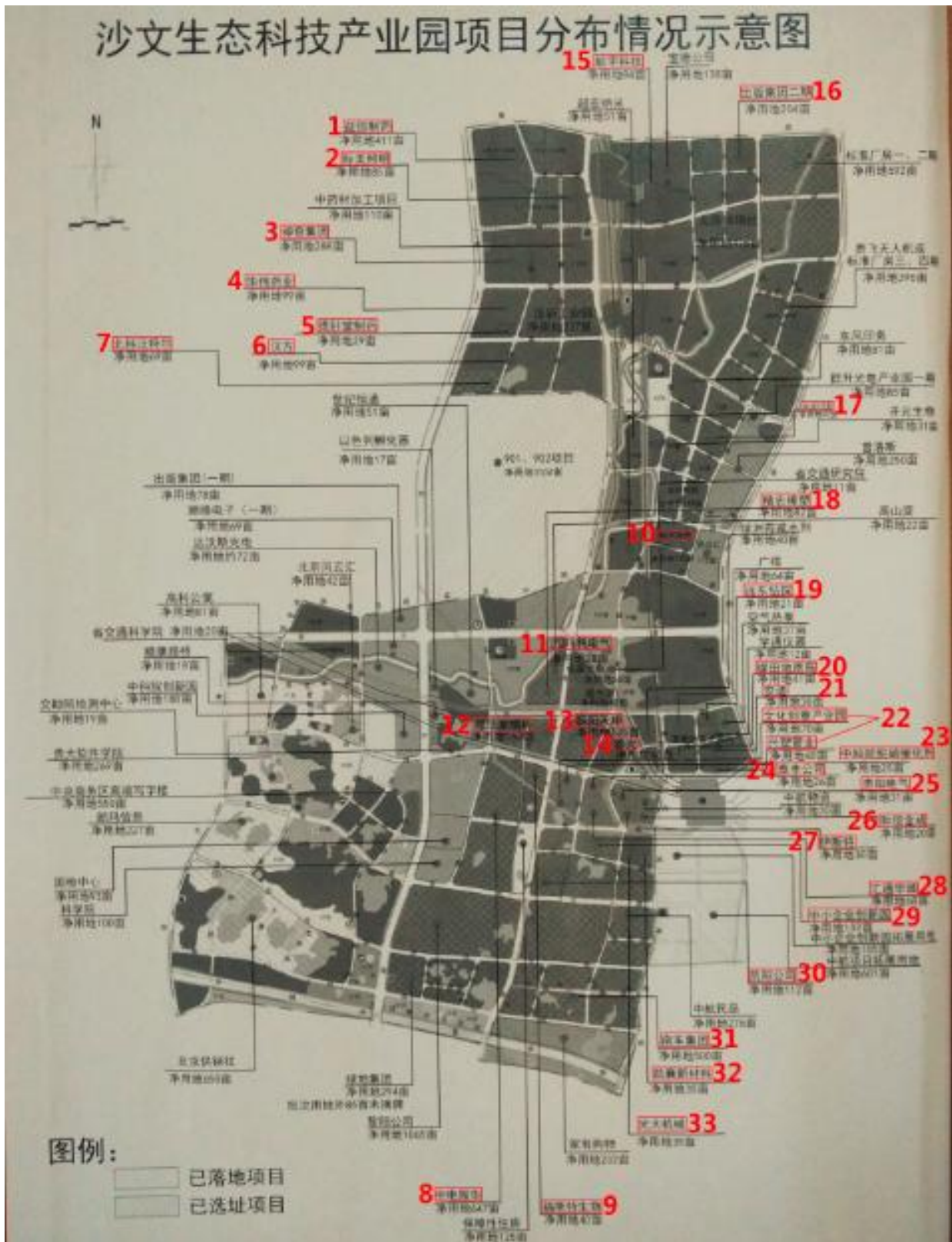
资产总额	6,558.69 万元	所有者权益合计	3,395.66 万元
Revenue 销售总额	24,340.05 万元	利润总额	3,795.34 万元
销售总额中主营业务收入	24,340.05 万元	净利润	3,095.66 万元
纳税总额	229.56 万元	负债总额	3,163.03 万元

