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COMPANY: Ausnutria Dairy Corp Ltd | HK: 1717  
INDUSTRY: Infant Milk Formula

On August 15, 2019, we published our investment opinion (the “Report”) on Ausnutria Dairy Corp Ltd (HK: 1717) (“Ausnutria” or the “Company”) detailing an extensive investigation which indicated that Ausnutria inflates revenues, hides costs, misleads Chinese consumers and secretly enriches executives through undisclosed related party transactions. Less than 24 hours later, Ausnutria issued a hasty, incomplete and flimsy 6-page response (the “Response”) which barely addressed our Report in any substantive or meaningful way.

Ausnutria’s Response was so hasty we wonder if management even had time to read our Report before concocting blanket denials and tepid admissions. In this rebuttal, not only do we present **NEW** evidence from the Company’s ESG data suggesting Ausnutria misrepresents its financial performance, but we also pick apart the Response.

### 1) Company Admits Lactose in Goat Milk Formula is From Cow Milk

Most notably, Ausnutria admitted in its Response that the lactose in its Kabrita goat milk infant formula is actually from cow milk. If we were a Chinese parent, we would be furious. In its Response, the Company fell back on Chinese law. It said that PRC law “does not require milk powder products to indicate the animal source of lactose.” We disagree. Our reading of the applicable Chinese FDA regulation is that Article 31 clearly requires Kabrita to disclose that its goat milk contains lactose from cows.

第三十一条 产品名称中有动物性来源的，应当根据产品配方在配料表中如实标明使用的生乳、乳粉、乳清（蛋白）粉等乳制品原料的动物性来源。使用的乳制品原料有两种以上动物性来源时，应当标明各种动物性来源原料所占比例。

Article 31 Where there is an animal source in the product name, the animal source of raw materials such as raw milk, milk powder, whey (protein) powder, etc. used in the ingredient list shall be clearly indicated according to the product formula. **When there are more than two animal sources of dairy raw materials used, the proportion of raw materials of various animal origins should be indicated.**

Source: [http://www.gov.cn/gongbao/content/2016/content\\_5145569.htm](http://www.gov.cn/gongbao/content/2016/content_5145569.htm)

But regardless of its obligations under Chinese law, Kabrita told Chinese parents that lactose in its product was from goats, not cows. This matters because the source of the milk was central to many of the Company’s spurious health claims regarding its flagship product.

### 配方羊奶粉的优点

配方婴幼儿奶粉包括牛奶粉、羊奶粉等都能满足宝宝生长发育的需要。但羊奶粉相比牛奶粉有他独特的优点。羊奶粉特别接近母乳，特别对牛奶或牛奶粉过敏的宝宝，羊奶粉更是最佳的选择。

Especially for babies allergic to cow milk or cow milk formula, goat milk formula is the best choice.

Source: <http://www.kabrita.com.cn/yuer-zhishi/31107.html>

Kabrita helps your baby to overcome lactose intolerance

### 佳贝艾特帮你宝宝打败乳糖不耐“兽”

Published Date: Jan 8, 2016

Author: Administrator

发布时间: 2016-01-08 来源: 互联网 作者: 管理员 浏览次数:93

Source: <http://www.kabrita.com.cn/yuer-zhishi-2/25195.html>

Is goat milk formula better than cow milk formula?

### 羊奶粉好还是牛奶粉好? 该如何对比区分?

Author: Administrator

发布时间: 2018-10-29 来源: 互联网 作者: 管理员 浏览次数:1669

羊奶粉可以防止牛奶蛋白过敏

Goat milk powder can prevent cow milk protein allergies

羊奶粉比牛奶粉好，也表现在它可以防止牛奶粉中牛奶蛋白对宝宝产生的过敏现象。在牛奶中含有的 $\alpha$ -S1酪蛋白和 $\beta$ -乳球蛋白等是导致一些婴儿过敏的物质。这两种蛋白质对于健康的宝宝是没有什么影响的，但是对于消化能力不足的宝宝们来说，就容易引起他们的过敏反应。特别是对于0-6个月的婴儿，这种情况就更多一些。而羊奶中这两种蛋白质的含量要比牛奶中低很多。

Source: <http://www.kabrita.com.cn/yuer-zhishi-2/33224.html>

On Kabrita's Chinese website, it promoted articles advertising its goat milk formula as a healthy alternative to cow milk for babies who are lactose intolerant or who are allergic to cow milk protein. But such marketing is misleading, because on Kabrita's [American](#) and [European](#) websites, the Company clearly warns parents that **lactose intolerant babies or babies allergic to cow milk should NOT be given Kabrita goat milk formula.**

We think Chinese parents should be and will be outraged.

