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Muddy Waters Capital LLC (“Muddy Waters”) announced in a presentation on June 7, 2017 that we are short Man Wah Holdings Ltd. (“MWH”, 1999 HK). MWH promptly halted the stock and on June 9<sup>th</sup> issued a clarification announcement in response. MWH’s response accurately quotes the presentation slides, although it does not present the complete deck. We address MWH’s response.

Our opinion remains that MWH is likely committing fraud. We presented six arguments in the presentation:<sup>1</sup>

- MWH’s profitability is an outlier,
- Macau profits – a red flag,
- Panjiva data casts doubt on export sales,
- Fieldwork casts doubt on the China growth story,
- MWH has inconsistencies in taxes, a strong indicator of fraud,
- MWH has undisclosed debt

In our view, MWH has only attempted to substantively address two of these points: The New High Technology Enterprise income tax preference it reported for its Huizhou entity, Man Wah Furniture Manufacturing (Huizhou) Co. Ltd.; and, our argument that the company has undisclosed debt of HK\$1.55 billion. This report will first cover the four arguments we view as having been left without substantive response, and then will provide our thoughts on the NHTE and debt responses. This report is limited to the material in the presentation and MWH’s responses, and is not a complete discussion of our research on MWH.

### Too Good to be True

Our presentation began with a riddle:

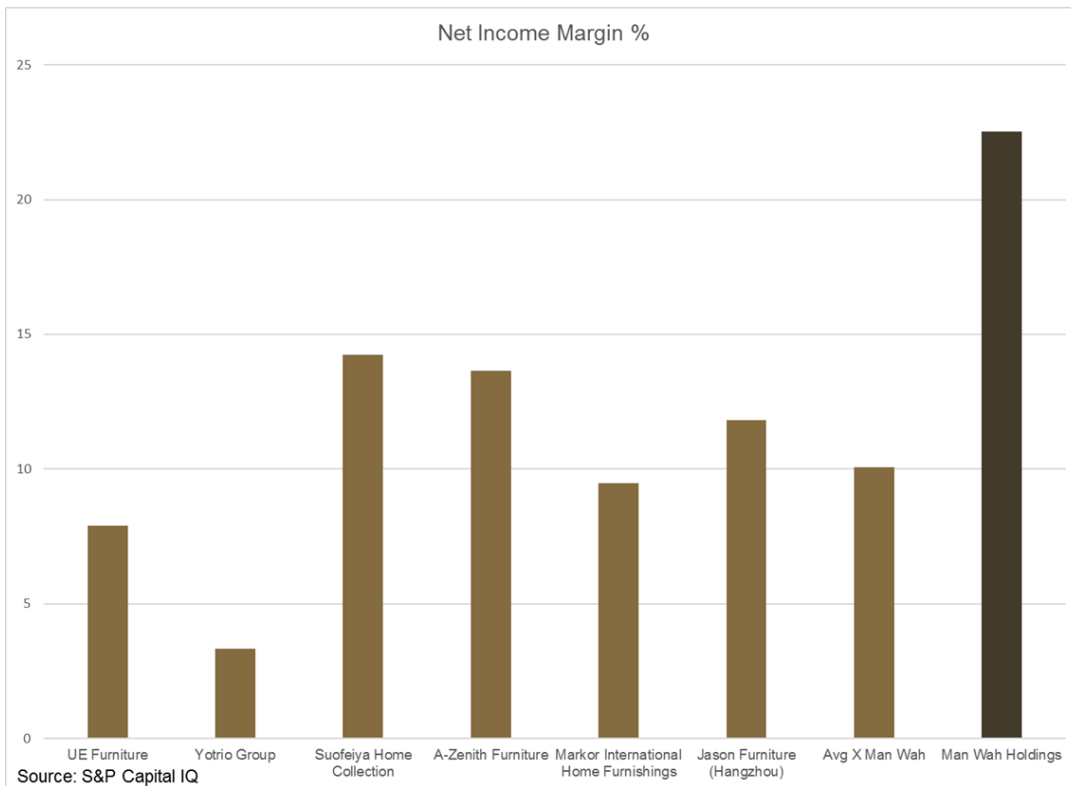
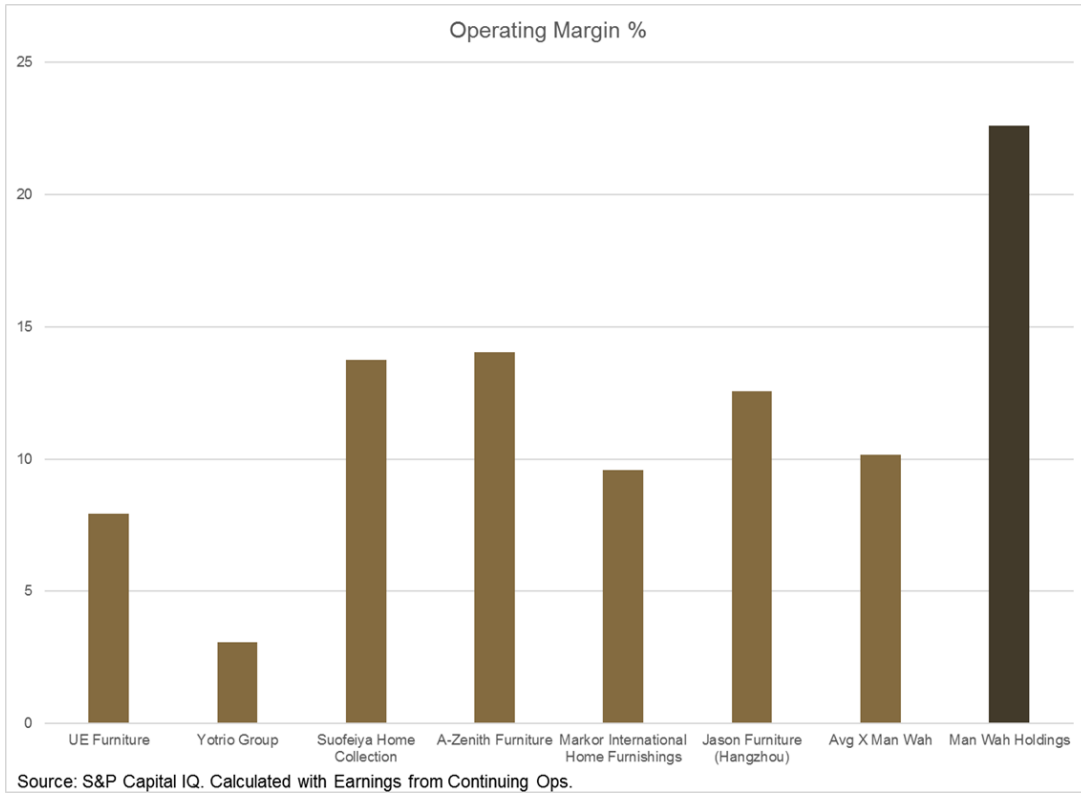
Q: What’s made out of wood, glue and foam, and is purportedly more profitable than an iPhone?

