

SilverCorp Management Failed to Disprove They Inflated Earnings 5X

SVM management asserts that its key operating subsidiary Henan Found Mining Co. Ltd. ("Henan Found") is highly profitable, having made 850,723,013 RMB (\$125 million) combined net income in 2009 and 2010 attributable to its two shareholders as follows:

77.5% to Victor Mining Ltd., SVM's 100% owned offshore subsidiary
22.5% to Henan Non-Ferrous Geological Mineral Resources Co., Ltd.
 ("HNGMR"), SVM's Chinese State-owned JV partner

Under Chinese international accounting standards HNGMR reports its 22.5% share of Henan Found's net income as investment income on its audited financials. We obtained original stamped copies of HNGMR's audited 2009 and 2010 financials (available [here](#) with translation [here](#)) that in our experience should be highly reliable due to the fact that HNGMR is a Chinese state-owned enterprise ("SOE") with no incentive to hide earnings or evade tax. HNGMR includes its share of earnings from Henan Found along with earnings from minority stakes in five other companies. To determine precisely the amount of proportional income from its 22.5% investment in Henan Found, we obtained the financials of each of HNGMR's five other minority holdings (available [here](#)). From these records we calculated the amount of HNGMR's investment income from Henan Found as shown in the following table that breaks down the sources and amounts of HNGMR's investment income in 2009 and 2010:

	Ownership	2009	2010
Henan Found Audited Net Income (RMB)		335,936,620	514,786,393
22.5% JV Partner (HNGMR) Share	22.50%	75,585,740	115,826,938
HNGMR Audited Total Investment Income		20,213,988	31,065,876
HNGMR Investment Net Income By Source			
		2009	2010
Henan Non-Ferrous Survey Co., Ltd.	16.00%	-7,728	-335,760
Henan Yurun Mining Co., Ltd.	30.00%	0	10,050
Henan Xindu Stock Co., Ltd.	2.26%	-6,780	-1,975
Henan Jinbolai Mining Co., Ltd.	30.00%	-34,500	-160,920
Henan Xinxiangrong Mining Co., Ltd.	29.80%	1,371,396	9,436,170
Henan Found Mining Co., Ltd.	22.50%	18,891,600	22,118,311
Shortfall in HNGMR's Audited Income from Henan Found		-56,694,140	-93,708,627
	Variance	400%	524%

HNGMR's share of income from its investment in Henan Found for 2010 was only 22,118,311 RMB, or 93,708,627 RMB less than the 115,826,938 RMB that Henan Found reported, a difference of 524%. There is no possible excuse for this variance. This strongly indicates that Henan Found's 2010 earnings disclosed by SVM are likewise overstated by 524%.

In 2010 Henan Found was SVM's only profitable subsidiary. Hence SVM's reported net income appears to be overstated by at least 5X.

SVM management responded by disclosing that an "allocation exists" whereby 70% of HNGMR's dividend from Henan Found is actually paid to a **never before disclosed** additional non-controlling interest holder of Henan Found they abbreviate "HNGMR's 1st Bridge" without providing the legal name of this "separate legal entity" for investigators to be able to verify its existence, ownership or financial records. A thorough search found no such separate legal entity in the ownership records of Henan Found or HNGMR.

Our previous analysis shows that HNGMR's investment income reported for 2010 from Henan Found is less than 1/5th of the amount Henan Found reported paying. Rather than explaining this serious discrepancy SVM management simply changed the subject and offered up a false and confusing look at dividend payments from Henan Found to HNGMR and the undisclosed "1st Bridge" entity.

SVM management falsely claims that HNGMR and the "1st Bridge" entity are subject to an additional 12.5% tax on dividend payments from Henan Found. **There has been no such tax in China since January 1st, 2008.** According to the Income Tax Law published in 2007 (link [here](#) for the Tax Law and [here](#) for its Implementation), the dividend or bonus received by a resident enterprise for its investment in another resident enterprise is exempt from the income tax. As Henan Found and HNGMR are both resident enterprises, the dividend Henan Found paid to HNGMR is exempt from tax.

To completely disprove SVM management's claim, let's assume HNGMR did pay the 12.5% income tax on the dividends from Henan Found. SVM claims this tax payable amounted to 2,883,022 and 3,437,125 RMB in 2009 and 2010.

If we take a look at HNGMR's financial reports, we see pretax profits for 2009 and 2010 of 20,213,989 and 31,065,876 RMB, respectively. Income tax payable is only 175,783 and 373,865 RMB for 2009 and 2010, respectively, completely inconsistent with the tax payable claimed by SVM management.

How is this possible unless HNGMR, as we showed in accordance with the Income Tax Law pays no income tax on dividends from Henan Found?

Furthermore in SVM management's calculation of the alleged 12.5% tax paid by HNGMR on dividends received management miscalculated.

The correct formula is:

$\text{Dividend Income} / (1 - 12.5\%) * 12.5\% = \text{tax payable}$

For 2009, for example: $20,925,000 / (1 - 12.5\%) * 12.5\% = 2,989,285.71$ RMB tax payable

It does not match with the 3,437,125 RMB that SVM management calculated in their response.

Anyone familiar with Chinese taxation can verify the calculation above.

In conclusion, SVM management completely failed to refute the strong evidence we presented showing the company's earnings are inflated at least 5X. We encourage SVM's auditor and independent directors to take a careful look at these facts.