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Sound Global – One Simple Question

February 16, 2015

On February 13 Sound Global put out a “clarification” announcement in response to the challenges in our February 4 report. It is really difficult for us to respond to such a lousy “clarification”, which dodges all the critical questions that we raised originally. But we do have a simple question for the management: did they know who was Sound Global’s biggest customer? And we’ll bring to our readers a document by a third party entitled [Sound Global Presentation v25](#) which details more Sound Global tricks and lies from a different angle.

One Simple Question

We have a simple question for Sound Global’s management. This question is related to this sentence in p.9 of the clarification:

The Group recognised revenue of approximately RMB314 million with respect to the three aforesaid Anshan BOT projects and approximately RMB61.8 million with respect to the pipe network and pump stations construction ancillary to three Anshan BOT projects using the percentage of completion method in 2012.

So, the company is saying that it recognized a total of Rmb376m in construction revenue from the three BOT and related pipe network projects in Anshan. That’s 14.2% of the Rmb2.65bn total revenue in 2012.

In a BOT project, the real customer of the construction contractor is the local government agency and not the project company. The clarification notes that “the revenue of approximately Rmb550m ... was in fact not entirely derived from these three projects”, which signifies that Sound Global regards the local government agency (i.e. the Anshan Environmental Protection Bureau or Anshan EPB) as its customer.

However, the 2012 annual report has this to say about its biggest customer for the year:

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Exhibit 1 – Biggest Revenue Contributor in 2012

Revenue from Jiangyan City Housing and Urban Construction Bureau in turnkey projects and services segment contributed 10.73% of the Group's total revenue for the year ended December 31, 2012. (2011: Revenue from Power & Water Utility Company for Jubail & Yanbu (Marafiq) in turnkey projects and services segment contributed 14.45% of the Group's total revenue for the year). Except for this, no other single customers contributed 10% or more to the Group's total revenue for the year ended December 31, 2012.

Source: Sound Global 2012 annual report, p.116

So, what went wrong? A government agency from Jiangyan contributing Rmb285m of revenue was said to be the biggest customer at 10.73% of total revenue, whereas Anshan EPB contributing Rmb376m or 14.2% was relegated to one of those who contributed no more than 10%. Did Sound Global know who was its biggest customer in 2012?

Of course Sound Global knew perfectly well that Jiangyan was the biggest customer and Anshan not when it wrote the 2012 annual report in early 2013. That means the three Anshan sewage projects and the relevant pipe network actually accounted for the bulk of the Rmb550m of revenue (17.5% of the total Rmb3.14bn revenue) in 2013. Now that the clarification has moved Rmb376m to 2012, Sound Global must create three additional projects (the Lishan District sewage collection pipe network project, the Qianshan District sewage collection pipe network project, Panjialu sewage interception project) to make up the required amount for 2013. There are two other reasons why we are convinced that these three “clarification” projects are fictitious:

- As we have said in our February 4 report, we have two persons on tape, one being a Sound Engineering's engineer working in Anshan, and the other being the head of the wastewater administration center at Anshan EPB, confirming that Sound Global has no other EPC projects in Anshan.
- As far as we understand, sewage collection pipe networks are mainly handled by Anshan Urban Development Bureau (Anshan UDB or 鞍山市城市建设管理局). Drainage and sewage work on roads and highways sometimes also involves the traffic department, whereas sewage interception projects that connect to sewage treatment plants are the responsibility of Anshan EPB.

As an example, we present below the tender result announcement of the Anshan Road (Yuanlin Avenue to Huiyuan Avenue) sewage project, awarded by Anshan UDB. According to the tender invitation, the estimated contract value was Rmb23.4m¹.

¹<http://www.dowater.com/zhaobiao/2013-05-30/148391.asp>

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Exhibit 2 – Anshan UDB Sewage Project Tender Result

鞍山市公共资源交易网
AN SHAN SHI GONG GONG ZI YUAN JIAO YI WANG
廉洁 高效 诚信

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您现在正在浏览： 首页 中标人公示 » 汤岗子新城（东区）鞍山路（园林大道至汇园大道）段污水工程中标结果公示

汤岗子新城（东区）鞍山路（园林大道至汇园大道）段污水工程中标结果公示

2013年06月25日 打印 转发 字号: 大 中 小

**汤岗子新城（东区）鞍山路（园林大道至汇园大道）段污水工程
中标结果公示**
(招标项目代码: G21030120130529127611419580)

汤岗子新城（东区）鞍山路（园林大道至汇园大道）段污水工程施工公开招标评标工作于 2013 年6月19日在鞍山市公共资源交易中心结束, 中标候选人经法定程序公示已生效, 招标人依据《中华人民共和国招标投标法》及本次招标评标委员会向招标人提交的评标报告确定中标人, 现将中标结果公示1工作日, 如有疑义, 请在公示期内以真实姓名和单位向该项目的监督部门反映。

