

Seeking Alpha α

Silvercorp Proves It's Not A Fraud

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If you've been reading my articles here on Seeking Alpha, you'll know that I love shorting stocks. I also 100% support researchers that expose fraudulent companies. In [my article on Harbin \(HRBN\)](#), I argue that Andrew Left might be the greatest short seller in history.

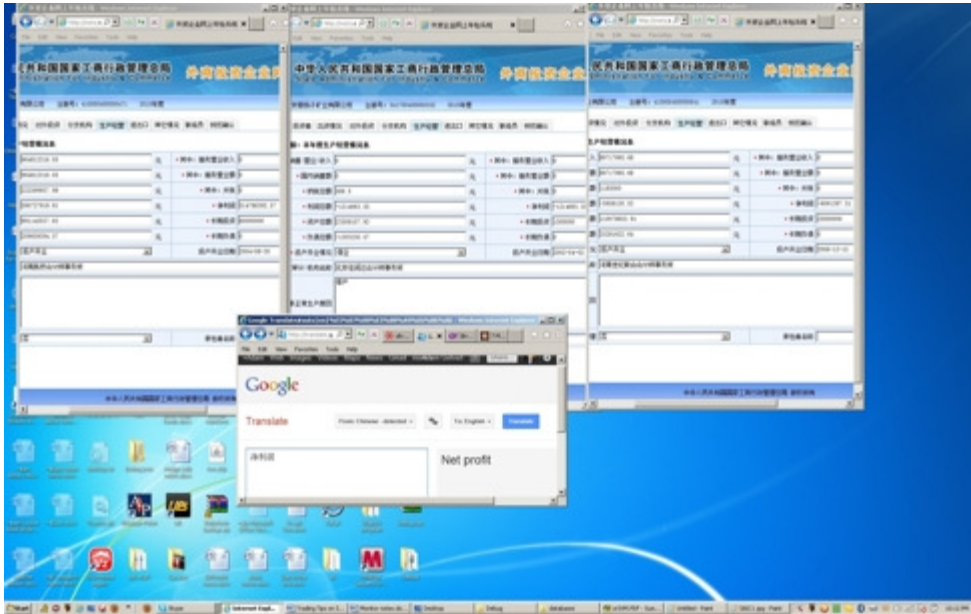
When I read about Silvercorp Metals ([SVM](#)) being a possible fraud, I took the opportunity to look into it. It could either be a good short play, or a good opportunity to buy when others are fearful. Silvercorp received an anonymous letter about a week ago from a short seller who claims it's a fraud.

However, there is no showing of that letter anywhere on the web. None of the great Chinese fraud busters: Andrew Left, Andrew Little, Carson Block, etc., have ever said anything about Silvercorp. In fact, the only announcement that there are fraud charges against the company is from the company itself. It noticed shares short had risen to 23 million shares on 9/2/11. So it sent out a [95 page press release](#) (.pdf) responding to the charges.

After thoroughly going over and checking each step of the press release, I find the verdict against Silvercorp ... **not guilty**. The company first disproved the allegation that it reported to the Chinese State Administration of Industry and Commerce (SAIC) a loss of \$0.5 million for calendar year 2010 while reporting a profit to the SEC of \$66 million.

The press release shows pictures of the SAIC filings and profit of each **subsidiary**, but I still wanted to check it myself on the actual SAIC website. While the press release shows how to do this, it is still no easy task. I had to hire a Mandarin speaker to type for me the Chinese characters to spell the name of each **subsidiary**. And it was still a pain to go through it. I took a screen shot of the filings and translated "net profit" so you don't have to go through the trouble.

click to enlarge



Now, if there are any doubters here, I've checked to make sure that this is the real SAIC website. In putting "saic.gov.cn" in Alexa, [here](#), it shows that its traffic rank is 938 out of all the "cn" websites. Considering there are about 2 million "cn" websites, this is an extremely high ranking. Now that I've established that those numbers are legit, I will use it later on to disprove another claim by the anonymous short seller.

Next, the letter said that the company's cash position is grossly overstated. I'm not sure how the short seller had come to that conclusion since the company just recently raised \$100M in a share offering in December, 2010. SVM showed many pictures of copies of its different bank statements from China and Canadian banks.

Third, the letter said that the grade of the company's deposits are "too good to be true". Now, this statement, I'm not sure I can prove or disprove. But a couple geologists at B.K. Exploration Associates from Spokane, Washington flew out to China to check out the deposits in the SGX Mine. The [report](#) (.pdf) was done in May, 2011 which I admit I did not take the time to thoroughly read.

Lastly, the short seller found that Silvercorp's JV partner of its most profitable subsidiary, Henan Found, sold a 5% interest in Henan Found for only \$7 million. The short seller concluded that this means Henan Found is only worth \$140 million.

What the short seller didn't say is that the JV partner is a Chinese government owned company, and it sold the 5% interest to one of its affiliates. We don't know what other arrangements it has with that affiliate. One can't value Henan Found based solely on this one transaction. Some details of the transaction are explained on this translated [Chinese website](#).

The selling price, \$7 million, is about 5% of the assets. In my screen shot above, the financials on the far left web page are those of Henan Found. It shows net profit to be RMB514,786,392, which is about \$80 million. A company that generates \$80 million in profits per year is worth a lot more than \$140 million. I realize that SAIC filings can be lies, but this is unlikely when a JV partner is the Chinese government.

Further strong evidence that the company's financials are correct, is on the right column of its [homepage](#). Not only does the company list every single one of its calendar year 2010 Henan Found and Henan Huawei customers [here](#) (.pdf), but it also shows tax forms for the [Chinese VAT tax](#) (.pdf) and [Income Tax](#) (.pdf), with the Chinese government's official chop. It's rare for any Chinese company, let alone frauds, to show this much proof and transparency.

In December, 2010, Silvercorp raised \$100 million through an offering that sold shares for about \$12 apiece. That also shows the practical advantage of being on an American exchange. Chinese companies don't become RTOs just to scam westerners. They do it because it makes it easier to raise capital.

Silvercorp is now debt free, and can use its cash hoard for acquisitions and share buybacks. Originally, the share offering was for acquisitions, but now that the stock is so cheap, a buyback is too good a deal to pass up. If you are a shareholder, each share that is bought back is essentially making you a 50% net profit: the company had sold each share for \$12, now buying them back for \$8 = \$4 profit per share. SVM has already [bought back](#) 2 million shares for \$8 apiece since its [share repurchase program](#) started on June 29, 2011 to repurchase up to 10 million shares.

The recent fraud accusations against Silvercorp might be a blessing in disguise. Because of all the press about frauds like Sino-Forest ([SNOFF.PK](#)), many people were wary of Canadian companies that do most of their business in China. The short interest has been rising for Silvercorp the last few months, reaching its peak on September 2nd at about 23 million shares.

However, now that it is all out in the open, Silvercorp had an excuse to go balls-out and write the extensive 95 page report of full transparency. Since it had published the report, about 4 million short shares have been covered. Silvercorp has now made a 100% effort to make it clear that it is one of the good apples. It has succeeded in that effort in my opinion.

Disclosure: I am long [SVM](#).