



## February 2011

# CHINA AGRITECH: A SCAM

Based on our research, China Agritech, Inc. (listed on NASDAQ as CAGC) is not a currently functioning business that is manufacturing products. Instead it is, in our view, simply a vehicle for transferring shareholder wealth from outside investors into the pockets of the founders and inside management. Our price target of \$2 is based on the cash currently reported on CAGC's books—\$45.8 million—divided by the number of shares outstanding. The company's remaining business does not, we believe, exceed \$7.5 million in revenue per year. If the overhead associated with maintaining a listed company is taken into account, there is no profit. Since we believe China Agritech has no valuable technology, intellectual property, customer relationships, or capital assets, there is no value to the company other than dissolution value.

**Disclosure: Writers and contributors to this report have short positions in CAGC (and / or own options on the stock), and therefore stand to realize significant gains in the event that the price of the stock declines. Following publication of any report, we intend to continue transacting in the securities covered therein, and we may be long, short, or neutral at any time hereafter regardless of our initial recommendation. This is not an offer to sell or a solicitation of an offer to buy any security, nor shall any security be offered or sold to any person, in any jurisdiction in which such offer would be unlawful under the securities laws of such jurisdiction. We have obtained all information contained herein and in reports from sources we believe to be accurate and reliable. However, such information is presented "as is," without warranty of any kind – whether express or implied.**



*Company:* China Agritech Inc. (NASDAQ: CAGC)

*Current Stock Price:* \$11.00

*Target Price:* \$2.00

*Current Market Capitalization:* \$230 million

*Basic Argument:* The Company's actual revenues are under \$7.5 million and dwindling.

## Summary

- China Agritech (“CAGC”, “Agritech” or the “Company”) is a \$230 million company that purportedly manufactured and sold \$119 million worth of “green” fertilizers throughout China in 2010. In reality, we believe Agritech’s factories are currently all idle and only one out of its four factories produced anything at all in 2010.
- Despite having raised over \$70 million in capital since 2005, Agritech appears to have acquired only several million dollars worth of capital equipment. By contrast, it has paid its two founders at least \$4 million in rental fees and real estate purchases during that time.
- We have been unable to obtain even one sample of Agritech product, even from headquarters, nor have we found a single distributor or sales outlet.
- Companies Agritech claims as clients, such as the big state-owned fertilizer company Sinochem, deny having any contracts with Agritech. Sinochem has told us that it does not sell any Agritech products.
- Government officials in China told us that Agritech does not have a license to manufacture granular fertilizers, which the company claims are its largest product line.
- We visited each Agritech facility and found each one empty, idle, and without production equipment.
- Agritech’s CFO has been involved in two listed companies before Agritech in which he personally collected seven-figure sums while the companies went to zero. Analysts have called these earlier companies “pump and dump” schemes.
- In early 2010, the U.S. Financial Industry Regulatory Authority (FINRA) lodged a formal inquiry with CAGC questioning insider share transactions.
- Our calls and emails to the company requesting clarification have gone unanswered.
- All evidence suggests that this company has never been a successful vendor of fertilizer and is currently fraudulent.

## Table of Contents

<b>Summary</b>	<b>2</b>
<b>China Agritech: A Company that barely exists</b>	<b>3</b>
<b>Financial anomalies</b>	<b>9</b>
<b>Checkered history of humic acid</b>	<b>9</b>
Low-revenue, low-profit business	10
Money-losing compounds	11
<b>Organizational Structure as of 12/31/09</b>	<b>12</b>
Corporate Structure as of September 2010	12
<b>Self-Dealing</b>	<b>13</b>
Real estate	13
Stock-Based Compensation	13
Company Background	13
Executives, directors, and service companies	14
Fundraising	15
<b>Conclusion</b>	<b>16</b>

## China Agritech: A Company that barely exists

On January 21<sup>st</sup>, China Agritech Inc. (listed on the NASDAQ under the ticker CAGC) reported 2010 annual revenues of \$119 million: up 56% from 2009 and well ahead of the \$107 million average estimate. The share price rose 5%. As far as we can determine, however, this revenue number was invented out of thin air.