Source: ECIS (Guizhou)

# Hua Han – Bad for Your Financial Health

## Appendix IV: Land Price of Shawen Park and Land Transactions in Liupanshui and Tongren

Exhibit 61 – Shawan Park land ownership



Source: Emerson Analytics

# Hua Han – Bad for Your Financial Health

**Exhibit 62 – Summary of Shawen Park Industrial Land Transactions**

No.	Owner	Date	Area (hectares)	Area (mu)	Amount (Rmb m)	Average price per mu
1	益佰制藥	10/29/2014	10.8	162	30.3	187
		10/29/2014	5.9	89	16.7	188
		9/30/2013	10.7	160	26.9	168
2	標美照明	8/6/2013	5.7	85	14.3	168
3	神奇集團	7/26/2013	7.6	115	19.5	170
		7/26/2013	11.6	174	29.5	169
4	華偉藥業	6/18/2013	6.6	99	16.6	168
5	德軒堂制藥	8/6/2014	2.0	29	5.0	170
6	<b>漢方(Hanfang Group)</b>	<b>7/29/2012</b>	<b>6.6</b>	<b>99</b>	<b>16.8</b>	<b>169</b>
7	<b>北科泛特爾(Beike Factorr)</b>	<b>7/30/2012</b>	<b>4.6</b>	<b>69</b>	<b>11.6</b>	<b>169</b>
8	中電振華	2/23/2011	12.9	193	31.0	161
		6/6/2011	16.8	252	40.0	158
9	福斯特生物	6/16/2011	2.6	40	6.3	159
10	皓天光電	9/23/2013	7.5	112	18.9	168
11	司瑪特電氣	8/8/2014	2.5	38	6.5	171
12	振華單螺桿	4/16/2012	8.8	132	22.2	168
13	黎陽天翔	9/17/2012	9.0	135	22.9	169
14	雅光	11/18/2014	4.2	63	11.8	188
15	航宇科技	7/19/2013	5.6	84	14.0	166
		8/29/2013	4.2	63	10.6	169
		3/18/2013	4.6	69	11.8	170
16	出版集團二期	3/18/2013	4.8	72	12.2	169
		7/30/2014	5.2	78	14.6	185
17	永吉印務	7/30/2014	5.2	78	14.6	185
18	精忠橡塑	11/2/2012	5.5	82	13.9	169
19	遠東鈷探	7/18/2013	1.4	20	3.5	169
20	煤田地質局	5/6/2013	2.8	41	7.0	168
21	安迪	9/9/2013	2.0	30	5.0	167
22	文化創意產業園、興塑管業	10/12/2011	7.3	110	18.7	170
23	中科院脫硝催化劑	8/30/2014	1.7	26	4.8	186
24	泰豐公司	4/6/2012	1.7	26	4.4	170
25	貴陽電氣	12/3/2012	2.0	31	5.3	171
26	和信金成	4/4/2012	1.4	20	3.5	170
27	伊斯特	6/18/2012	2.0	30	5.2	171
28	匯通華城	4/4/2012	4.5	68	11.6	170
		3/31/2011	3.4	51	8.4	163
29	中小企業創新園	3/31/2011	3.4	51	8.1	159
		10/12/2011	1.9	28	4.6	165
		8/10/2010	7.5	112	16.2	144
30	凱陽公司	9/30/2011	13.1	196	32.5	165
		3/23/2011	3.3	49	8.3	169
		3/23/2011	17.0	255	42.0	164
31	南車集團	3/23/2011	17.0	255	42.0	164
32	凱襄新材料	9/30/2013	2.3	35	5.8	167
33	光大機械	11/7/2013	2.3	35	5.9	168
<b>Total/average</b>			<b>247.3</b>	<b>3,710</b>	<b>624.0</b>	<b>168</b>