## 2) Who is Ausnutria's Largest Customer?

But as bad as Ausnutria's Response, it was nothing compared to the conference call the Company held for investors the day after we published our Report. The call deserves a special place on the mantelpiece of all-time self-inflicted management wounds, including for the Company's strange answer to a simple question.<sup>3</sup>

<sup>1</sup> The web page is currently inaccessible but was active as of July 24, 2019.  
<http://webcache.googleusercontent.com/search?q=cache:nAqpX6RbCtEJ:www.kabrita.com.cn/yuer-zhishi-2/25195.html+&cd=2&hl=en&ct=clnk&gl=jp>

<sup>2</sup> The web page is currently inaccessible but was active as of June 12, 2019.

<sup>3</sup> We are paraphrasing here because the call was in Mandarin.

**Question:** what percentage of sales is your largest distributor?

**Ausnutria Chairman:** our current largest distributor... who it is specifically ... I don't have the answer now. I can provide you the information later.

*Source: Ausnutria Investor Call, August 16, 2019<sup>4</sup>*

**What business owner does not know the identity of its largest customer?** This is what we call a freebee for short sellers. Our report did not even scrutinize the Company's largest distributors because Ausnutria never disclosed who they were. Now, in response to a simple question, we believe the Company has shot itself in the foot.

One of two things are true. Either the chairman does not know the identity of Ausnutria's largest customer (which we consider highly unlikely), or he is refusing to answer because he does not want anyone scrutinizing the relationship. In our report, we uncovered numerous undisclosed related party distributors owned in whole or in part by Ausnutria executives. Yet our investigation was limited because the Company has rarely disclosed the identity of its largest customers. Our presumption is that the Company refuses to answer such simple questions because the answer is damaging.

The call was muffled, but an Ausnutria executive followed the chairman's obfuscation by stating that the largest distributor of Kabrita was "*Si Chuan Chuang Duo.*" The call was hard to decipher, but we searched and could not find an infant formula distributor by that name. We call on the Company to spell out the name of the distributor referred to as Kabrita's biggest customer on the investor call.

Given Ausnutria's history of scandal, investors should insist on a basic level of transparency. Analysts and shareholders should ask the Company to disclose its top five customers for the last five years. If there is nothing suspicious about its distributors, this should be no problem. But if the Company refuses, we think investors can infer that Ausnutria is hiding something.

### 3) ESG Disclosures Inconsistent with Reported Sales and Production Growth

Beginning in 2016, Ausnutria started publishing an annual environmental, governance and sustainability report (the "ESG Report"), which discloses the amount of resources and the packaging materials used by the Company in any given year.

We would expect to see the amount of packaging material used to move proportionally, or at the very minimum, in the same direction, with the production volume and sales growth reported by the Company.

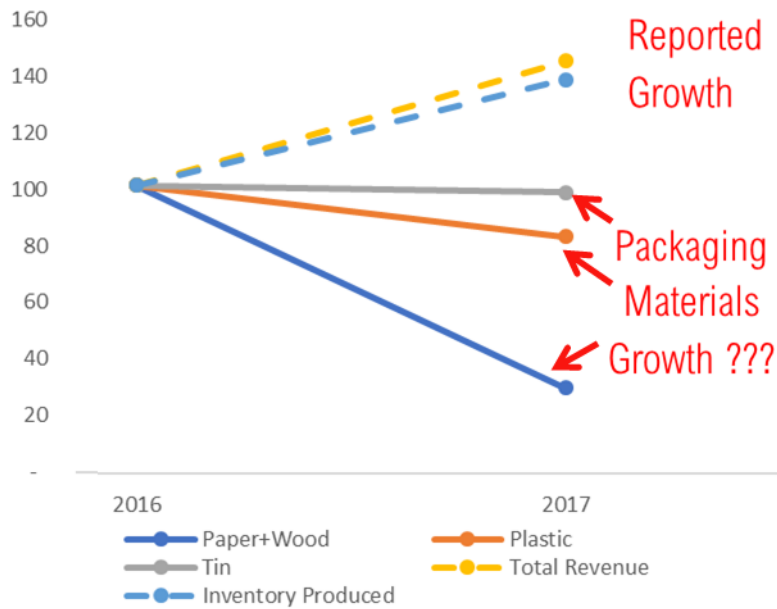
However, Ausnutria's packaging material usage **dropped 41% in 2017**, despite Ausnutria supposedly producing 37% more infant milk formula products.

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<sup>4</sup> 提问：贵公司现在最大的经销商占你们业务额的情况是什么？

澳优主席：现在我们最大经销商，具体是哪家，我现在答不出来啊。我可以迟一点提供信息给你。

Tonnes/Rmb M	2016	2017	2018	CAGR 2016-2018
Paper+Wood	9,634	2,875	3,772	
Change		<b>-70%</b>	31%	-37%
Plastic	993	816	1,819	
Change		<b>-18%</b>	123%	35%
Tin	6,897	6,735	9,563	
Change		<b>-2%</b>	42%	18%
Total	17,524	10,426	15,154	
Change		<b>-41%</b>	45%	-7%
Total Revenue	2,740	3,926	5,390	
Growth		<b>43%</b>	37%	40%
Ending Inventory	800	1,083	1,544	
Add: Cost of inventories sold	1,560	2,153	2,676	
Minus: Beginning Inventory	580	800	1,083	
Inventory Produced	1,781	2,436	3,137	
Growth		<b>37%</b>	29%	33%



Note: 2016 resource usage/revenue indexed to 100  
 Source: Ausnutria ESG reports; Annual Reports

The sharp drop in the use of tin is especially difficult to reconcile with Ausnutria’s reported sales and production growth. Most Ausnutria’s products, including Kabrita, are sold in tin cans.