**Factories are idle:** After visiting Agritech’s reported manufacturing facilities in Beijing, Anhui, Xinjiang, and Harbin, we found virtually no manufacturing underway. The single exception was the facility in Pinggu County on the outskirts of Beijing, where the plant was not in operation on the Friday when we visited but local people told us that it has sporadically produced some liquid fertilizer over the last year. Plants in Bengbu, Anhui (supposedly the largest), Harbin, and Xinjiang were completely shuttered.

**Harbin plant for sale:** The Harbin facility – supposedly a major manufacturing facility for the \$100 million revenue business – whose name has never been officially changed in government documentation from “Pacific Dragon,” had a sign hanging on the gates last summer reading “this factory is for sale.” Although the company gives an adjacent address for its facility, which has a

signboard reading “Harbin Agritech,” the registration documents with the local Administration of Industry and Commerce (AIC) have not been updated (a serious regulatory violation in China).



“For Sale” sign on CAGC’s factory in Heilongjiang. Photo taken in Fall 2010.

**No contract with Sinochem:** A January Agritech announcement states: “In May 2010, the Company signed a renewed contract supplying organic liquid compound fertilizers to Sinochem, China's largest fertilizer distributor. The sales contract is worth RMB 61 million (approximately \$9 million) and the Company will also continue to supply Sinochem with organic granular compound fertilizer under another existing contract.” But a manager with Sinochem told us that Sinochem has no contract with Agritech and in fact has never bought or sold organic liquid fertilizers.

**No distribution centers:** A \$19 million raise managed by Rodman & Renshaw in 2010 was billed as funding for a proprietary distribution network, and last month, Agritech announced that it was ahead of schedule in setting up regional distribution centers. The company said it had established 21 such centers in Henan and Jiangsu provinces. In reality, we could find none, whether online, through directory information, through calling the company itself, or asking other fertilizer companies. Here are the words of a manager of one of China’s largest fertilizer distribution companies, which previously distributed product in Henan for China Green Agriculture (CGA):

"I have never heard of anybody besides ourselves in Henan Province who distributes liquid humic acid fertilizer. The sales volume for liquid humic acid-based fertilizers is insufficient, so China Green Agriculture’s factory stopped selling in Henan this year. I don’t know of another such distribution center in Henan, for another company; if there was one, I would be the first one to know."

**Agritech not permitted to make granular fertilizer:** Agritech claims that most of its sales volume now derives from granular compound fertilizers. But government officials familiar with the Agritech operation say that Agritech has not received a license to manufacture granular compound fertilizer and does not sell any.

**Unable to buy the product:** Although the company has announced 21 regional distribution centers, we have not been able to locate any. We attempted at some length to purchase at least one bottle of the Agritech product but were disappointed. Fertilizer distributors listed on a popular industry website did not carry Agritech product. We looked for the addresses of retail locations. Then we tried buying online via the popular site Taobao or an agricultural products site, with no luck. Then, we telephoned the company. We asked for retail locations, but the staff member who answered the phone said that they could only fill our order directly. We explained that we wanted one bottle as a sample before making a bigger order. She said that the company is able to fulfill only wholesale orders. When we persisted, the staff member said that a distributor would be passing through our area, Beijing, the following week and would drop off a sample, but that did not happen. When we called the number for the “distributor” the following week, the phone was unanswered.

**Fictional revenue:** Through legal agents, we have received an analysis of audited CAGC revenues reported to the Chinese government for the year 2009 in every subsidiary we were able to trace—including the Beijing subsidiary, which is mysteriously unreported by the company. We were able to review CAGC’s results from its companies in Anhui, Beijing, Heilongjiang, and Xinjiang. The branch company in Chongqing, we were told by government sources, does not keep a separate P&L but instead records its revenue through its parent company. We did not find a record of a Xinjiang branch company.