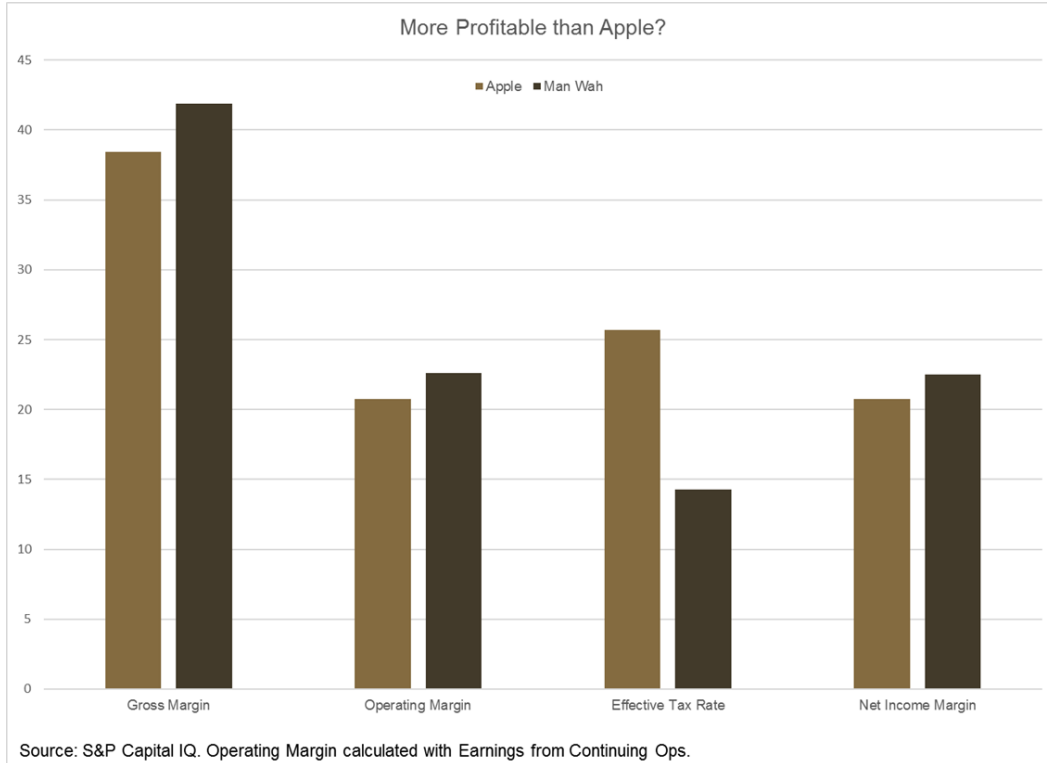
A: a couch

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<sup>1</sup> Including the introduction, which laid out a “too good to be true” argument.