Source: [https://ausnutria.world.tmall.com/category.htm?spm=a312a.7700824.w4011-3472045218.81.1a4118a8vheGlh&scene=taobao\\_shop&viewType=grid&search=y&orderType=defaultSort](https://ausnutria.world.tmall.com/category.htm?spm=a312a.7700824.w4011-3472045218.81.1a4118a8vheGlh&scene=taobao_shop&viewType=grid&search=y&orderType=defaultSort)

Since most Ausnutria products are sold in tin cans, we would therefore expect the Company’s tin usage to move in the same direction, if not proportionally, with the Company’s reported growth in infant formula sales<sup>5</sup> and inventory. Yet the Company’s tin usage **declined by 2% from 2016 to 2017**, despite Ausnutria reporting that sales grew 43% and inventory produced supposedly grew 37% that year.<sup>6</sup>

Tonnes/RMB M	2016	2017
Tin	6,897	6,735
Growth		-2%
Infant Formula Revenue	2,290	3,285
Growth		43%
Inventory Produced	1,781	2,436
Growth		37%

Source: Ausnutria ESG reports; Annual Reports

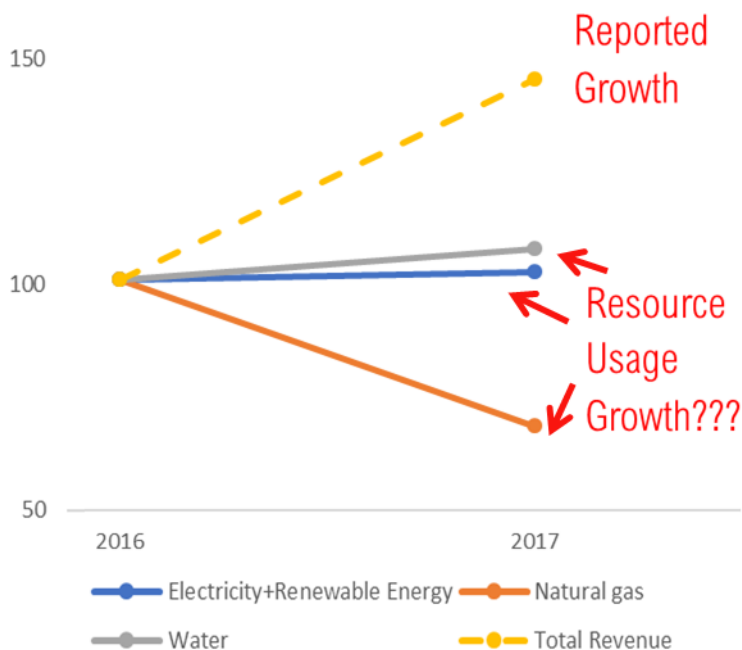
<sup>5</sup> Infant formula revenue includes revenues from both Ausnutria branded products and private label business

<sup>6</sup> We observe the same trend over the last three years. Tin usage has only grown by a CAGR of 18% from 2016 through 2018. Meanwhile, the Company reported that sales of its infant milk formula grew by a CAGR of 44% over the same period.

Ausnutria’s reported usage of packaging materials corroborates customs data and import records, and indicates, in our opinion, that the Company is producing and selling far fewer cans of infant milk formula than it reports to investors.

Similar discrepancies are also evident when comparing the Company’s reported sales growth with the resource usage disclosed in Ausnutria’s ESG reports. Despite reporting a 43% growth in revenue in 2017, Ausnutria’s electricity and water usage barely changed and natural gas usage dropped by 32% that year.

Type of Resources	Unit	2016	2017	2018	CAGR 2018-2016
Electricity+Renewable Energy	KWh	21,627,011	21,981,709	27,284,394	
<i>Change</i>			<b>2%</b>	24%	12%
Natural gas	m <sup>3</sup>	10,956,456	7,491,289	11,297,029	
<i>Change</i>			<b>-32%</b>	51%	2%
Water	m <sup>3</sup>	592,947	632,405	781,765	
<i>Change</i>			<b>7%</b>	24%	15%
Reported Total Revenue	RMB M	2,740	3,927	5,390	
<i>Growth</i>			<b>43%</b>	37%	40%



Note: Indexed 2016 resource usage/revenue to 100  
 Source: Ausnutria ESG reports, Annual Reports

How could Ausnutria increase production and sales so dramatically without using more gas, water and electricity in the production process?

