

James' Analysis

WEDNESDAY, SEPTEMBER 14, 2011

Is Silvercorp Another Chinese Fraud?

Silvercorp Metals Inc. (TSX: SVM), a Chinese silver producer, was accused of fraud by an anonymous letter dated August 29, 2011 addressed to the OSC, the Company's auditor and various media. September 13, 2011, Silvercorp was hit by a second round attack, which is an 8-page long report (see here) published on a short-seller's research website, Alfredlittle.com. Silvercorp has responded quickly to deny all allegations on September 2 and 14 respectively (see here).

Is Silvercorp another Chinese fraud like Sino-Forest?

My short answer is: No.

Revenues can be inflated, assets can be exaggerated, but the records of cash activities and tax payments are hard to cook.

Cash

According to Brad Humphrey, an analyst from Raymond James:

"...since 2004 the company has raised just over \$200 mln, paid some \$40 mln in dividends, ~\$30 mln in share buybacks, spent more than \$175 mln acquiring, developing, expanding and exploring (both in China and Canada) and still have roughly \$220 mln in the bank."

It's clear that the Company has been a cash cow.

Tax

According numerous copies of tax remittance forms and verification letters from China tax authorities published on Silvercorp website, the company's major operating subsidiary Henan Found has paid USD\$106 million of taxes for the period 2006 to June 2011. The published annual tax payments are in line with the reported annual revenues of the Company and its subsidiaries'.

If you have doubts about the reliability of documents published by the Company, you can easily verify them with your own online research. For example, according to the State Tax Bureau of Henan Province, Henan Found paid taxes of RMB145.82 million in 2009 and ranked No.50 largest taxpayer in Henan (see here).

Review of Alfredlittle's Allegations

1. Production

Alfredlittle's investigators spent two weeks counting the number of 30 tonne capacity trucks delivering ore to SVM's two mills and then calculated the actual production. The problem here is that in China a 30 tonne capacity truck would be loaded with 40 tons, 50 tons or more, as truck overloading is just a day to day business there. Please see here a serious report regarding truck overloading, and here are some funny vehicle pictures including overloaded trucks.

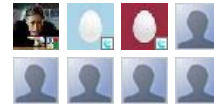
The Alfredlittle Report also cited the designed production on the mining permit and the tonnage reported to the local Land and Resources Bureau to question SVM's reported production in filings. In China the designed production on the mining permit is determined at the time when the permit was approved, and usually will not be updated till expiry or

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renewal of the permit. It is a universal phenomenon in China that the actual production of a mine is bigger than the designed production on the permit, and the miner intends to align the number with the permit or industry norms when reporting to certain government departments.

2. Quality

The questions raised by Alfredlittle did bring doubts with regard to the quality of SVM's mineral reserves, however, they are not convincing evidence.

According to Alfredlittle, the quality of the Ying mine ore in the local L&R bureau records is much lower than it in SVM's 43-101 reports. SVM has already responded that the government record is outdated (2005). Does the government have updated record? Probably it has, but the record is not accessible to the public. Chinese government has built a system to keep the documents of current mineral reserves confidential. From a government website (here) we can see that the government has documents regarding the reserves of SVM's two subsidiaries, Henan Found and Henan Huawei, but the documents have been protected.

Alfredlittle's investigators sent two samples fell from the trucks at the mine site to a local lab and the results showed significantly lower silver grade than it in SVM's 43-101 reports. Two samples certainly do not represent the quality of the whole mine. Due to the uneven distribution of silver in different site and different depth, if Alfredlittle intended to keep going with site sampling, a more appropriate method would be to randomly collect samples from those trucks during a time span of at least several months.

In my opinion, the cash SVM has made and the taxes the Company has paid surely have demonstrated the quality of its ore, if not the whole, at least the ore that the Company has dug out in the past several years.

3. Auction Sale of 5% Henan Found

Auctions of state-owned mining assets are always tricky in China. It's not uncommon that the appraisal, the buyer and the final price are often fixed in such auctions.

4. Questionable Acquisition of Yangtze Gold Inc.

As Alfredlittle report hints that SVM might have overpaid in the acquisition of Yangtze Gold Inc, it is ironic that Larry H.P. Lang (Lang Xianping), a well-known Chinese economist and lecturer, accused foreign companies including Silvercorp of taking over Chinese mining assets cheaply in one of his books. The book, titled 'Production Chain Plots III: The Truth of New Imperialism Acquiring Chinese Enterprises', is available for reading online, and here is the part about Silvercorp taking over Henan Found and Yangtze Gold Inc.

When SVM acquired Yangtze Gold Inc, SVM clearly stated that Yangtze Gold was controlled by SVM's CEO Rui Feng and his relative (see [here](#) the news release in 2008).

Was the CDN\$62 million a fair price? The independent directors and the auditor of the Company should have the answer. And, investors will see the answer very soon, as GC Project, one mine owned by Yangtze Gold, will achieve a 700 tonne per day mining capacity and a 1,500 tonne per day milling capacity by the end of fiscal 2012.

Posted by James Cai at 5:51 PM

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Labels: [China](#), [Fraud](#), [Silvercorp](#), [Stock](#)

2 comments:

 **John Hempton** said...

Are you sure the company has the money in the bank?

Longtop did not - but it had plenty of documentation to say it did!

Just saying that these things are more difficult than you would like.

J

[September 16, 2011 2:40 AM](#)

 **James Cai said...**

Thank you for your comments.

I am not 100% sure the company has the cash it claimed, but I believe because:

1. Its tax payments are in line with its revenues and net income, which corroborate its cash.
2. After Longtop story, posting forged bankstatements would be a quick suicide. I do not think Rui Feng would be so stupid.
3. It's not hard to verify the cash if you have connections with Chinese banks. Probably the Anonymous already did the verification.

[September 16, 2011 9:11 AM](#)

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