Gross revenue, profit and fixed assets reported to the government in these companies for 2009 was as follows:

Subsidiary Name	2009 Gross Revenue (RMB)	Profit (Loss) (RMB)	Fixed Asset Value (RMB)
Harbin Pacific Dragon Liquid Compound Fertilizer Co. Ltd.	580,000	(7,000)	1 million
Agritech Fertilizer Company (Beijing)	46.65 million	7.61 million	10.95 million
Anhui Agritech Agricultural Development Co. Ltd.	530,000	(94,000)	2.73 million
Xinjiang Agritech Agricultural Resources Co. Ltd.	3.82 million	(250,000)	20,000
<b>Totals Reported to SAIC (in RMB)</b>	<b>51.58 million</b>	<b>7.259 million</b>	<b>14.7 million</b>
<b>Totals Reported to SAIC (in USD)</b>	<b>\$7.58 million</b>	<b>\$1.067 million</b>	<b>\$2.16 million</b>
<b>Numbers reported to the SEC</b>	<b>\$76.13 million</b>	<b>\$5.69 million</b>	<b>\$5.98 million</b>
<b>SEC figures as a multiple of SAIC</b>	<b>10x higher</b>	<b>5x higher</b>	<b>3x higher</b>

In its Q3 2010 report, Agritech claims that it has 100,000 metric tons of production capacity in Anhui, 50,000 metric tons in Harbin, and 50,000 tons in Xinjiang. But a total value of US\$3,000 in plant and equipment in Xinjiang would be insufficient to support 50,000 tons of production capacity. Indeed, when we visited the site of the Xinjiang plant, we found little more than a warehouse, shared with two other companies and demonstrating no activity.

Our early attempts to find the Xinjiang factory were unsuccessful; there is no Agritech building at the company's legally registered address, and neither local government officials nor other companies in the high-tech park on the outskirts of Urumqi that is officially the site of the plant had ever heard of China Agritech. Finally, after searching the area and asking county officials, we were able to discover a facility bearing Agritech's name along with the names of two other companies, including the instruments company from which Agritech reportedly rents its facility. The facility, however, is idle, and we were told by local people that there is no production activity there.



The facility outside of Urumqi, which is idle, has Agritech's name but also the names of two other factories.

In Anhui, which Agritech calls its principal production facility, \$400,000 worth of plant and equipment would seem slim for 100,000 tons of production capacity. We visited and found a small plant on a rutted road outside Bengbu, completely deserted.



The Agritech factory in Bengbu, Anhui, January 2011

The Beijing plant is larger, but plant staff said in our presence that the facility was idle. The company would not allow us in, but we drove around the plant and saw a few people on site washing clothes but no evidence of production. Local government officials said that Agritech had not been able to obtain a production license for granular fertilizer and that it produced a very small volume of liquid fertilizer.



Agritech factory in Pinggu County, Beijing, January 2011

We can only conclude that China Agritech has no product. Insiders are taking wealth from their shareholdings, since clearly they cannot derive wealth from company profits: in January alone, co-founder Teng Xiaorong took in about \$260,000 from share sale proceeds, and in 2010 she sold over \$1 million worth of stock in the company in addition to being issued new shares. Ms. Teng, who according to the company's 2010 annual proxy received \$131,524 in direct cash compensation last year from CAGC, is a director of the company without an executive role.

In other words, as Agritech's actual revenue and profitability have dwindled to nothing, insiders have levered more money out of the company in shares sales. Added to that, insiders have reaped benefits from the sale and rental of real estate to Agritech.

**No distribution centers:** In May 2010, Agritech issued over 1.4 million new shares, raising just under \$19 million for the construction of distribution centers. But we have not been able to find evidence that any distribution centers were actually built.

**Mysterious suppliers:** The companies that Agritech lists in its corporate materials as suppliers of raw materials, including Harbin Haiheng Chemical Distribution Co., Beijing Zhongxin Chemical Development Co., and Shenzhen Hongchou Technology Co., cannot be found in any directory under possible Chinese names that would correspond to the transliterated names or under the alphabetic names. No companies with names resembling these appear on industry lists of companies making humic acid or ingredients for "green" fertilizers. In fact, we speculate that the companies, if they ever existed, form an outdated supplier list, since at least three of Agritech's four factories are closed down.