Since ESG reports are seldom scrutinized by investors (other than us), there is less incentive for the Company to lie about their energy or materials usage. Hence, we believe that data on packaging material and resource consumption is more likely to be credible. Yet such data directly contradicts the spectacular growth in sales and production reported by the Company, lending further credence to our investment thesis that Ausnutria is misrepresenting its financial performance.

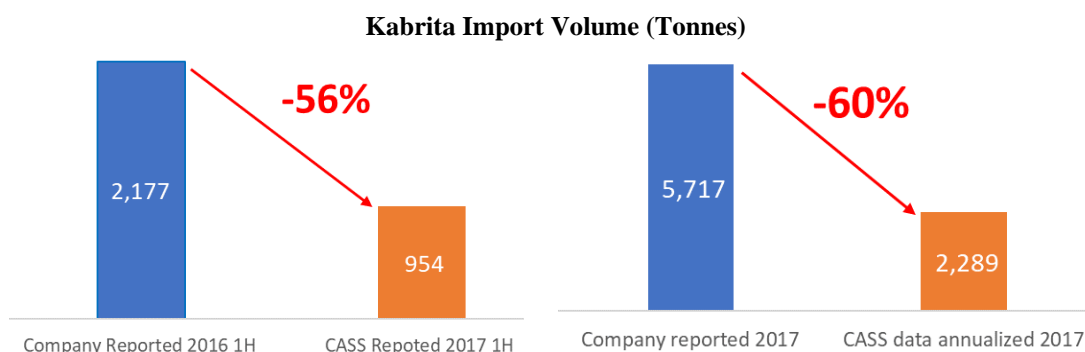
#### 4) Customs Data Indicates Infant Milk Formula Sales in the PRC Overstated by 52%.

In our Report, we showed publicly available Chinese customs data which indicated that the Company is not importing nearly enough milk formula (by volume or value) for its sales to be true. For the two-year period from 2016-2017, we estimate that based on the value of imports reported by the Company's import agents, that Ausnutria overstated its sales of infant milk formula by 52%.

In its Response, Ausnutria issues a blanket denial without issuing any supporting evidence of any kind. Instead, Ausnutria claims that its previous disclosures about imports "can be supported by official documents issued by the General Administration of Customs of the People's Republic of China."

**If Ausnutria is in possession of other, authoritative customs records, which show its disclosures are true, then we challenge the Company to produce them immediately.** After all, such records supposedly exonerate the Company. If such records exist, produce them so they can be tested and weighed in the crucible of the market. If Ausnutria doesn't produce them immediately, we **think it's fair for investors to assume that such records are incomplete, irrelevant or simply fabricated by a desperate management team willing to tell the market anything to stay afloat.**

On its investor call, Ausnutria tried to address some of our most damning evidence. We highlighted a government-affiliated research report (the "CASS" report) which states that in the first half of 2017, Ausnutria imported **only 954 tons of Kabrita branded infant goat milk formula**. This is 56% less than the Company claimed to import the year before (1H 2016) and if we annualize it, it is 60% less than the amount of Kabrita (by volume) that Ausnutria claimed to import in 2017.



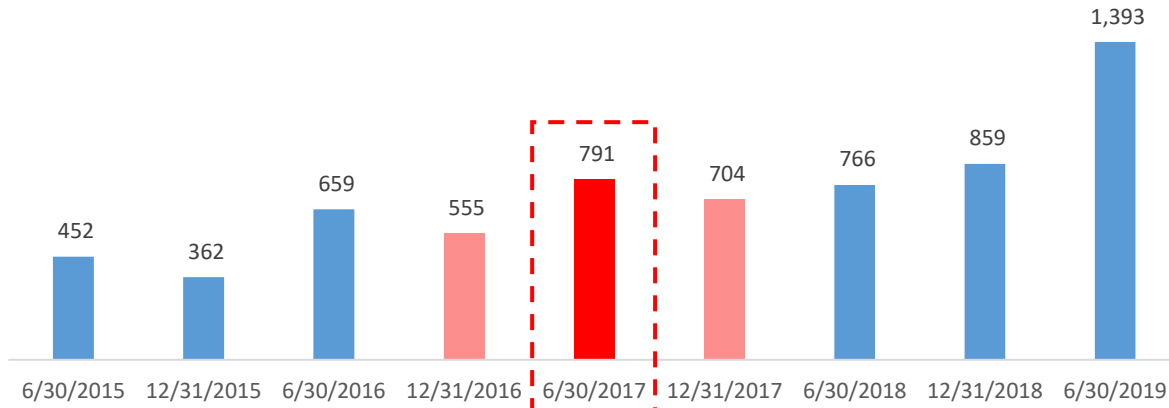
On its investor call, Ausnutria essentially **admitted** that the CASS data is accurate.<sup>7</sup> The Company likely had no choice, considering that Ausnutria previously cited the CASS research report on its official Kabrita Chinese website.