Source: Ministry of Land and Resources of China

Note: Land 8 excludes 202mu of educational land while Land 12 excludes 31mu of educational land  
Land numbers in this table correspond to those in the above map

# Hua Han – Bad for Your Financial Health

## Exhibit 63 – Land Transaction Information for Liupanshui Hospital

中国土地市场网				
www.landchina.com		土地市场信息发布 全面、及时、准确		
网站首页	土地供应	开发利用	市场监测	行业动态 政策法规 专项服务
今日导读: 3.国土资源部发布2015年前三季度主要统计数据 [2015-10-30] 4.在整体回调中逐步趋稳——2015年前三季度土地市场运行态势解读 [2015-10-30] 5.在整体回调中逐				
供地结果信息				
行政区: 六盘水市本级	Area: Liupanshui City	电子监管号:	5202002015B00015	
项目名称: 六盘水市凉都人民医院				
项目位置: 凉都大道北侧、钟山西路南侧、西山路西侧、西宁路东侧				
面积(公顷): 12.027952	Area (Hectare): 12.027952	土地来源:	现有建设用地	
土地用途: 医疗卫生慈善用地	Land Use: Medical Charity Land	供地方式:	挂牌出让	
土地使用年限: 50		行业分类:	卫生	
土地级别: 二级		成交价格(万元): 5424.0000	Transaction Price (Ten Thousand) : 5,424	
分期支付约定:	支付期号	约定支付日期	约定支付金额(万元)	备注
	1	2015年07月09日	5424.0000	
土地使用权人:	六盘水市凉都人民医院有限公司	Land Owner: Liupanshui City Liang Dou People's Hospital Company Limited		
约定容积率: 下限: 上限: 2.00		约定交地时间:	2015年09月08日	
约定开工时间: 2015年09月08日		约定竣工时间:	2017年09月08日	
实际开工时间:		实际竣工时间:	-270	
批准单位: 六盘水市人民政府		合同签订日期: 2015年06月09日	Date of Signature: June 9, 2015	

Source: Ministry of Land and Resources of China

## Exhibit 64 – Land Transaction Information for Tongren Stem Cell Factory

中国土地市场网				
www.landchina.com		土地市场信息发布 全面、及时、准确		
网站首页	土地供应	开发利用	市场监测	行业动态 政策法规 专项服务
今日导读: 五中全会公报透多重亮点 经济增长转向重福祉 [2015-11-02] New 3.国土资源部发布2015年前三季度主要统计数据 [2015-10-30] 4.在整体回调中逐步趋稳——2015				
供地结果信息				
行政区: 铜仁地区本级	Area: Tongren City	电子监管号:	5222002015B00126	
项目名称: 铜仁高新区控规(一期)A-03-01、A-03-02号地块				
项目位置: 铜仁高新区控规(一期)A-03-01、A-03-02号地块				
面积(公顷): 10.617600	Area (Hectare): 10.617600	土地来源:	新增建设用地(来自存量库)	
土地用途: 工业用地	Land Use: Industrial Land	供地方式:	挂牌出让	
土地使用年限: 50		行业分类:	医药制造业	
土地级别: 十二级		成交价格(万元): 1274.0000	Transaction Price (Ten Thousand) : 1,274	
分期支付约定:	支付期号	约定支付日期	约定支付金额(万元)	备注
	1	2015年07月24日	1274.0000	
土地使用权人:	铜仁市泛特生物技术有限公司	Land Owner: Tongren Factorr Bio-Technology Co., Ltd.		
约定容积率: 下限: 1.00 上限:		约定交地时间:	2015年09月24日	
约定开工时间: 2016年03月24日		约定竣工时间:	2018年03月24日	
实际开工时间:		实际竣工时间:		
批准单位: 铜仁市人民政府		合同签订日期: 2015年06月24日	Date of Signature: June 24, 2015	

Source: Ministry of Land and Resources of China