We then showed three graphs:





It is noteworthy that AAPL has been attacked for engineering its tax rate lower through transfer pricing arrangements, and yet MWH, which generates approximately 85% of its revenue in the U.S. and China, has a much lower reported tax rate.

We showed two pictures of a MWH sofa purchased in the U.S. that we had gutted.







We used the above pictures to illustrate that “There’s no pixie dust in MWH sofas”. The interiors of the sofas are almost entirely wood (plywood, pine, and fiberboard) and foam. There is only a small amount of metal outside of the electric reclining mechanism, which in the case of our sofa, had been largely (likely wholly) produced by a third-party vendor. We therefore struggle to understand how a company making such a low technology product could manage to be so profitable.

#### Macau Profits – a Red Flag

We estimate that MWH’s Macau entity is responsible for over 50% of its reported net income.<sup>2</sup> MWH claims a Macau preference that gives it a 0% tax rate; however, it is difficult to see how MWH could carry out unnoticed a transfer pricing scheme that has booked estimated profits in Macau greater than 10x those booked in the Huizhou factory, which is located in an export processing zone and appears to a) effectively only produce for exports, and b) serve as the production center for substantially all of Man Wah’s exports. In contrast, the Macau entity appears to lack substance.

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<sup>2</sup> The Macau entity is Man Wah (Macao Commercial Offshore) Ltd.

We wrote “At best, this is likely tax evasion; at worst, similar to China Metal Recycling, the Macau entity is used to overstate profit”. The company’s response in our view was non-substantive.

We presented the below table to show how we estimate the proportion of MWH’s net income generated by Macau, and we pointed out that Panjiva U.S. import data shows Macau is the consignor for virtually all shipments to the U.S. (the U.S. is 77% of reported revenue for exports from China):

<u>HKS Millions</u>	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Reported Tax Exemption	77	100	74	74	117	118
Implied Macau Net Profit	307	399	620	614	975	984
Man Wah Net Profit	303	568	977	1,075	1,327	1,759
% Macau	101%	70%	63%	57%	73%	56%

The company did not dispute these calculations, nor the assessment that Macau has booked profits over 10x those of the Huizhou factory. The company’s written response was limited to a statement that MWH sells to “the United States, Canada, PRC (including Hong Kong and Macau), Europe and other countries. The Group is respectful of laws and regulations of the jurisdictions in which it operates and would respond to any such tax concerns raised by a regulatory authority.” The foregoing clearly is not a denial of the importance of Macau to reported profits.

In the presentation, we also explained that the Macau subsidiary appears to lack substance. PRC customs data shows that the Huizhou entity produces and ships MWH’s exports. However, U.S. customs data almost always show Macau as the consignor. Our investigators spoke with a MWH employee who had the Macau office listed on his business card. He stated that the Macau office has no showroom, and “Macau is more focused on accounting”.<sup>3</sup> A different MWH employee (non-Macau) told our investigators that Macau is for “financial settlement and tax avoidance”.<sup>4</sup>

We listened to a June 9th call between management and investors. On this call, an analyst asked MWH to “briefly walk us through some of your transfer pricing policies and how you ensure your Macau profits stay in check and not to inflate it?” In our view, the CFO’s response was completely evasive – particularly because he was unwilling to admit the extent to which MWH does business through Macau (emphasis added):

“Ok, firstly I just mentioned that we are doing business globally we are selling products to different countries and we need to make sure we comply with tax laws regulations in all countries including China, Macau, other countries including US, UK. A lot of countries globally **and if some of our transactions are conducted through Macau** and we do make sure these transfer pricings are not in breach of any regulation of any countries, not just Macau. And we from time to time will arrange tax health checks

<sup>3</sup> “澳门那个可能偏财务多一点”

<sup>4</sup> MW: “好象公司有一个澳门公司, 对于公司的运作会不会有很大帮助呢?” A: “它主要是用来财务结算方面的。” MW: “好象税收也比较优惠。” A: “财务结算和避税”

health checks by this some big four auditor and we already since our [inaudible] already this very careful study on this arrangement so we recorded that we already proper arrangement and no liability for this under provision or tax liability.”

Another analyst asked two questions about Macau that each time elicited nervous laughs from the CFO:

Q: “In terms of the Macau entities can you help us to name what other listed companies may have used a similar type of structure so more investors are aware how this is being done?”