For example, Agritech lists a supplier they call "Beijing Zhongxin Chemical Development Company." No such company exists, although there is one in Beijing called "Beijing Zhongxin Trading Company" listed on the Internet.<sup>1</sup> However, when we called the Beijing operator for directory assistance, she could find no such company listed in the active directory. We gave her the phone number listed on the Internet site (010-66067374) and asked her to do a "reverse look-up" of the number. She advised us that this is a number for a public phone booth, not a legitimate business phone number. All other searches for the suppliers mentioned in the 10K filing were futile.

Agritech gives no information about customers or distributors in the two most recent 10Ks; we had to go back three years to find the names of any such companies. We decided to contact each of the companies mentioned in that three-year-old 10K. We could verify only one of the names – Sinochem, which had already told us they do not do business with Agritech. We were not able to find active businesses with active phone numbers for any of the other supposed customers listed by Agritech.

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[http://www.701sou.com/index.php?lang=en&act=approximatch%20search&cat=1101&where=BEIJING&what=Wholesales&dAction=Search&refinement\[ennbhd\]\[1\]=XiCheng+District&item=1&sort=distance](http://www.701sou.com/index.php?lang=en&act=approximatch%20search&cat=1101&where=BEIJING&what=Wholesales&dAction=Search&refinement[ennbhd][1]=XiCheng+District&item=1&sort=distance)



## Financial anomalies

We have done some analysis of financial reports that Agritech has provided to its SAIC regulators in China and have determined the following:

1. The Harbin company, Pacific Dragon, has cumulative losses since 1994 of over 4 million RMB. None of its 2009 revenue was actually received but all was entered into “accounts receivable.” Meanwhile, the debt-to-asset ratio is 98% and quick ratio is 61%. There were no sales expenses at all, only administrative expenses. In short, the 2009 audit report on CAGC’s Harbin company shows a dead company.
2. The Anhui facility has generated losses every year since its establishment in 2006. By the end of 2009, it had lost 3.89 million RMB. The company had zero cash on its books.
3. The Xinjiang company reports zero fixed assets, meaning that it owns no equipment for production. Moreover, its 75% parent is the Anhui company, yet the Anhui company never reported making the required investment in the Xinjiang subsidiary.
4. The Beijing facility has licensed registered capital of \$20 million, but by the end of 2009 had received 88 million RMB, so only more than half of the legally required amount. But despite the missing capital, half of the registered capital was still sitting in the account in cash in 2009, indicating that the company had not purchased much, if any, equipment.

## Checked history of humic acid

China’s fertilizer market is very large: China consumes about 30% of the world’s total fertilizer. But the vast majority of these fertilizers are nitrogen, phosphate, and potash chemical fertilizers. A large volume of natural fertilizers, derived from manure or various types of plant mulch, are still used by individual farmers but not commercialized. The market for specialty fertilizers like humic acid is small, fragmented, and suspicious of the commercial players that have come sprinting into the market since about 2006. Interviews with multinational fertilizer companies have confirmed to us that they do not see any market in China for humic acid, “fulvic acid,” or other commercial organic fertilizers.

The national interest in humic acid—the key component of organic fertilizers made by CAGC, China Green Agriculture (CGA) and others—was prompted by Long Marcher Wang Zhen in the late 1970s. As a key influencer of the coal industry, agricultural policy, and the territory of Xinjiang (whose capture was largely attributed to his military skill), Wang Zhen formulated the idea that humic acid could be a high value-added product of coal for use in medicine and farming, and he directed funds to research and development of humic acid. That funding lasted for nearly two decades, until, in 1987, human trials of humic acid for medicinal use reportedly led to disastrous results.<sup>ii</sup> The government withdrew licensing authority from four provinces up to the national level.

A number of institutes under the former Ministry of Coal continued researching the use of humic

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ii Qin Wandu: “The Humic Acid Industry: Retrospective and Outlook,” Coal Industry Ministry Publication 100713, 2004, courtesy of Wanfang Data.

acid in agriculture, but as the price of coal rose, starting around 2000, few institutes wanted to focus on coal byproducts. Individual researchers instead broke out of the government companies and labs to start up companies that would commercialize humic acid. Around 2004, technological improvements made it possible to extract more of the active ingredient, fulvic acid, and make it water-soluble. By the end of 2004, there were roughly 3,000 companies in China making humic acid or its derivative fertilizers. Sales were driven by speculative capital, and the market appears to have peaked in 2008.