中标情况如下:

工程名称	汤岗子新城（东区）鞍山路（园林大道至汇园大道）段污水工程
中标人名称	鞍山市市政设施修建总公司

招标人: 鞍山市城市建设管理局
地址: 鞍山市中华南路240甲
联系人: 高向宁
电话: 0412-5600053

Source: <http://www.asggzyjy.cn/news/notice/one/index.jsp?id=3354>

It can be seen from the example:

- Clearly, sewage system buried under the city's roads and streets are the responsibility of Anshan UDB, but Sound Global pretends that it got its contract from Anshan EPB; and
- Anshan UDB bothered to put a sewage project worth about Rmb23.4m up for tender in early 2013. But Sound Global wants us to believe that it could get two sewage projects worth Rmb100m and Rmb250m, respectively, by private negotiation in January of the same year.

Other Lies and Contradictions in the Clarification

- In our February 4 report, our analysis on the Jingzhou project shows clearly that Sound Global's so-called percentage completion accounting is simply a load of crab. The clarification now directly contradicts the listing document, prepared in mid-2010, for Sound Global's Hong Kong listing.

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Exhibit 3 – Clarification Contradicts Listing Document

approximately RMB72.4 million* and RMB68.1 million* respectively were recognised by the Group in the same year. The project was completed in the first half of 2009 and commenced trial operation. In 2009, revenue from construction amounted to approximately RMB14.6 million* was recognised by

Source: Sound Global Clarification Announcement, p.11

Project Location	Jingzhou City, Hubei Province, the PRC*
Plant Type	Wastewater treatment plants for municipal wastewater
Contract Value	RMB90.65 million
Expected Completion	Second quarter of 2010
Date	

Source: Sound Global listing document (writing in mid-2010), p.139

- We've provided sufficient information in our February 4 report to show that Beijing Epure is a shell company with no real business. According to the clarification, Sound Global simply overlooked the categorisation error because it was "focused rather more on discussing the trends of the projected revenue/cashflows of the Group in totality and concerned of the final valuation of the company".

Exhibit 4 – Sound Global Revenue Forecasts 2015-19

产品类别	单位个数	2011年	2012年	2013年	2014年1-6月	2014年7-12月	2015年	2016年	2017年	2018年	2019年
bot营运收入	24.00	7,078.45	9,351.82	17,870.55	10,070.95	10,433.96	23,654.12	26,706.96	28,675.54	29,474.27	30,282.75
成长性		0.00%	32.12%	91.09%	14.74%	14.74%	15.36%	12.91%	7.37%	2.79%	2.74%
在建bot营运收入	19.00	0.00	0.00	0.00	0.00	0.00	9,692.51	12,740.29	15,642.72	17,627.76	18,730.97
成长性		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	31.44%	22.78%	12.69%	6.26%
托管营运收入	14.00	1,660.01	2,131.96	3,661.83	2,416.41	2,586.49	5,146.15	5,238.48	5,276.80	5,315.13	5,353.45
成长性		0.00%	28.43%	71.76%	36.62%	36.62%	2.86%	1.79%	0.73%	0.73%	0.72%
工程技术收入	1.00	102,491.95	117,268.77	106,244.03	39,525.91	39,526.00	83,005.00	85,495.00	87,205.00	87,205.00	87,205.00
成长性		0.00%	14.42%	-9.40%	-25.59%	-25.59%	5.00%	3.00%	2.00%	0.00%	0.00%
工程施工收入	1.00	85,039.26	121,260.80	183,167.53	112,504.37	112,504.00	247,509.00	272,260.00	289,486.00	329,435.00	362,379.00
成长性		0.00%	42.59%	51.05%	22.84%	22.84%	10.00%	10.00%	10.00%	10.00%	10.00%
设备销售收入	1.00	24,003.06	22,919.48	19,917.41	9,422.68	1,856.00	3,712.00	3,712.00	3,712.00	3,712.00	3,712.00
成长性		0.00%	-4.51%	-13.10%	-43.37%	-43.37%	-67.09%	0.00%	0.00%	0.00%	0.00%
收入合计	60.00	220,272.73	272,932.83	330,861.35	173,940.32	166,906.45	372,718.78	406,152.73	439,998.07	472,769.16	507,663.18

Source: CR appraisal report, p.71

* Units in Rmb10,000

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But if Beijing Epure were really in predominately the same business line as Sound Engineering, why would Sound Global management be so pessimistic on Beijing Epure's prospects, growing just 5% in 2015 and then falling to stagnation in 2018? On the other hand, they were very upbeat on Sound Engineering, seeing it growing 10% each year for the next five years!

