

Is Guangzhou Rural Commercial Bank the "Stupid" Lender?

August 28, 2019

The Basics	
Ticker:	1196.HK
Recent Price:	HK\$4.4
Market Cap:	HK\$6.3bn

Emerson Analytics Forecast
<i>Bankruptcy</i>

Six days after our report "Realord Group – Real Lord of the Lies", the company issued a profit warning August 26 saying that profit attributable to shareholders for the six months ended June 30, 2019 is likely to amount to HK\$44m, down 87% year-on-year (YoY). This effectively confirms our analysis in the report. A subsequent clarification announcement also admits that the company's investment properties are unlikely to generate any meaningful revenue, as we have already laid out in that report.

We only want to make a few comments on Realord Group's laughable "clarifications" as follows:

- (i) *The Board clarifies that apart from Tong Bao, the Group also generated its revenue of the EP Segment by (i) the EP Company on its own; and (ii) Shenzhen Weilu Technology Holdings Co. Ltd ("Weilu Technology"), which is a wholly-owned subsidiary of the Company outside the EP Group.*

In the clarification announcement, Realord Group created a lie about sales in the environmental protection (EP) and motor vehicle parts (MVP) segments to independent third parties in mainland China. According to the 2016 acquisition announcement, EP Company mainly acted as an agent by sourcing scrap metals from Hong Kong and overseas markets for reselling to recyclers and cycle materials processors in Guangxi province. Given the 77% YoY decline in authorized imports of scrap metals for Guangxi in 2018, how could the EP Company have maintained a steady revenue trend?

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Exhibit 1 – Guangxi authorized imports fell 77% but EP Company revenue steady

Year end Dec 31 (HK\$ m)	2017	2018	Chg (%)
EP segment	572	571	
- Weilu Technology		88	
= EP Group	572	483	
- Tong Bao	282	194	
= EP Company	291	289	0%
Authorized imports – nationwide (k tons)	6,363	1,671	-74%
Authorized imports – Guangxi (k tons)	308	72	-77%

Sources: Realord Group, China Solid Waste and Chemicals Management Center and Emerson Analytics

Weilu Technology is said to have contributed HK\$88m of revenue to the EP segment in 2018. Yet it is the owner of the so-called Guangming Property, and the 2018 annual report of Realord Group indicates that its main business is property investment¹. Further, a [Credit Report on Weilu Technology](#) shows that this company had zero revenue in 2017 and 2018. The relevant evidence has been provided to the Securities and Futures Commission (SFC) of Hong Kong.

- (ii) *While Emerson had accepted the Residential Development Costs, they discredited the book value of the total development cost of Guanlan Property in the accounts of the target companies. Obviously, their logics are contradictory.*

Of course the relevant data used by Emerson Analytics, whether Rmb284m or Rmb2,278m, have been disclosed by Realord Group. As they contradict each other, we naturally choose to accept the one that is closer to the truth. As can be seen from the table below, the Residential Buildings cost an average Rmb6,033 per square meter (sm), whereas the average cost of Guanlan Property was Rmb5,560/sm. The two numbers are reasonably close to each other, and are of course more credible than the 6x inflated book value.

¹ <https://www1.hkexnews.hk/listedco/listconews/sehk/2019/0426/ltm201904262653.pdf>, p.201

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Exhibit 2 – Similar costs for Residential Buildings and Guanlan Property

	Actual investment (Rmb m)	Total GFA (sm)	Unit price (Rmb/sm)
Residential Buildings	796	131,980	6,033
Guanlan Property	284	51,039	5,560
Total/Average	1,080	183,019	5,901

Source: Emerson Analytics

- (iii) Regarding the Guangming Property, our research in 1H19 covered the costs of similar projects in the neighborhood. As shown in the following table, their costs were similar to Guangming Property's Rmb1,779/sm. We have supplied SFC with relevant evidence.

Exhibit 3 – Costs of neighboring projects

	Actual investment (Rmb m)	Total GFA (sm)	Unit cost (Rmb/sm)
Property I	618	339,438	1,821
Property II	38	24,033	1,581
Property III	103	54,584	1,887
Property IV	59	25,524	2,300
Total/Average	818	443,579	1,843

Source: Emerson Analytics

- (iv) Is the Guangzhou Rural Commercial Bank Co., Ltd the "Stupid" Lender?

Our August 21 report raises questions about why any bank would want to lend billions of dollars to Realord Group against such lousy properties as the Guanlan and Guangming Properties that have been valued at an absurd 2.7x of inflated book value or 16.4x of actual costs. According to our analysis in August 21 report, this bank should be the Guangzhou Rural Commercial Bank Co., Ltd. (GRCB, 1551.HK). Was the GRCB so "stupid" that they have no clue of what we have exposed? Of course not!

Subsequent to our August 21 report on Realord Group, the Chinese Communist Party Guangzhou Metropolitan Commission for Discipline Inspection announced that it was investigating Wang Jikang, who resigned July 21 as chairman of GRCB. As investigations into Wang's irregularities progress, it is likely that we will hear more about the bank's relationship with Lin and Realord Group.

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Exhibit 4 – CCP Guangzhou discipline commission probes GRCB ex-chairman Wang



(v) Stock Exchange of Hong Kong (SEHK) Asleep?

Realord Group's clarification contains so many lies and nonsenses that it is really a waste of time for us to deal with them one by one. We will only bother with a few of them:

With respect to the carpark valuation, the assumption in the 2017 acquisition valuation was "capable of being sold in the open market". Realord Group now tries to defend the acquisition valuation with a so-called "long-term use of rights of the car parking space". **Shouldn't SEHK have asked** Realord Group about the differences between the two? Further, all the residents at Realord Villas are tenants who may move away in a few years. **Shouldn't SEHK have asked** Realord Group why any of the residents would commit to a carpark for the long term?

Realord Group argues that it is reckless to use the accounting value of a right-of-use asset of an 8-year lease tenant as a relevant base to determine the capital value of a property title ownership with the benefit of a long-term leasehold land title. **Shouldn't SEHK have asked** Realord Group for the fundamental difference between an eight-year NPV method and a longer-term NPV method?

Realord Group dares say in the announcement that HK\$209m of EP Company was used by its immediate holding company in 2018 but that was recorded as EP Company's net cash used in investing activities. **Shouldn't SEHK have asked** Realord Group what kind of accounting policy this represented?

All of the above nonsense should have been challenged by SEHK to prevent the dissemination of misleading or false information by listed companies. It appears to us that SEHK is only interested in maximizing stock trading rather than eliminating a false market.

Enough for now. Deloitte should resign in the near future, and regulators especially SFC are likely to act soon.