A: “As far as that we cannot comment on the tax arrangement of other companies even we know there should be *haha* but we cannot.”

Q: “Let me put it the other way, can I safely say that there are other listed Hong Kong companies that has a similar arrangement?”

A: “*Hahaha* ... We believe so, yes.”

We reason that some portion of the profit booked in Macau is fraudulent because we think it is unlikely that MWH a) is permitted to use transfer pricing to book such an outsize percentage of its profits in Macau, and b) could get away with doing so on such a large scale, given that i) under tax laws and regulations, transactions with affiliates aggregating RMB 200 million or more per year are reported to the PRC Tax Bureau along with supporting documentation, and ii) there is a tax agreement between Macau and the PRC that facilitates information sharing.<sup>5</sup> We also theorized that frauds, such as China Metal Recycling, find Macau attractive for booking fraudulent profits because of the SAR’s low tax rates and opacity.<sup>6</sup>

The bottom line on Macau is that management left our concerns unaddressed.

### Panjiva Data Casts Doubt on Export Sales

We pointed out that there is a significant discrepancy between what MWH reports in export revenue, and what customs data (through Panjiva) shows. Further, this delta has been growing over the years – in FY 2014 it was 31%, and in FY 2017 the delta was 48%. The Panjiva data is declared export shipment values for all MWH entities, and is provided by a licensed provider of PRC customs data.<sup>7</sup> We compared the PRC customs data to calendar year SAIC financials for Huizhou. The deltas between Huizhou and Panjiva are far less significant (particularly considering that the timing is different by one quarter), so in our view, the SAIC data ratifies the

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<sup>5</sup> Notice of the State Administration of Taxation on Issuing the Measures for the Implementation of Special Tax Adjustments (for Trial Implementation) No. 2 [2009] of the State Administration of Taxation 《特别纳税调整实施办法（试行）》国税发〔2009〕2号 (Some sections of this Notice have been superseded by a May 2017 Notice)

<sup>6</sup> [http://legalref.judiciary.hk/lrs/common/ju/ju\\_frame.jsp?DIS=97425&currpage=T](http://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=97425&currpage=T)

<sup>7</sup> <https://support.panjiva.com/customer/en/portal/articles/1896541-china-trade-data>



Panjiva data. It therefore seems almost certain that revenue booked in Macau constitutes the difference, and as we have written, we believe the Macau contributions are highly suspect.

	Huizhou SAIC	Panjiva	HK filings	Diff	Diff
	CY2013-2016	HK\$mm	HK\$mm	HK\$mm	%
		$b=a/0.129$	c	$d=c-b$	$e=d/c$
FY2014	3,341	3,224	4,234	1,009	31%
FY2015	3,519	3,072	4,488	1,416	46%
FY2016	3,512	3,329	4,874	1,544	46%
FY2017	2,936	2,842	4,214	1,372	48%

Even though MWH could have responded with the export sales it has booked by entity, it failed to do so. Instead, the Clarification Announcement reads “The Company will not comment on the veracity of the information relating to Panjiva. However, the Company believes that it is inappropriate to compare Panjiva’s data in respect of imports into the United States to the Group’s sales worldwide (other than the PRC) which approximate the figures under the column headed ‘HK filings’ in the above table.” On the call, the CFO stated, “They use the sales to U.S. from the Panjiva data to compare our total sales to the whole world.”

It should be an additional red flag that the company is dodging a discussion of the discrepancies in its export revenue – particularly on the back of a nonsensical excuse related U.S. import data. The slide on which the above title was shown reads “The table below compares Panjiva data for China export to reported overseas sales”.

We strongly suspect that some portion of MWH’s reported export sales is overstated, and it seems highly likely to relate to Macau. The bottom line is that investors should demand a full explanation of Macau operations, financials, and the export discrepancies.

#### Fieldwork Casts Doubt on the China Growth Story

In FY 2017, MWH reported China sales grew 37%.<sup>8</sup> While anecdotal, our fieldwork calls the blowout reported growth into question. We categorize China sales in two ways: sales through company-owned stores, and sales to distributors. Distributor stores greatly outnumber company-owned stores, but company-owned stores reportedly generate far more revenue per average store than do distributor stores.

One interesting point is that SAIC filings shows MWH’s store closures have been concentrated in Tier 1 cities:

<sup>8</sup> FY2017 AR, p.103 (note: the growth in China comes from calculation of segment info).