Because no quality or active-ingredient standards have been applied to natural fertilizers like humic acid, the quality of product on the market has been extremely uneven, and acceptance by farmers has been cautious. By the accounts of many companies that distribute fertilizer, in 2009, the market dwindled, and now farmers show little interest in the humic acid fertilizers that had been billed as a wonder drug for crops.

To make matters worse, in 2009-2010, government environmental regulation gradually closed down some of the manufacturers and put a ban on expansion for the others. The production process uses around 10 tons of dusty, weathered coal each day that has to be crushed then liquefied in order to make 2,000 tons per year of humic acid. The manufacturing process, to some extent borrowed from Japanese 1960s technology, is outdated and dirty and makes an easy target for local governments that are trying to meet new environmental standards. China's largest manufacturer of humic acid, in Inner Mongolia, closed in 2010. High-quality humic acid has become difficult to obtain, with major manufacturers in Xinjiang and Shaanxi saying that they are refusing domestic orders since they intend to go into manufacturing end product instead. There is a 60-day wait for order fulfillment for the best overseas customers.<sup>iii</sup>

### ***Low-revenue, low-profit business***

We visited one of China's largest manufacturers of pure humic acid, a factory that produces 2,000 tons of humic acid per year. Based on the current requirement that humic acid fertilizers contain 4% of the active ingredient, and that the blended humic acid fertilizer can be combined with 30% inactive ingredients, the 2,000 tons of humic acid can yield about 75,000 tons of fertilizers. Currently earning 10,300 RMB per ton of humic acid—a price that has doubled in 12 months—this company estimates 20 million RMB in gross revenues for the current year, or about \$3 million. The managers believe that, if they can use all their production for their own end product, they may be able to triple revenues. Even these optimistic estimates, however, would not bring the company anywhere close to the revenues claimed by Agritech.

Not permitted to expand production and concerned that its existing outdated equipment may have to be replaced, this company is now driving into the manufacture of blended fertilizers under its own brand, in order to extract more value from the existing facility.

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<sup>iii</sup> Based on interviews in January with the Chinese Humic Acid Association, the State Environmental Protection Ministry in Beijing, and companies in humic acid production.

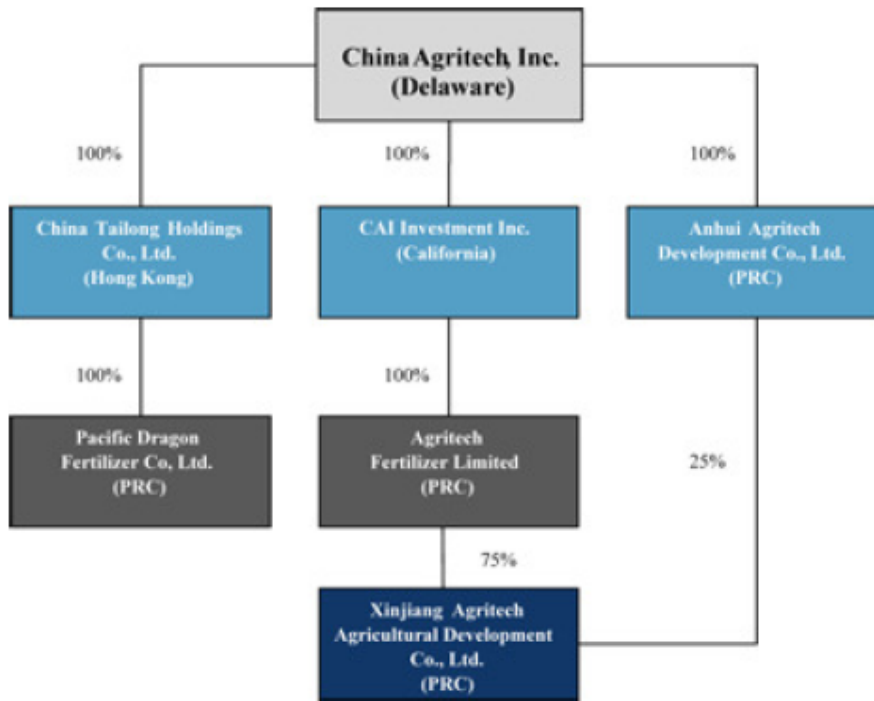
## ***Money-losing compounds***

As market prospects for humic acid have dwindled, China Agritech, China Green Agriculture, and other producers of natural fertilizers have been driven into compounds, where the admixture of chemical fertilizers adds volume and market acceptance.