However, Ausnutria tries to reconcile the CASS data (for the first half of 2017) with its previous disclosures by claiming that it imported 3.3x the volume of Kabrita products (4,452 tons) in the second half of the year. Ausnutria said it had to significantly increase the pace of imports in the second half of 2017 because it had a "shortage" of Kabrita products.

This is a nonsense excuse, directly contradicted by the Company's financials. If the Company's explanation was true, and it was experiencing a genuine product shortage of Kabrita which required it to import 3.3x the amount of Kabrita in the second half of 2017, then we would expect the Company's inventory levels to be substantially lower at mid-year. But inventory levels suggest the opposite.

According to the Company's 2017 interim report, finished goods inventory **was higher in June 2017** (RMB 791 million) than at the end of either years 2016 or 2017.

<sup>7</sup> On the investor call, Ausnutria claimed that it imported 1,362 tons of Kabrita in the first half of 2017.

**Finished Goods Inventories (RMB M)**

Source: Ausnutria Interim and Annual Reports

If Ausnutria was truly experiencing product shortage in mid-year 2017, then its interim report would show **low** inventory levels of finished goods. Yet the opposite is true. The Company's inventory of finished goods (products) was near all time highs.

Ausnutria's own inventory disclosures undercut the Company's lame explanation to investors that a product shortage forced it to increase the pace of imports so dramatically in the back half of 2017. The CASS data indicates that Ausnutria imported between 56-60% less than should have been the case for the Company's financials to be true. And Ausnutria's nonsense explanation only reinforces our conviction in our investment opinion that import records show the Company is substantially overstating sales in the PRC.

#### 5) Nutriunion: Sham Transactions and Siphoned Subsidiaries.

Ausnutria claimed to own 60% of Nutriunion HK, which markets and distributes the Company's Nutrition Care products in the PRC. On July 8, 2019, the Company claimed to acquire the remaining 40% of Nutriunion HK from three Company executives for RMB 236 million (satisfied mostly through shares). However, in our report, we showed Hong Kong corporate registry filings which clearly state that as of both May 23, 2018, and May 23, 2019, **Nutriunion HK was owned 100% by Wong Wei Hua Derek, the Company's CFO.**

Not only do such records suggest that the Company lied about its ownership rights to this entity but also indicates that the buyout of minority interest holders in July 2019 was a sham transaction because such executives did not actually own any shares of Nutriunion HK.

In its Response, the Company claims that the **CFO held the shares in trust** on behalf of the Company and its three executives. Then, according to Ausnutria, on July 3, 2019, (5 days before the Company announced the acquisition), the CFO supposedly transferred the shares held in trust to the three executives so they could sell them to the Company for RMB 236 million.

This is ridiculous. First, the Company's explanation contradicts the documentary evidence. If, on July 3, 2019, the CFO transferred the shares to the three executives – where is the Hong Kong registry filing showing the transfer? The last ownership filing on the Hong Kong corporate registry database shows that as of May 23, 2019, the CFO continued to own 100% of the shares of Nutriunion HK.

Wong Wei Hua Derek	Flat A, 20/F., Block 5, One Silversea, 18 Hoi Fai Street, Tai Kok Tsui, Kowloon.	100	N/A	N/A	
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Source: Hong Kong 2018 Annual Report for Nutriunion HK, May 23, 2019

According to the Hong Kong corporate registry, there was no change in the ownership of Nutriunion HK since then. A Notice of Change in Particulars of Company Secretary and Director was filed on August 7, 2019, in which Nutriunion HK still listed the Company's CFO Wong Wei Hua Derek as the sole director.



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### Document Index Search

CR No.: 2380659

Company Name: Nutriunion (Hong Kong) Company Limited  
雲養邦(香港)有限公司

Document Group:  ▼

Filing Year:

Order Type			No.	Document Name (E) - English; (C) - Chinese	AR / AC Year	Submission / Filing Date	Document Ref. No.	Pages	File size	Document Status
Download	Certified Copy	Online View								
			1	(E)FND2B - Notice of Change in Particulars of Company Secretary and Director	-	07-AUG-2019	22801997159	3	98KB	Available
			2	(E)FNAR1 - Annual Return	2019	30-MAY-2019	23501569761	9	258KB	Available
			3	(E)FNAR1 - Annual Return	2018	30-MAY-2018	23201468847	9	250KB	Available
			4	(E)FNAR1 - Annual Return	2017	06-JUN-2017	22301444504	9	251KB	Available
			5	(E)FND2A - Notice of Change of Company Secretary and Director (Appointment/Cessation)	-	08-JUN-2016	22901498466	3	146KB	Available
			6	Certificate of Change of Name	-	06-JUN-2016	40010595124	1	34KB	Available
			7	(E)FNNC2 - Notice of Change of Company Name	-	06-JUN-2016	22801305661	1	51KB	Available
			8	Certificate of Incorporation	-	23-MAY-2016	40010548249	1	32KB	Available
			9	(E)Articles of Association	-	23-MAY-2016	22301242657	9	383KB	Available
			10	(E)FNNC1 - Incorporation Form (Company Limited by Shares)	-	23-MAY-2016	22301242656	7	207KB	Available

