



China Biotics Suspected of Inflating Financial Performance

By Jinyuan Lu, Yicai.com dated January 21st, 2011

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Recently, accountant Xia Cao published an article on his blog suggesting the operating subsidiary of China Biotics is involved in massively fabricating net income and causing a fabricated massive tax liability.

According to the Company's second quarter financials, spanning July 1st, 2010 to September 30th, 2010, the company's tax payables exceed over 30.57 million USD, translating into over 200 million RMB. According to calculation done by Xia Cao, the taxes payable by CHBT is 60% of the total taxes payable over the past six and a half years.

Responding to this, China Biotics states that commission caused the overstatement in its tax payables.

In addition to suspecting the Company's financial performance, plenty of questions linger around the number of stores the Company allegedly had.

Where are the hundred stores?

On August 30th, 2010, a firm named Citron Research published an article titled "CHBT, where are your stores?" questioning the execution of CHBT's strategy of opening up new stores over the past couple of years; most of the stores were completely fabricated. On August 31st, the Company's stock price dropped over 18%.

According to CHBT's 2010 financials, "up until March 31st, 2010, we have over 111 dedicated Shining outlets, with over $\frac{3}{4}$ of them located in Shanghai and 12 of them in other cities in China".

Going with the calculation above, there should be about 70 stores in Shanghai. But the journalist visited one of the dedicated outlets of Shining on Xietu Road and one on Zhangyang Road; the sales representative at Xietu Road stated to the journalist: "we only have six stores in Shanghai, one in Pudong, 5 in Puxi". The store employee

at Zhangyang Road stated that there is only one store in Pudong. Additionally, the journalist visited the manufacturing facility of CHBT located in Pudong Jinqiao Export Production Zone (No. 999 Ningqiao Road). A manager responsible of administrative matters by the last name of Li was surprised by the over 100 store number. "From what I know, we don't have that many stores", he said.

The vice executive chairman, Eva Yan told the newspaper: " with regards to the store problem, it's a matter of definition. The company also considered shelf spaces and locations in supermarkets as outlets. There had always been around sixty to seventy stores, among them, over 60% of them are Company stores, which is around 40 stores. 40% of them are supermarket shelf space and in-store locations." Even if we take it at the face value, the 40 store number is still a far cry from the 6 stores claimed by CHBT's store employee.

But some of the supermarkets stated to us that they never carried any products branded as "Shuangjin" or Shining; Moreover, Tesco stated to us they used to carry some probiotics by Shining, but the sales volume was too low and therefore stopped taking delivery from the Company in July 2010. Tesco recently took a small delivery of the product.

Accrual caused high tax payables?

According to CHBT's 2010 annual report, as of March 31st, 2010, the Company's revenue number was 81 million USD; by the exchange rate at that time, almost 550 million RMB.

By the Company website, CHBT is engaged in the research, development, production, marketing, and distribution of probiotics products, which are products that contain live microbial food supplements. The Company manufactures and sells several health supplements under the Shining brand in China. But according to Dachao Zhang, the chairman of the Working Group for Healthcare Product Consulting Services at China Health Care Association, currently, there is no domestic company that has any scale in manufacturing healthcare product. And probiotics is mostly used as food additives.

Dachao Zhang further introduced:" in mainland China, the companies of scale include Danisco, the company recently acquired by Du Pont and a Taiwanese Company called "Grape King". They all have stores in mainland China".

Persons at the headquarter marketing department of Danisco China located in Guangzhou stated that compared to Danisco, the amount of probiotics that Shining (CHBT) provides to Dairy companies is miniscule. Also, the above mentioned marketing person expressed that he could not possibly understand how could CHBT sell over 80 million USD probiotics products.

On September 30th, 2010, the Company invited investors to tour the Company facilities to disperse doubts. One of the viewers, Sean Wright published a blog article on Seeking Alpha titled “ What happened during the Investor Day of CHBT” and cited Jinan Song, the chairman of CHBT as saying CHBT has been providing probiotics for leading dairy manufacturers in China including Yili, Mengniu and Bright Dairy.

But journalist at our newspaper got the response from Mengniu :” Shining or CHBT is not our supplier, we purchase from the two biggest manufacturers in the world, Danisco and Hansen.” Also, people at Bright Dairy stated that they do not know about the Company because Bright Dairy mostly use its own probiotics.

Eva Yan stated that the Company has yet to sign officially with Yili, and it merely cooperated with Bright Dairy in 2007 when they were innovating probiotics "mooncakes".

According to 2010 annual reports by CHBT, the Company’s food additive revenue is 26.8% of its total revenue, and retail products occupy the other 73.2%. Eva Yan also stated, currently the Company’s products on bulk additives and retail is about 4:6.

When the journalist visited CHBT’s flagship store at Xietu Road and its store at Zhangyang Road, the journalist observed no customers during his half hour in the store. The sales representative said most of the customers are older people and come by in the morning. Interestingly, in the sales record that store employees at Zhangyang road showed to the journalist, even 2008 sales was still recorded.

In a Lianhua Supermarket on Xinzha Road, the journalist saw Shining protein probiotics on the shelf, but the manufacturing date was January 2nd, 2010, over a year from the date of visit. The shelf employee said: “almost no one buys this product.”

Xia Cao suspected CHBT’s fabricated performance was the primary reason for its high tax liability. But CHBT responded by saying, the tax liability was a result of commissions. “Five years ago, the Company was exempted from taxes as a high-tech firm, but no document can show such status; afraid of being pursued by tax bureau, the Company accrues taxes.” Eva Yan emphasized: “It’s not tax liability.” But some one from the tax department of a Big Four accounting firm stated to the journalist, according to Chinese tax laws, corporations cannot accrue taxes as such. “What’s the basis of accrual? How did the company calculate this? It’s increasing every year? This is not quite possible.”

The newspaper will follow up on the story.