The problem is that compounds earn slim or negative margins. In 2008, the compound fertilizer production volume showed negative growth, as raw materials prices soared and farmers limited consumption to manage their costs. According to the China National Chemical Industry Information Center (CNCIC), China's production volume for compound fertilizers in 2008 was 200 million tons per year, while actual production was only 50 million tons. Product prices are essentially determined by the input costs plus 1-3%. That means manufacturers of compounds, if they produce at all, are doing so at razor-thin margins. Given that Agritech claims to produce 200,000 tons of granular compounds against 13,000 tons of higher-margin liquid compound fertilizers, a 28.5% EBITDA margin in 2009 should be viewed as a feat of magic by large competitors like Sinofert (HKG: 297). In 2009, Sinofert sold about 1.01 million tons of granular compounds. The company's EBITDA margin in 2009 was negative. Although only 20% of Sinofert's revenues is derived from its own manufacturing rather than agency sale of compounds, margins are similar on that side of the business.

Faced with industrial fragmentation and losses, China's government agencies in 2008-2009 issued policies designed to consolidate the industry, shutter high-cost manufacturers, and convey expansion capital and other benefits to large producers. Lower prices of nitrogen in 2009 bolstered production of compounds to about 55,000 tons, often at a small profit. But small producers and newcomers like Agritech were not able to obtain production licenses for compounds. Local government officials told us that Agritech had not obtained licenses for manufacturing compounds in any of its facilities and was restricted to making liquid compounds at the facility in Beijing. A government official in charge of regulating a part of Agritech's business and who was very familiar with the company estimated that, nationwide in 2010, Agritech did not have more than 50 million RMB in revenues.

## Organizational Structure as of 12/31/09<sup>iv</sup>



### **Corporate Structure as of September 2010**

By the end of November 2010, Agritech’s 424B3 report filed with the SEC stated that the company had established several new subsidiaries: Diamond King Group (BVI), China Agritech Investments (Hong Kong), and Yinong Agricultural Co. Ltd. (PRC), as well as a new branch company in Xinjiang. Our checks against government records, however, found no companies involved in fertilizer with Chinese characters sounding like “Yi Nong” in the name whose parent company is named Agritech. The company of course could exist. But we have found a frustrating pattern with Agritech of announcing only English-language company names and choosing names that could represent dozens of different Chinese characters.

The November prospectus also indicates that China Tailong Holdings has established a new representative office in Beijing. Given that the headquarters building in Beijing was deserted other than by about five people when we visited, we are puzzled as to why the company would need an additional representative office. Representative offices are highly restricted as to the scope of their activities and pay onerous taxes if they are deemed to be engaging in commercial activities. The representative office structure is most appropriate for non-profit trade associations and NGOs.

<sup>iv</sup> Note: Tailong is sometimes called “Pacific Dragon,” the English translation of the name.

## Self-Dealing

### *Real estate*

Real estate companies owned by founders Chang Yu (常玉) and/or Teng Xiaorong (滕晓荣) have earned at least \$4 million from China Agritech since 2004. Since its reverse merger, Agritech has been renting certain of its Harbin and Beijing premises from its founders, with the rent cost totaling more than \$500,000 annually over the past few years. The premises are mostly empty. Agritech has also purchased real estate from its founders.

The Harbin factory has a rental agreement with the founders through the founders' company Harbin Yinlong. Since July 2005, rent has been 3.6 million RMB per year. Based on that rate, CAGC has paid more than \$2.5 million in rent to companies controlled by Chang Yu and Teng Xiaorong since becoming a public company.