**END OF RECORD**

Source: <https://www.icris.cr.gov.hk/csci/>

If the Company is telling the truth, then we believe there should be a filing in the Hong Kong corporate registry records of Nutriunion HK showing a July 3, 2019, transfer of shares from the CFO to the executives. If the trust and pre-acquisition transfer was real, why don't the HK registry filings show any update of the shareholding structure or documentary evidence of any kind supporting the Company's farfetched narrative?

Second, the Company gives **no reason** why the shares had to be held in trust. Ausnutria simply fails to conjure any excuse as to why its executives could not hold their shares in Nutriunion HK directly, either as individuals or through their respective Cayman entities. These same executives owned shares in Cayman entities, so they were clearly not prohibited by Chinese law to hold equity in offshore holding companies.

We have been researching Hong Kong companies for 10 years, we have not encountered any other instance in which a PRC based executive was prohibited from owning shares of a Hong Kong entity.

Furthermore, if the shares had to be held in trust by the CFO, what changed on July 3, 2019, which suddenly permitted the individuals to dissolve the trust and take title of the shares for 5 days before selling them to Ausnutria for RMB 236 million? In our opinion, the Company cannot provide any credible explanation because there is none.

Ultimately, the Company's excuse is nonsense. Ausnutria's provides no credible explanation as to why the trust arrangement would be necessary, and such a trust contradicts both the Company's previous disclosures and the documentary evidence available on the Hong Kong corporate registry database. We continue to think the buyout was an obvious sham, in which Ausnutria paid RMB 236 million to three executives for shares they didn't even own.

#### 6) Understating Labor Costs.

In our report, we highlighted Dutch regulatory filings of Company subsidiary Ausnutria B.V. and its subsidiaries. Together they account for only 40% of Ausnutria full time employees. But according to their Netherlands filings, Ausnutria B.V. and its subsidiaries reported 94% of the total consolidated wage, salary and pension costs reported by the Company in 2017. Either the remaining 60% of Ausnutria's employees are working for free, or the Company is underreporting its labor expenses and employee costs in its Hong Kong filings. We think it is obviously the latter.

Ausnutria's Response on this point was vague and evasive. In two brief paragraphs the Company blanketly asserted that the discrepancy was due to the difference in Dutch GAAP and IFRS. **What difference? The Company simply asserts a difference**, without any explanation as to the accounting rules or treatments which would require a simple category like wages or salaries to be reported differently under the different accounting standards.

In its 2017 guide "*IFRS Compared to Dutch GAAP*," KPMG [noted](#) that under Dutch GAAP, "**like IFRS, liabilities and expenses for employee benefits generally are recognized in the period in which the services are rendered.**" The treatment of wages and salaries are not complicated accounting items. They are generally expensed as incurred. So why would there be any difference between how such salaries are recognized under Dutch GAAP than IFRS?

Ausnutria posited that some of the discrepancy was due to the inclusion of "temporary personnel costs, social security charges and other expenses including travel costs, messing and other allowances." But such line items are included under employee related expenses under both Dutch GAAP and IFRS.

Components of Employee Benefits Expense	Dutch GAAP	IFRS	Source
Wage and Salaries	✓	✓	IAS 19.8
Management Fees	✓	✓	IAS 19.8
Pension Costs	✓	✓	IAS 19
Social Security Charges	✓	✓	IAS 19.8
Temporary personnel	✓	✓	IAS 19.7
Other expenses (travel costs, education, canteen)	✓	✓	IAS 19.8

#### 2.2.1 General scope requirements of IAS 19

The standard makes clear it applies widely and in particular to benefits:

- (a) **provided to all employees (whether full-time, part-time, permanent, temporary or casual staff and specifically including directors and other management personnel); [IAS 19.7]**

Source: *International GAAP 2016: Generally Accepted Accounting Principles under International Financial Reporting Standards* by Ernst & Young LLP, p 2515

## 12 SHORT-TERM EMPLOYEE BENEFITS

Short-term employee benefits are employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service. [IAS 19.8].

The standard states that reclassification is not necessary if an entity's expectation of the timing of settlement changes temporarily. However, if the characteristics of the benefit change (such as a change from a non-accumulating benefit to an accumulating benefit) or if a change in expectations of the timing of settlement is not temporary, then the entity considers whether the benefit still meets the definition of short-term employee benefits. [IAS 19.10].

They can include:

- wages, salaries and social security contributions;
- paid annual leave and paid sick leave;
- profit-sharing and bonuses; and
- non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees. [IAS 19.9].