City	SAIC - active	SAIC deregistered	Total SAIC registration
Shenzhen	14	2	16
Shanghai	34	11	45
Guangzhou	30	7	37
Huizhou	3	2	5
Chengdu	15	2	17
	96	24	120

Company-owned stores reportedly generated HK\$5.6 million in revenue per average store in FY 2017, which has grown at a CAGR of 15.6% since FY 2014:

HK\$000	FY2014	FY2015	FY2016	FY2017
Sales of self operated sofa stores	570,549	551,259	577,287	561,536
Average No. of self operated stores	156	123	109	99.5
Sales per self operated sofa stores	3,657	4,482	5,296	5,644

Fieldwork turned up scant evidence of stores performing at this level. The SAIC financials for company-owned stores support the reported revenue; however, because we are aware that companies committing fraud frequently try to match their SAIC financials to reported revenue, we undertook fieldwork to try to verify the revenue. Our investigators visited 57 out of 99 company-owned stores – including what we believe to be all stores in Shanghai and Shenzhen.<sup>9</sup>

In Shenzhen, our investigators received sales color from employees at nine stores. At two stores, employees claimed the store is the best performing in the area at approximately HK\$7 million in annual revenue. At the other seven stores, employees stated sales were approximately HK\$4 million each. We therefore believe Shenzhen average store sales are approximately HK\$4 million, which would be a decent bit short of HK\$5.6 million.

In Shanghai, our investigators visited 34 store locations. 12 of the locations had closed down. Our investigators got little sales color from employees in the stores, so our impression that Shanghai has likely failed to meet the reported average is largely drawn from the inordinately high number of store closures, and comparisons to KUKA stores. Our investigators visited four KUKA stores in Shanghai, which appeared to have similar stores sizes, traffic levels, and merchandise, save for motion furniture only accounting for about 10% of revenue.<sup>10</sup> Looking at KUKA's SAIC files for its 33 Shanghai stores, we see CY 2016 revenue per store of HK\$4.2 million.

We acknowledge that the above fieldwork is not a complete indictment of MWH's company-owned store sales, but it does appear that MWH has had a problem in Tier 1 cities. In the presentation, we asked how MWH could be doing so poorly in Tier 1 while supposedly doing well in the rest of China. The company's response was evasive – instead it questioned when we obtained the SAIC files and visited the stores.

<sup>9</sup> Store count as of FY 2017.

<sup>10</sup> KUKA 2016 Prospectus, p.321.

Distributor stores reportedly bought on average HK\$1.5 million of merchandise from MWH in FY 2017. We identified a large distributor with stores in Beijing: Beijing Classic Living Co. Ltd. Beijing Classics was highlighted in a 2014 Forbes article about MWH and Chairman Wong.<sup>11</sup> Beijing Classics has approximately 40 stores selling MWH product. However, its stores also sell other products. Its CY 2016 SAIC financials show COGS / store barely greater than HK\$1 million. This leaves us wondering: If a large, prominent distributor in one of China's wealthiest cities missed the mark by **at least** approximately ~1/3, then how do franchisees in smaller markets do so much better?

损益表 (千元)	■ 股东权益 ■ 负债		2016
	2015	变化率 (%)	
营业收入	57,770	27.7	73,773
减: 营业成本	24,139	55.89	37,583

We also noted the online CV of a former MWH employee who claims to have been responsible for selling to distributors in a northeastern province. His CV claimed sales per average store were approximately HK\$960,000 in CY 2015 (In FY 2016, MWH reported average sales to distributor stores of HK\$1.2 million). If VAT was included in that figure, then sales per average store would only have been HK\$820,000. We find that in Mainland, online CVs for salespeople if anything tend to embellish, rather than understate.

The bottom line from our fieldwork was that we found no evidence to contradict our view that MWH's reported China sales are highly questionable. We instead found evidence that, while far from being a smoking gun, calls into question the company's reported tremendous strength in China sales.

### MWH Has Inconsistencies in its Taxes, a Strong Indicator of Fraud

We found four inconsistencies with how MWH has applied a tax preference to its Huizhou entity. We consider these inconsistencies to be an accounting red flag. Issues and inconsistencies in taxes are often red flags regarding fraud – especially in China. Taxes are highly complex, even when the books are accurate. In our experience, book cooks are most likely to leave traces of their work in the tax accounts because of the ease of making mistakes due to the complexity. We have long suspected that it was our tax issue analysis that led to Rino International Corp.'s auditor to resign in 2010; and, improbable tax treatment was a dead giveaway to us that Sino-Forest was a fraud.