In 2007, the company began paying Ms. Teng 492,000 RMB annually to rent its office space in Beijing. Last August, the rental agreement was terminated, and the company paid Ms. Teng \$1.49 million for the 750 square meter office space. The price was within the range of comparable real estate in Beijing. However, our visits to the office suggested that China Agritech did not need nor was utilizing 750 square meters of office space.

### *Stock-Based Compensation*

Over the past twelve months, at least 200,000 registered insider shares have been sold by Ms. Teng, CFO Gareth Tang, and officer Zhu Mingfang (Steve Zhu) for a value exceeding \$2.5 million.

### *Company Background*

Company founders Mr. Chang and Ms. Teng formed Pacific Dragon in Harbin in 1994 to manufacture liquid and granular organic and chemical fertilizers.

In 2003, Mr. Chang and Ms. Teng incorporated a shell in Hong Kong called China Tailong Holdings to hold the equity of Pacific Dragon, the Harbin manufacturing plant where the company then produced about 5,000 tons of liquid fertilizer. Tailong acquired a 90% interest, and a PRC company held by Ms. Teng and Mr. Chang, called Yinlong Industrial or "Silver Dragon," held 10%.

Basic Empire Corp. in 2002 was the shell of a Nevada-based mining company originally called Argyle Mining. In May 2004, Timothy Halter, the reverse-merger specialist who founded the "Halter USX Index," bought majority control of the company for \$200,000. In February 2005, the company completed a reverse acquisition with a Hong Kong corporation that had been established by company founders Mr. Chang Yu and Ms. Teng Xiaorong. On May 12, 2005, the company's name was changed to China Agritech. A private placement in June of that year

preceded a January 2006 offering that raised \$11 million.

In May 2009, Tailong agreed to acquire the 10% balance of Yinlong's interest in Pacific Dragon for \$1 million in cash plus 1.745 million new shares for the two founders.

### ***Executives, directors, and service companies***

***Gareth Yau-Sing Tang, CFO:*** Gareth Tang has a history of improper insider transactions. From 2003 to 2005, Tang was CFO of a small company quoted on Pink Sheets called China Cable and Communication Inc. (formerly CCCI.ob, now CCCI.pk). CCCI was a dubious venture, built around a cable TV system with 200,000 subscribers in the city of Baoding in Hebei Province. During his tenure as CFO, Mr. Tang took at least \$1.5 million in share sale proceeds from the company and received shares worth more than \$50,000 per month of his tenure. Mr. Tang's last stock sale came in September 2005, shortly before CCCI stopped reporting to the SEC and, for all intents and purposes, disappeared. The investor Isaac Silberman, writing in Seeking Alpha, discussed Mr. Tang's earlier history as CEO of a Hong Kong-listed company called China Prosperity Holdings.<sup>v</sup> Essentially, Mr. Tang bought up cheap shares in a defunct Hong Kong-listed shell. Then a rumor that the company would receive the right to operate the first media joint venture on the mainland sent the share price soaring. After heavy insider trading, the company announced that the venture had been aborted and did not disclose a reason.

***Linda Lingxiao Dai, Vice President of Finance:*** Ms. Dai's previous position is listed as CFO of the China branch of American Yellowstone Power Co. But searches turn up no record of a company of that name in China or in the United States. The closest name that can be found in Chinese translates as Yellowstone Resources, but there is no record of Ms. Dai having been associated with that company.

***Gene Michael Bennett, Director, Chairman of Audit Committee:*** Formerly a CPA with Grant Thornton, Gene Michael Bennett is or has been a director of China Shen Zhou Mining & Resources (SHZ), China Pharma Holdings (CPHI), China Fire & Security Group, Inc. (CFSG), and China Shenghuo Pharmaceutical Holdings, Inc. (KUN).