Source: International GAAP 2016: Generally Accepted Accounting Principles under International Financial Reporting Standards by Ernst & Young LLP, p 2565

Moreover, a plain reading of both the Dutch and IFRS disclosures suggest that they include the same categories of wage and labor expenses.

	2017 RMB'000	2016 RMB'000
Employee benefit expenses (including directors' remuneration) (note 8):		
Wages, salaries and staff welfare	445,092	331,916
Equity share option expense	7,585	11,793
Pension scheme contributions*	31,707	20,828
	<b>484,384</b>	<b>364,537</b>

Source: Ausnutria 2017 Annual Report

	2017 €	2016 €
<b>Wages, salaries and social security charges (23)</b>		
Wages and salaries	31.313.483	26.989.977
Management fees	63.167	226.031
Pension costs	2.086.582	1.371.562
Social security charges	4.204.845	4.039.037
Temporary personnel	10.540.967	6.898.866
Other expenses (travel costs, education, canteen, etc.)	11.277.089	8.105.252
	<b>59.486.134</b>	<b>47.630.725</b>

Source: Ausnutria B.V. – 2017 Annual Report in Netherlands Regulatory Filings

We find no accounting differences between Dutch GAAP and IFRS which would explain why the treatment of such expenses should be different. Rather, Dutch regulatory filings suggest that the Company is likely understating its labor and staffing costs and that Ausnutria is substantially less profitable than it claims.

## 7) Corporate Scandal and a Pattern of Undisclosed Related Party Distributors.

In our Report, we showed three examples in which the Company is clearly selling products through undisclosed distributors controlled or partially owned by current Ausnutria executives. One such distributor is even partially owned by the disgraced ex-CFO of Ausnutria China, one of the executives at the epicenter of the accounting scandal that almost brought down the Company.

In its Response, Ausnutria never denies that it sells through such distributors. Rather, the Company falls back on the technicality that such entities are not “connected persons” under the listing rules or such transactions are not material.

Ausnutria misses the point. Heightened disclosure rules for distributors owned or controlled by Company executives exist to allow auditors and investors to subject such relationships and transactions to heightened scrutiny. That is impossible when Ausnutria hides behind technicalities.

It is even more inappropriate to hide behind technicalities of “connected parties” when the distributors refer to themselves as Ausnutria subsidiaries. One such distributor even lists an @ausnutria email address in its company registration. The Company’s Response is that distributors refer to themselves as subsidiaries for “convenience,” and that distributors sometimes use Ausnutria’s logo, brands and email addresses to support their marketing efforts.

By far the more likely explanation is that such entities refer to themselves as subsidiaries and use @ausnutria email addresses and Company logos because, for all practical purposes, these management owned distributors are quasi-subsidiaries operated for the personal benefit of such executives. Yet these dealings are undisclosed, making it impossible for auditors or investors to subject them to the proper heightened level of scrutiny.

Moreover, we dispute that such transactions are immaterial. One such distributor, owned in part by the Company’s disgraced ex-CFO, [claims](#) to be targeting RMB 1 billion in sales for Ausnutria’s Mygood brand. That same distributor runs Ausnutria’s Mygood brand’s Tmall and JD stores and its WeChat account.

Ausnutria is stuck in a catch 22. Such transactions certainly appear material. But the Company claims they are not. But why would Ausnutria risk the corporate governance stink of transacting with a disgraced CFO central to its previous scandal when by its own admission, such transactions were immaterial? In other words, if such relationships are immaterial, why risk it?

In its Response, Ausnutria also tried to deny that Xiao Shihu, another executive who was at the epicenter of the scandal, was still a Company executive.

**Question:** Is Xiao Shihu still a current VP at Ausnutria?

**Ausnutria Chairman:** We give him some title. The purpose is to support them to do good business. This is totally for the purpose of supporting them to do good business. That is to say, we allow them to use their past titles to do this.

*Source: Ausnutria Investor Call, August 16, 2019<sup>8</sup>*

This is a nonsensical answer. Either he is an executive or he isn’t. The Company obviously wants to contend he’s not an executive because of his undisclosed equity interest in a distributor, which we identified in our Report. The Company’s denials are even more ridiculous considering Xiao Shihu was recently and prominently featured in Ausnutria’s 15-year anniversary announcement. The Company even honored him in September 2018, with special recognition for his 15-years of service.