Our presentation contained a slide that stated the following:

- MWH has disclosed the preference became effective as of July 2012, but we have not previously observed stub-year NHTE preferences in the PRC – particularly true in this case because the preliminary approval is effective as of January 1, 2012
- SAIC financials show the preference becoming effective on 1-Jan 2013, with a CY2012 tax rate of 25%. This is inconsistent with MWH's HK filings, and likely the result of

<sup>11</sup> <https://www.forbes.com/sites/russellflannery/2014/01/08/rising-furniture-billionaire-wong-man-li-shakes-up-u-s-market-widens-aim-at-chinas/#639b784c334f>

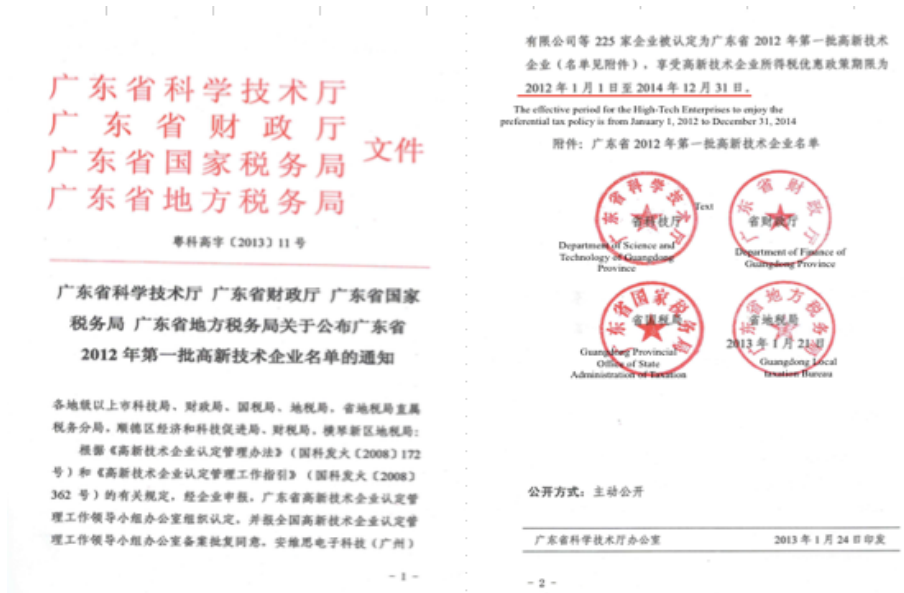
sloppy book cooking in that MWH forgot to post-facto match its SAICs with what it was saying in the HK filings

- Disclosure timing is suspicious – the preference wasn’t disclosed until the H1 2014 filing, despite highly likely having been approved at time of filing CY 2012 taxes (which would have been before the FY 2013 financials were filed)
- Huizhou should not have qualified for NHTE because it does not spend at least 3% of gross revenue on R&D (MWH consolidated R&D is only ~1% of Huizhou gross revenue)
- Failure to renew the qualification is odd because renewals are apparently fairly routine

The company’s response fails to explain a) why it only claimed the preference for a stub year, when the approval was for a full year, b) discrepancies in the application of the preference between the Hong Kong and SAIC filings, c) how it could have utilized the NHTE preference in any tax year, given that it did not meet one of the key criteria, and d) why, if the Huizhou entity really had been granted the preference, MWH did not renew it after 2014. We therefore feel that the tax inconsistency issues remain as a red flag.

#### A. Timing Issue

We first noted that Man Wah Furniture Manufacturing (Huizhou) received preliminary approval for the NHTE preference in Jan 2013, retroactively effective to January 1, 2012:



The company responded as follows regarding the timing of its preference:

“By the time the Company published its results for the financial year ended 31 March 2013 (“FY2013”), endorsement by the tax bureau was not received. The Company, for the sake of prudence, made tax provision for the relevant PRC subsidiary on the basis of a tax rate of 25%. During the financial year ended 31 March 2014 (“FY2014”), the PRC

tax authorities' assessment for the eligibility of 15% for the financial year ended 31 March 201[3] was made available. The relevant PRC subsidiary then reflected the corresponding overprovision for FY2013 in FY2014.

While MWH's response gives the impression that the tax preference applies for the three-year period running from January 1, 2012 to December 31, 2015, the 2017 AR shows that MWH only accounted for a half-year of the preference in CY 2012 / FY 2013 – the AR states (emphasis added):

“During the year ended 31 March 2014, a PRC subsidiary obtained the qualification of being a high technology enterprise for a consecutive three years from year 2012 to 2014. With such qualification, the subsidiary is approved to enjoy the preferential tax rate of 15% (subject to annual review by PRC tax authority) for its **profits earned from July 2012** to December 2014, resulting in an overprovision of income tax expense amounted to HK\$13,899,000, credited to the consolidated statement of profit or loss and other comprehensive income for the year ended 31 March 2016.”<sup>12</sup>

The purported stub year application of the preference is inconsistent with the NHTE approval MWH received, our understanding of standard practice, and the governing regulations. The official document above clearly states that the three years began as of January 2012. The full year treatment in the approval document accords with our understanding that this tax preference is generally applied to an entire calendar year, rather than to a stub year. The tax regulations provide a clear explanation of how to effectuate the HNTTE preference: Submit a copy of the qualification (shown above) to the local tax bureau, along with supporting documents that show the HNTTE criteria were met for the prior calendar year. There generally are no additional steps needed.<sup>13</sup>