- KUN recently agreed to settle with shareholders who had filed a lawsuit for damages due to false and misleading statements by the company.<sup>vi</sup>
- China Fire & Security Group Inc. is a questionable business that is associated with a group of middlemen and service companies that have been connected in the past to stock manipulation.<sup>vii</sup>

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v Isaac Silberman: "China Agritech: Questioning Management's Credibility," October 5, 2010, <http://seekingalpha.com/article/228751-china-agritech-questioning-management-s-credibility-part-2>

vi Shareholders Foundation:

<http://shareholdersfoundation.com/case/china-shenghuo-pharmaceutical-holdings-agrees-settlement-shareholder-class-action>

vii Chris Carey: "China Fire & Security Inc.", Share Sleuth, March 10, 2008,

<http://sharesleuth.com/investigations/2008/03/china-fire-security-group-inc/>

**Auditors:** Agritech was downgraded last September by boutique investment bank Chardan Capital Market because of Agritech's retention of sub-standard auditing firms. China Agritech originally retained Kabani & Co., the Los Angeles-based accountancy that audited the notoriously fraudulent Bodisen Biotech, an organic fertilizer company that was delisted in 2007, and China Green Agriculture (CGA), a firm which we believe also falsely reports its results to U.S. investors. Agritech ended its relationship with Kabani in April 2008 and retained Crowe Horwath LLP. After being downgraded for not choosing a "Big Four" auditor, Agritech last autumn appointed Ernst & Young Hua Ming, which is the joint venture that Ernst & Young was required to form in the early 1990s in order to access the Chinese market. "Big Four" firm Ernst & Young is an equity owner, but E&Y Hua Ming is an independent company.

Currently, we believe E&Y Hua Ming is going through all past audits and talking openly with management about how to present the 2010 results appropriately. Unfortunately, neither "Big Four" auditors nor their Chinese joint ventures can protect investors from carefully calculated fraud.

## **Fundraising**

China Agritech has been active in the market for capital since going public in 2005.

- In January 2006, the company raised \$11 million in a private placement.<sup>viii</sup>
- In July 2007, the company raised \$13 million in another private placement.<sup>ix</sup>
- In October 2009, the company raised \$14 million by issuing about 2.8 million new shares to Carlyle, through two of its Asia-based vehicles. Carlyle also received warrants, with additional warrants to be awarded in case CAGC missed certain growth targets. In late November, the company registered the Carlyle warrants for sale.
- In the June quarter of 2010, the company raised \$31 million via a public offering and the exercise of the 2009 warrants.<sup>x</sup>

In total, the raises brought more than \$70 million into China Agritech. However, fixed assets on the books of the company subsidiaries totaled only \$2 million at the end of 2009. Although some investor relations companies associated with Chinese reverse mergers like to say that Chinese government audit reports are always wrong, the fact is that companies have no incentive to under-report their fixed assets. For one thing, depreciation decreases income taxes. For another, fixed assets are appraised by government agencies, are usually meticulously entered into the books, and are harder to fake than revenues. Finally, many benefits accrue to Chinese companies that register high levels of "registered capital," and fixed assets make it easier to raise the level of registered capital. Based on these facts plus our own inspection of Agritech plants, we have no reason to doubt that the company owns a mere \$2 million in capital assets.

The company's own reports to the SEC indicate that the book value of its fixed assets was \$8.3 million at the end of the September quarter in 2010.

viii <http://www.sec.gov/Archives/edgar/data/1166389/000120445906000024/chinaagritech8k.htm>

ix [http://www.sec.gov/Archives/edgar/data/1166389/000114420407035613/v080413\\_8k.htm](http://www.sec.gov/Archives/edgar/data/1166389/000114420407035613/v080413_8k.htm)

x [http://www.sec.gov/Archives/edgar/data/1166389/000114420410043954/v193268\\_10q.htm](http://www.sec.gov/Archives/edgar/data/1166389/000114420410043954/v193268_10q.htm)

Rodman & Renshaw handled the public offering in April 2010 of 1.24 million shares of CAGC stock, raising almost \$19 million. The money was intended for the buildout of distribution centers, Agritech said. But the company by summer 2010 had still not received production permits for granular fertilizer, while demand for liquid fertilizers was limited. We have not been able to identify any distribution centers that were built with the share proceeds.

## **Conclusion**

Our careful examination of China Agritech's business indicates to us that along all parameters, Agritech has grossly inflated its revenue, failed to account for tens of millions of investor dollars, and now has virtually no product in the market. We believe this company should not be listed on NASDAQ. Fundamentally, CAGC is worth no more than the \$2-per-share cash that is still in the company's accounts – if insiders don't empty it first.