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<sup>8</sup> 提问：肖诗弧他是不是目前还在澳优担任副总裁？

澳优主席：我们给他的就是一些名分，目的是支持他们把业务给他们做好。这是完全是出于支持他们做好业务的这么一个目的。就是我们允许他们沿用一些历史里的 title 来做这个事情

十五年的发展，梦想照耀澳优人砥砺前行



Xiao Shihu

关于澳优的十五年，每一位陪伴过澳优成长的人，都有太多的话想说。从回望初心，砥砺前行，荣耀时刻到展望未来，部分见证过澳优十余年发展的澳优合作伙伴在一段VCR里说出了自己的心里话。

**伍跃时（澳优创始股东）：**我们按照国际上最严格的标准来打造澳优的第一款奶粉。我们的初心就是要用世界的优质奶源，打造让中国宝宝放心的奶粉。

**陈远荣（澳优创始股东）：**在品类迭代、品类发展的机会面前，澳优重要的是把握了创新，把握了机会，这成就了澳优的现在。

**刘育标（澳优中国区副总裁）：**早年去招商的时候，基本上没有休息时间，都是披星戴月。

**肖诗弧（澳优中国区副总裁）：**澳优的模式是一种全球自控产业链的模式，是利用全球资源，为中国宝宝服务的模式。

**Xiao Shihu (Vice President of Ausnutria PRC region)**

我们澳优人始终在一起，阔步向前，迈向第一阵营。我们都能立于不败之地。

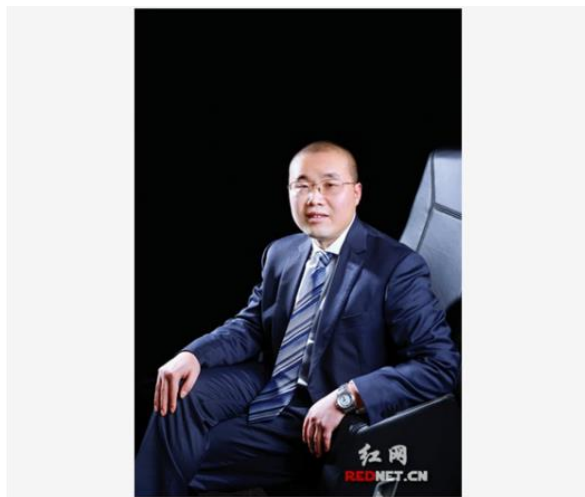
**戴智勇（澳优中国区副总裁）：**通过低渗透压奶粉的专利和我们的市场推广，大大提升了澳优的品牌实力。

晚会上，澳优十五年员工颜卫彬、刘跃辉、戴智勇、刘育标、屈治劲、肖诗弧、谈宁南、李四化、曾志斌、王胜男、陈远军、何家香、江玲、宁波、文丽辉、周亿如、廖长兵、易美红、卢波获得荣誉员工称号和澳优十五周年纪念奖章。

Ausnutria's 15-year employees Yan Weibin...Xiao Shihu... have received recognition as Honor Employees...

Source: <http://www.ausnutria.com/index.php/new/info/308>

Shihu has also been giving interviews as Ausnutria Vice President and the General Manager of Mygood. Clearly, he is a senior executive at Ausnutria.



澳优乳业副总裁、美优高事业部总经理  
肖诗弧

Ausnutria Dairy Vice President, General Manager of MyGood BU Xiao Shihu

Source: <https://3g.163.com/dy/article/DBB192040514R9L5.html>

That Ausnutria now tries to deny that Xiao Shihu is an executive should speak to the credibility of the Company and its Response.

On its investor call, Ausnutria even tried to minimize the extent of its previous corporate scandal.

**Question:** what's your view on the risk associated with the previous CFO?

**Ausnutria Chairman:** this is how we see it. First, Mr. Dai, what he did previously was more due to an unfamiliarity with the rule here. This has been pointed out in the previous investigation. Our number is right when added up. The problem is about cut off point. And that is because the team then did not know enough about the Hong Kong rules. This is a gradual process.

*Source: Ausnutria Investor Call, August 16, 2019<sup>9</sup>*

Ausnutria shares were halted for 858 days, and an independent investigator found sufficient evidence of fraud and malfeasance that the Company had to revise and restate its net profit downward by 46% for one year. It should be a major red flag to investors that Ausnutria is trying to downplay the gravity of the scandal or the egregiousness of its prior conduct.

Ausnutria claims in its Response that since the scandal, it has been maintaining good corporate governance and internal control systems. But such claims ring hollow in the face of evidence of frequent dealings with undisclosed distributors owned or controlled by Company executives (especially disgraced executives central to the Company's past misdeeds). This creates the material risk that Company executives could use undisclosed influence over distributors to fake sales (again). It also creates the presumption, we believe reasonably, that Ausnutria executives are unjustly enriching themselves at the expense of Company shareholders.

Investors should insist on transparency. Ausnutria's Response was so opaque and defensive that it only enhances conviction in our investment thesis.

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<sup>9</sup> 问题: …对之前的财务总监…所以你怎么去看他个人的一些风险呢?

澳优主席: 我们是这么来看这件事情的。第一个呢, 这位戴先生, 他之前他更多的是由于对这边规则不太了解所造成的这么一个问题。至于以前在努力的调查中已经指出, 我们的整个数字加起来没有问题, 而是一些 cut off 方面的这么一些事情。还是因为当时的团队对香港的规则不够了解所引起的。这是一个渐进的这么一个问题。

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