The company has offered no credible explanation why the preference is not applied to profits earned during the period from January 2012 to July 2012. The company claims the reason for overprovision for FY 2013 is approval was not received until after the FY 2013 filings were published. We find this dubious because the final FY 2013 annual report was uploaded to the exchange on June 10, 2013 while CY 2012 taxes were most likely completed by May 31, 2013 at latest.<sup>14</sup>

The company does not address the overprovisions in later years. The 2016 Interim report confirms our understanding that the preference is granted retroactively for each calendar year generally by May at the latest (emphasis added):

“During the year ended 31 March 2014, a PRC subsidiary of the Group has obtained the qualification of being a high technology enterprise for a consecutive three years from year 2012 to 2014. With such qualification, the subsidiary is then approved to enjoy the preferential tax rate of 15% for its profits earned from July 2012 to December 2014,

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<sup>12</sup> MWH 2017 AR, p. 105.

<sup>13</sup> See Circular of the State Administration of Taxation on the Issues Concerning Implementation of the Preferential Income Tax for Hi-Tech Enterprises.

<sup>14</sup> See Article 54, Enterprise Income Tax Law of the PRC.

resulting in an overprovision of income tax expense amounted to HK\$14,147,000 and HK\$8,740,000, credited to the condensed consolidated statement of profit or loss and other comprehensive income for the period ended 30 September 2015 and 2014. **The preferential tax rate of 15% for the year 2014 was approved by the PRC tax authority in May 2015.**”

If the company received approval in May 2015, why does the FY 2015 final annual report, filed on June 2, 2015, include an overestimate of taxes that subsequently resulted in a credit of HK\$13.9 million in FY 2016?

Given that the company has provided no credible explanations for these timing inconsistencies, they remain, in our view, a red flag.

#### B. HK / SAIC Discrepancy

MWH also failed to address the discrepancies we found in the application of the HNTE Tax Preference between its SAIC and consolidated Hong Kong financials. The company has neither restated its CY 2012 SAIC filing, nor applied the reported overprovision to the CY 2013 filing.

Before 2012, PRC companies committing fraud frequently had significant discrepancies between their SAIC and exchange filings across substantially all their accounts, with the SAIC filings often showing the much closer to true accounts. Fraudsters wised up, and now largely match up their SAIC and exchange filings; however, in our view taxes remain the area most likely to find a discrepancy due to book cooking. Thus, the discrepancies between Man Wah’s SAIC and consolidated financials are a red flag.

MWH claims that Huizhou’s HNTE preference retroactively kicked in on July 1, 2012, and that the company received a credit for CY 2013 taxes due to overprovisioning for CY 2012. However, the below SAIC financials for the Huizhou entity neither show that it received a stub year HNTE preference in CY 2012, nor that it received a credit in CY 2013 for overprovisioning in 2012:

RMB 000	CY2012	CY2013	CY2014	CY2015	
Pre-tax income	38,066	67,684	114,119	87,639	a
Income tax	9,511	10,175	17,361	22,548	b
Net income	28,555	57,509	96,758	65,091	c
Effective income tax rate	25%	15%	15%	26%	d=b/a



The following is our calculation of the pro-forma SAIC filing if the overprovision had been applied in a manner consistent with how the CFO described MWH's application of the preference on the call:<sup>15</sup>

RMB 000	2012	2013	2014	2015	
Pre-tax income as per SAIC	38,066	67,684	114,119	87,639	a
Income tax at 25%	9,517	16,921	28,530	21,910	m=a*25%
Overprovision of previous years	-	(3,807)	(6,768)	(11,412)	n (y1)=a (y0)*10%
Pro Forma Income Tax*	9,517	13,114	21,761	10,498	o=m+n
Income tax as per SAIC	9,511	12,339	17,361	22,548	

\*Estimate based on the CFO's comments and the fact that the HK filings show credits for overprovisioning every year from FY 2014 through FY 2016.

### C. Failure to Meet HNTE R&D Requirement

MWH did not even attempt to deny that its R&D expenditure was below the 3% of gross revenue threshold required for the HNTE preference. The rule for the minimum expenditure can be found in *Administrative Measures for Certification of High and New Technology Enterprises Circular* ("Circular 32").<sup>16</sup> This was the extent of the company's response to that point:

The Company does not presume to speak for any regulatory authority in charge of vetting and approving tax filings and applications. The Company can confirm it had made proper applications and obtained approvals for tax treatments it has received."

The bottom line on the tax inconsistencies is that in our view, the company failed to explain them. Therefore, we see these issues as a red flag.