- The clarification says that most of Sound Global's EPC contracts have been awarded by local governments and state-owned enterprises by competitive or direct negotiations rather than public tenders and that most contracts are kept confidential. But in recent years the central government has required local governments and SOEs to be more transparent in their procurements and public tenders are becoming the norm. It is difficult to imagine that most EPC projects can still be negotiated without going through the tender process. Anshan UDB provides a shining example of increasing government transparency by putting Rmb20m projects up for tender in 2013.

To conclude, the only way to prove the integrity of its financial reports is for Sound Global to come up with a full list of its projects and basic information including the name, location, value and completion date of the contracts. We are not asking for any confidential details.

Sound Global Presentation v25

Within hours after we published our report *Sound Global – a Water Specialist in Deep Water* on February 4, 2015, we received by email a big document detailing the various tricks and lies employed by Sound Global and its controlling shareholder Wen Yibo.

It seems the document was completed some time in December 2014, ahead of Sound Global's EGM to approve the new issue + share sale + acquisition package that would restructure Wen's waste management empire.

The document was supplied to us by someone who works for a hedge fund and requests anonymity treatment.

At 145 pages, the document is in our view far too long with many details that are non-essential to the author's central argument that chairman Wen has built Sound Global into a house of cards. We therefore removed just over one-third of the pages and now present the rest in a separate document without editing (except for repaginating) to our readers:

[http://www.emersonanalytics.cloud/downloads/Sound Global Presentation v25.pdf](http://www.emersonanalytics.cloud/downloads/Sound%20Global%20Presentation%20v25.pdf)

We have verified some but not all of the assertions or claims made in the document, but they are definitely not a result of our own investigation and analysis.

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We believe that its contents supplement our work and provide a useful angle for investors to consider. There are, of course, many questions that Wen and his underlings need to answer.

Below, we highlight a few pages that investors may want to pay attention to:

- **P.10 Global Peer Gross Margins**

Sound Global's construction business claimed a gross margin of 29% in 2013, far higher than the mid-teens for comparable companies in China and outside

- **P.12 Saudi Arabia Project Reveals True EPC Margins**

Filings by Singapore subsidiary shows that the project suffered a loss

- **P.17 Calls with Competitors Confirm Discrepancies**

Competitors are deserting the rural wastewater treatment business because there is no money to be made

- **P.19 Poor Earnings Quality**

Negative operating cash flow from 2010 through 1H14, resulting in mounting debts

- **P.25 Frequent management turnover**

- **P.28&34 Changing Discount Rate Assumptions**

By using absurdly low discount rates of some 2-4%, way below its own 8-9% cost of debt, Sound Global inflates the present value of the expected future cash flow from BOT projects and dresses up near term profit at the expense of future profitability, leaving the balance sheet vulnerable

- **P.36 Shaanxi Hancheng**

The wastewater treatment is left in disrepair as the cash-strapped local government halves tariff

- **P.43 Jilin Changchun**

The giant Rmb2bn freshwater project in northeast China is suspended due to financial liquidity problems of the local government

- **P.46&87 Shanghai Jingke**

Sound Global pretends that this is an independent third party but the company is actually controlled by chairman Wen. The acquisitions of Hi-Standard, Anyang Mingbo and Tongliao were in reality connected transactions, with the last being sold to the listco at a whopping 226x P/E

Enjoy your Chinese New Year reading!

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Disclaimer

We are a group of seasoned equities analysts with many years of experience in the research of economic and political trends as well as individual stocks around the world. With background in various international investment banks, we have followed the development of the Chinese equities market right from day one.

We are determined to expose as much of the fraud in the Chinese stock market as we can. The most widespread and serious fraud is probably that undertaken by listed companies, in fabricating non-existent businesses and stealing shareholders money, among other tricks.

In exposing these crimes we challenge the listed companies to prove the integrity of their announcements and financial statements. The listed companies, of course, want everybody to believe that their announcements and financial statements are true. Their auditors, employees, independent directors, lawyers, shareholders and even the general public all hope that these announcements and financial statements are true.

We have made our best effort to ascertain that everything we say in this report is accurate. We have obtained our information from public sources that we believe to be accurate and reliable, or from sources whom we believe are not insiders or connected parties to the companies mentioned herein. However, we are certainly NOT in business of making investment recommendations. This is not an investment report and should not be regarded as such. Read and use our reports at your own risk. Most important of all, DO YOUR OWN RESEARCH BEFORE YOU COMMIT OTHER PEOPLE'S MONEY.

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