### MWH Has Undisclosed Debt

We made two arguments here – the current PBOC credit report for the Huizhou entity shows 48% more debt than the consolidated balance sheet (US\$200 million in trade finance borrowings as follows: US\$150 million for export bill purchases, and US\$50 million for import bill advances), and debt taken on by consolidated subsidiary Remaco in 2015 appears not to have

<sup>15</sup> "Another allegation in relation to the inconsistency in taxes they are referred to some tax treatment under this New High Technology tax preference. One company in China, we got approval from the government for the approval for the high-tech preference for three year from 2012 to 2014. But we cannot claim 15% tax rate unless it is approved or filed by this tax authorities and this approval by the tax approval there's some delay. For example, for calendar year 2012, we only got the final approval from the tax authorities in calendar year of 2013 or the fiscal year 2014. So to be prudent, we did provide 25% tax rate before we got the final approval which is reflected in fiscal year 2013. In fiscal year 2014 we finally got approval for this tax treatment so we reversed the 10% over provision for the income tax. This is how it works. It looks a little complicated but it is just normal tax treatment because of some delay in approval cause a little bit confusion but nothing related to some type of tax liability."

<sup>16</sup> <https://www.dlapiper.com/en/us/insights/publications/2016/02/china-updates-high-and-new-technology/>

been disclosed. The company's response focused on the Huizhou debt by stating the debt was disclosed in Note 38 to the FY 2017 financials. Note 38 states that MWH has US\$200 million of borrowings that are not on the balance sheet because they are offset against deposits against which the lender has the right to foreclose.

The first set of questions we have are:

- Does this pertain to the same debt in the PBOC credit reports?
- If "yes", are the cash deposits real?
- If again "yes", does the lender have the right to offset them?

Ordinarily a company with audited financial statements would be given the benefit of all doubt with respect to the above questions. Given our view that the five other red flags we discussed are each still valid, and our overall belief that MWH is committing fraud, we believe it is premature to take the company's word on this issue. Further, the scant description MWH has provided of the loan / deposit / hedging transactions does not seem to accord with the PBOC credit report's descriptions of the types of financing provided (export bill purchases / import bill advances).<sup>17</sup>

Adding to the argument that the company should not be taken at face value is the inconsistency between MWH's Note 38 and its responses. Note 38 reads:

"Financial assets and financial liabilities subject to offsetting

During the year, the Group entered into several agreements with a bank in the PRC to set off all its rights and obligations towards bank deposits amounted to RMB202,000,000 and USD169,588,000, bank borrowings amounted to USD200,000,000 and a forward exchange contract."

Apparently, the company borrowed US\$200 million, and offset it against deposits that were 84.8% U.S. dollars and 15.2% RMB. However, on the call, the CFO described the transaction in the following manner:

"Actually, [the offset loan] is part of the treasury management of the company. We had some arrangement with a major commercial bank in china. The bank provide a loan 200 million USD. At the same time, the money will be transferred into RMB and deposited totally in the bank. And also, we enter into a forward contract to convert RMB into USD as of the maturity date of the loan so this means there is no risk and we are guaranteed a fixed return from this arrangement."

Perhaps Mr. Wang is just not versed in the transaction, or perhaps the inconsistency is a sign of a deeper problem with the accounting for the loan.

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<sup>17</sup> See <http://www.abchina.com/en/corporate-banking/financing-and-credit-facility/international-trade-finance/ebp/> and [http://www.boc.cn/en/cbservice/cb3/cb35/200806/t20080627\\_1324126.html](http://www.boc.cn/en/cbservice/cb3/cb35/200806/t20080627_1324126.html)

Regardless, taking the company at its word leads to a very large question though. What was the purpose of these transactions? Why would the company borrow USD onshore against completely encumbered deposits, approximately 85% of which was supposedly in USD? There are so many corollary questions to this main question. Investors should demand far greater explanation of this series of transactions.

Beyond the core questions of whether the loans and deposits are as the company says they are, there are two other high level questions to answer:

- Are these loans properly kept off the balance sheet (and the cash flow statement)?
- If “yes”, are these transactions adequately disclosed?

We pointed out that in 2015, consolidated subsidiary Remaco borrowed RMB 45 million (HK\$56.8 million) per the PBOC credit report. Man Wah only disclosed one fixed-rate loan, which was for HK\$12.5 million from a related party. We therefore concluded that the loan to Remaco was variable rate. MWH disclosed that all its variable rate borrowings were fixed to offshore rates, which implied that Remaco’s debt was not consolidated.

MWH’s response is that RMB 35 million of the RMB 45 million loan was provided by a MWH entity through a PRC bank as an entrustment loan, and the debt was therefore accurately reflected. We lack the information to test this claim, other than to point out that at the time, MWH only owned 55% of Remaco. MWH is claiming that, in contrast, MWH provided 77.8% of the loan.